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Policy Pivot on Banks Followed Months of Wrangling

Former Fed Chairman Volcker, With Backing From Biden and Axelrod, Helped Shape Obama's Tougher Stance on Banks

By JONATHAN WEISMAN

For nearly a year, President Barack Obama's economic team resisted measures to restrict the size and activities of the biggest U.S. banks. Two days after Democrats suffered a devastating election loss in Massachusetts, the White House rolled out a proposal to do just that.

The policy's evolution took months, according to congressional and administration officials. Prompted by the cajoling of former Federal Reserve Chairman Paul Volcker and other respected voices, dissenters in the administration—notably Treasury Secretary Timothy Geithner and White House economics chief Lawrence Summers—gradually dropped their opposition.

On Jan. 13, Messrs. Geithner and Summers locked down the final regulatory proposals into a memo to the president that they said was unanimous.


Reuters
President Obama on Thursday with Paul Volcker, head of the Presidential Economic Recovery Advisory Board.

But the timing of the rollout appears to have been finalized very quickly. Last week, Mr. Volcker met with Senate Banking Committee Chairman Christopher Dodd (D., Conn.) to present his ideas. Mr. Dodd came away unsure that the president had embraced them, lawmakers and aides on Capitol Hill said.

During the weekend, as Democrats had begun to conclude the Massachusetts battle was lost, the White House decided to go ahead, even though one aide acknowledged it would look too political. White House officials said Thursday that the plan would have gone forward, regardless of Massachusetts. The White House's relationship with Wall Street is close to its breaking point. Democratic lawmakers and the administration have made banking policy a central part of their 2010 campaign playbook. Now, America's big banks are facing a double threat: an increasingly tough policy response to the financial crisis that is getting a goose from the White House's increasingly heated political rhetoric. According to Senate officials, the president had an ally beyond Mr. Volcker. One of Mr. Obama's top political advisers, David Axelrod, was also pressing to get tougher on the big banks. In addition, Vice President Joe Biden emerged as a key Volcker ally.

"Biden and Volcker are old friends," said Austan Goolsbee, a member of the White House's Council of Economic Advisers. The vice president "became a leading advocate."

On Thursday, Mr. Obama proposed a plan that would prevent banks that receive a federal backstop from investing their own money in financial markets—what is known as proprietary trading. He also pushed for new limits on the size and concentration of financial institutions. Both moves echo the Glass-Steagall Act, the Depression-era banking curbs that was repealed in 1999.

The proposal marked the return of Mr. Volcker to center stage in the Obama White House. The 82-year-old chairman of the president's Economic Recovery Advisory Board consulted closely with Democrats in the House and Senate as they drafted their proposals to address "too big to fail" entities, referring to financial behemoths whose collapse might bring down the economy. Mr. Volcker spoke frequently with Mr. Obama as well.

But he faced a philosophical divide with others on the economic team. Last March, at a casual dinner of the House Financial Services capital-markets subcommittee, that panel's chairman, Rep. Paul Kanjorski, recalled a discussion over drinks with Mr. Volcker about his ideas to separate commercial banks from their trading arms.

"Don't put a lot of stock in my thoughts because I'm out of vogue," the Pennsylvania Democrat said Mr. Volcker told him.

Mr. Volcker couldn't be reached for comment.

Administration officials say the White House pivot came in October.

Mr. Kanjorski was pushing an amendment to the House's financial-regulation bill that would clamp down on big banks. With the amendment gaining momentum, Mr. Geithner dispatched Michael Barr, an assistant secretary at the Treasury and confidant of Mr. Kanjorski, to help shape it. That month, Mr. Geithner testified before the Financial Services Committee that he backed the amendment's scope.

Treasury officials feared headlines would blare that Mr. Geithner had backed breaking up the banks. But the president continued to endure criticism, in particular from his left, that he was coddling Wall

Street. In talks with his financial team, Mr. Obama started letting his frustration show, asking why he was on the wrong side of the "too big to fail" debate.

White House officials said the president called a meeting of his entire economic team to press for additional proposals. But its members were at odds: Messrs. Geithner and Summers argued that proprietary trading was a problem but not a central cause of the financial crisis, according to an official familiar with the talks. Mr. Volcker saw proprietary trading as a fundamental risk.

In December, Mr. Obama decided he wanted to be on what he saw as "the right side" of the debate, according to an administration official. He asked his team to bring him specific proposals to limit the size of financial institutions and halt proprietary trading. Spurring their thinking: Goldman Sachs had sought the protection of the Federal Reserve during the financial crisis, and was now making big profits from its own trading, in part because it benefited from the explicit backing of the U.S.
It was a big step for the administration. White House economists argued that transparency and disclosure alone could shape Wall Street behavior.

But Mr. Obama was now on Mr. Volcker's side. His rhetoric began shifting against Wall Street in December, when he blasted "fat cat" bankers during a television interview. Last month, the president accompanied a proposed fee on big banks to recoup Wall Street bailout funds with a fresh rhetorical blast.

A senior official said the president asked Mr. Geithner in mid-December to take another look at the former Fed chairman's ideas. On Christmas Eve, Messrs. Geithner and Volcker had an extended lunch, which persuaded the Treasury secretary to get behind Mr. Volcker.

Then came Massachusetts, where Republican Scott Brown was on his way to taking the late Sen. Ted Kennedy's Senate seat—and with it, the president's lock on a Senate super-majority.

As the Senate campaign raged last weekend, the economic and political team at the White House held a conference call to go over the new banking proposal and the plan to roll it out. One aide questioned whether the timing was right. Win or lose in Massachusetts, unveiling tough new bank regulations would look political.

Other aides brushed by that concern. In fact, they argued, whatever Mr. Obama does after Massachusetts would be seen as political. And on the "too big to fail" front, they said, the administration needs to own the issue.

—David Wessel, Kate Kelly and Deborah Solomon contributed to this article.