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Elders of Wall St. Favor More Regulation

By LOUIS UCHITELLE for the New York Times, February 16, 2010

Put aside for a moment the populist pressure to regulate banking and trading. Ask the elder statesmen of these industries — giants like George Soros, Nicholas F. Brady, John S. Reed, William H. Donaldson and John C. Bogle — where they stand on regulation, and they will bowl you over with their populism.

They certainly don't think of themselves as angry Main Streeters. They grew quite wealthy in finance, typically making their fortunes in the '70s and '80s when banks and securities firms were considerably more regulated. And now, parting company with the current chieftains, they want more rules.

While the younger generation, very visibly led by Lloyd C. Blankfein, chief executive of Goldman Sachs, lobbies Congress against such regulation, their spiritual elders support the reform proposed by Paul A. Volcker and, surprisingly, even more restrictions. "I am a believer that the system has gone badly awry and needs massive reform," said Mr. Bogle, the 80-year-old founder and for many years chief executive of the Vanguard Group, the huge mutual fund company.

Mr. Volcker, 82, signed up the support of nearly a dozen peers whose average age is north of 70 and whose pedigrees on Wall Street and in banking are impeccable. But while Mr. Volcker focuses on a rule that would henceforth prohibit a bank that takes deposits from also buying and selling securities for its own account — risking losses in the process — most of his prominent supporters see that as a starting point in a broader return to regulation. And most do not hesitate to speak up in interviews.

Listen to Nicholas Brady, a Treasury secretary in the late 1980s and early 1990s and before that chairman of Dillon Read & Company, now extinct, but in its day a prestigious Wall Street house. "If you are a commercial bank," he said, "and you wish the government to guarantee your deposits and bail you out if necessary, then you can't be involved in speculative activity."

Does that mean Mr. Brady, now 79, would tell commercial banks they could no longer trade securities for their customers? Mr. Volcker, who gained fame in the 1980s as chairman of the Federal Reserve, would permit this and so would President Obama, who has endorsed the Volcker restriction on proprietary trading, but not the broader ban on trading for customers. Mr. Brady just might take that extra step.

"I'd certainly look into it," he said, arguing in effect that the current generation of bankers is so profit-oriented, it might well find a way to convert trading for a customer into surreptitiously trading for the bank itself, risking depositors' money in the process.

“You draw a line that is too tight,” Mr. Brady said. “That does not bother me a bit.”

Nor does it bother John S. Reed, a former Citigroup co-chairman, who played a role in building Citi into a powerhouse that mingled commercial banking and all sorts of trading activities. That mix helped to precipitate the current credit crisis, requiring a costly federal bailout of Citigroup, among others, in 2008.

Mr. Reed, now 71, was long gone by then, and from retirement he has second thoughts. He even thinks about resurrecting the Glass-Steagall Act of 1933, which prevented banks from engaging in any sort of trading activity involving stocks and bonds. (It was revoked in 1999, partly at the behest of Citigroup, then run by Sanford I. Weill.)

“I can be convinced that we should move back in the direction of Glass-Steagall,” Mr. Reed said, disagreeing on this point with Mr. Weill who, at 76, has not retracted his view that deregulation was the right course. Indeed, Mr. Weill has hanging on a wall of his retirement office, as a trophy, one of the pens that President Clinton used to sign the bill that revoked Glass-Steagall.

Mr. Reed, in contrast, wonders if a trading operation should even exist under the same roof as a standard commercial bank. The traders make more in salary and bonuses than the bank employees, and there are frictions. “The bank people say ‘if the capital market guys take big risks, why can’t we do so too and earn the same bucks?’ ” Mr. Reed said. “They start trying to do things that make them look good, like making risky commercial loans and driving for volume.”

The Volcker Rule would solve this in part by telling “the capital market guys,” as Mr. Reed put it, that they can trade only as agents for customers and not on behalf of the house. Restricted to serving only customers, they might or might not take fewer risks.

In any event, the restriction goes in the right direction, which is why George Soros, the billionaire trader, endorses it and falls into place as one of Mr. Volcker’s supportive elder statesmen, referring to him as “an extraordinary public servant.”

But the Volcker Rule is emphatically not enough, Mr. Soros said. A company like Goldman Sachs, barred from proprietary trading, would probably give up its status as a bank holding company and revert to its role as a big Wall Street investment house, free to trade as it wished. If it then failed, Mr. Volcker would use the federal government to usher it through an orderly liquidation. Mr. Soros, in contrast, would rescue Goldman Sachs.

“The danger is that Congress and the administration may try to hide behind the banner of Volcker’s reputation, enact this one dimension of reform and nothing more, and pretend that it is sufficient to repair the financial system,” Mr. Soros said. “That would be a dangerous mistake.”

At 79, Mr. Soros says, he has watched Goldman Sachs, and other firms like it on Wall Street, grow too big to fail, which means that no administration could allow such giants to go through Mr. Volcker’s orderly liquidation and disappear. That would be too damaging to the financial system, the economy and the political party in power.

“You have to recognize that they enjoy an implicit guarantee,” he said of the big trading houses. “To pretend they will be allowed to fail is not credible.”

The solution for Mr. Soros is to avoid failure in the first place. The big Wall Street firms “would have to be closely regulated to make sure they don’t fail,” he said. “You may decide to break them up, or restrict the number of markets in which they are allowed to operate and you would need to impose capital requirements” to curtail risk-taking.

Derivatives contracts are a major source of risk, and Mr. Soros would limit their use. These contracts — offering insurance, for example, on trading positions — are still ubiquitous. When they come due in great quantities, as they were about to do in the fall of 2008, the contagion spreads, undermining one financial institution after another.

That worries William H. Donaldson, a chairman of the Securities and Exchange Commission in the George W. Bush administration, and a co-founder of Donaldson, Lufkin & Jenrette, a prominent Wall Street firm in its day. To deal with such issues, Mr. Donaldson, now 78, would have Congress create a powerful regulatory body, independent of the Federal Reserve or any other government body, whose members would be appointed directly by the president.

“The Volcker Rule and Mr. Volcker’s initiative,” he said, “are really taking the discussion of regulation to a whole new level.”