Dissenting Views on the 2019 Revisions to the Volcker Rule

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Dissenting Statement, 2019 Volcker Rule
SEC Commissioner Robert J. Jackson Jr.

September 19, 2019

Yesterday the Commission finalized the rollback of the Volcker Rule—the risktaking limits that keep banks from gambling with taxpayer money. These limits are designed to help regulators address a basic problem of incentives: bankers, anticipating taxpayer-funded bailouts, prefer to take excessive risks to maximize their bonuses.[1] That's why I've called upon my colleagues to finalize the rules required by the Dodd-Frank Act to prohibit pay practices that reward excessive risk taking. Instead, having done nothing about banker bonuses, we are weakening structural limits on risk.

As always, I am grateful to my colleagues on the Staff in the Division of Trading and Markets for their hard work. But, as I said at the proposal stage, "[r]olling back the Volcker Rule while failing to address pay practices that allow bankers to profit from proprietary trading puts American investors, taxpayers, and markets at risk."[2] That's no less true today than it was a year ago, so I respectfully dissent.

* * * *

Because my dissenting colleagues, and Chairman Volcker himself, have already ably explained why this rollback is deeply misguided, I will offer just two brief thoughts.[3] ***First***, while the optimal design of structural risk limits is debatable, allowing bankers to get paid to gamble with taxpayer money is not. During the last crisis, nine million American families lost their homes because regulators neglected the basic economics of banker incentives. We could and should have addressed those incentives before considering the actions before us now.

Second, the facts offer little support for the belief behind this release—that the Volcker Rule reduces liquidity.[4] In August 2017, our Division of Economic and Risk Analysis reported to Congress on the effects of the Rule on liquidity. Contrary to lobbyists' alarmist predictions, our Staff found no evidence to support the claim that the Volcker Rule reduced the depth of primary or secondary

[1] *See* Commissioner Robert J. Jackson, Jr., Statement on Proposed Amendments to the Volcker Rule (June 5, 2018) (describing the "bipartisan lesson," and "basic economic truth," "that paying bankers to put government-insured deposits at risk makes no sense" (citing Lucian Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 Geo. L.J. 247 (2010))).

[2] *See* Jackson, *supra* note 1 (pointing out that, after the financial crisis, "Congress knew we would also need to regulate incentives to truly ensure that bankers never again get paid to gamble with taxpayer money." (citing Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Section 956 (2010))).

[3] *See* Statement of Director Martin J. Gruenberg, Federal Deposit Insurance Corporation (Aug. 20, 2019) (providing evidence that this rollback "opens up vast new opportunity—hundreds of billions of dollars of financial instruments—at both the bank and bank holding company level, for speculative proprietary trading funded by the public safety net"); Letter to Chairman Jerome Powell, United States Federal Reserve, from Chairman Paul Volcker (Sept. 10, 2019).

[4] Lobbyists made this argument even before the Volcker Rule was implemented—but their predicted liquidity crunch has simply not materialized. *See*, *e.g.*, U.S. Chamber of Commerce Center for Capital Markets Competitiveness, The Economic Consequences of the Volcker Rule (2012).

markets.[5] Although this week's release now reaches for a different conclusion, the facts haven't changed: a lack of proprietary trading simply hasn't starved the market of liquidity.[6]

But even if liquidity were quantifiably lower, it would be hard for me to support these changes. Ordinary American investors aren't kept up at night worrying about an imagined lack of bond liquidity.[7] They're wondering why they should trust a financial system that upended their lives a decade ago.[8] The benefits of investor trust in our financial markets are hard to quantify, but they're doubtless a reason why our markets are the envy of the world. Rolling back risktaking protections like this puts that trust at risk, makes ordinary Americans wary of our markets, and—ironically—may even undermine liquidity.[9]

* * * *

The Commission has justified the rollback of the significant investor—and taxpayer—protections in the Volcker Rule in the name of needed improvements in "liquidity and capital formation."[10] Because the facts and our own Staff's analysis offer no meaningful evidence that the Volcker Rule has affected either, I respectfully dissent.

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[5] U.S. Securities and Exchange Commission, Division of Economic and Risk Analysis, Report to Congress on Access to Capital and Market Liquidity (2017) (hereafter, "Report to Congress").

[6] In this release our economists draw opposite conclusions from the exact same finance papers they studied in our recent report to Congress. For example, that report correctly noted that the results in Jack Bao et al., *The Volcker Rule and Corporate Bond Market Making in Times of Stress*, 130 J. Fin. 95 (2018), were "sensitive to the choice of the pre-crisis period and that downgrades [in that period] do not appear to impact liquidity metrics, casting doubt on the robustness of that empirical design." Report to Congress, *supra* note 5, at 155. Today, however, we make no mention of those problems; now we say the study "suggests that dealers affected by the Volcker Rule decreased market making in newly downgraded bonds, and that unaffected dealers have not fully offset this decline." Securities & Exchange Commission, *Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*, September 18, 2019, Release No. BHCA-7 (hereafter, "Release") at 302. Similarly, our report to Congress read Jens Dick-Nielsen & Marco Rossi, *The Cost of Immediacy for Corporate Bonds*, 32 Rev. Fin. Stud. 1 (2019) carefully, noting that its findings were "consistent with post-crisis changes in dealer risk aversion and the low interest rate environment during this period." Report to Congress, at 112-113. Today, that same study shows that "the cost of immediacy [in bond markets] has more than doubled." *See*, Release at 299. We cannot expect Congress or commentators to take our economic analysis seriously when we draw opposing conclusions from the same studies in the course of arriving at predetermined policy outcomes.

[7] *See, e.g.*, Matt Levine, *People Are Worried About Bond Market Liquidity*, Bloomberg View (June 3, 2015) (skeptically describing Wall Street's repeated remonstrations about disappearing liquidity); Matt Levine, *Bond Investors Are Worried About Bond Market Liquidity*, Bloomberg View (Dec. 3, 2017) (noting that, despite Wall Street's concerns, academics and regulators "almost invariably say . . . corporate bond liquidity looks fine"); Matt Levine, *Good Investors Make Investing Harder*, Bloomberg View (July 3, 2019) (describing, with puzzlement, the fact that "*[e]very single day* I read articles worrying about bond market liquidity").

[8] *See* Ulrike Malmendier & Stefan Nagel, *Depression Babies: Do Macroeconomic Experiences Affect Risk Taking?*, 126 Q. J. Econ. 373 (2011) (showing that the recessionary period following the last financial crisis negatively impacted stock-market participation); Luigi Guiso, Paola Sapienza & Luigi Zingales, *Trusting the Stock* Market, 63 J. Fin. 2557 (2008) (showing that trust in financial markets affects stock-market participation).

[9] Ironically, this rollback may reduce liquidity, because a well-known lesson in corporate governance is that laws and institutions protecting investors are beneficial for liquidity and firm value. *See* Paul Brockman & Dennis Y. Chung, *Investor Protection and Firm Liquidity*, 58 J. Fin. 921 (2003); *see also* Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, *Investor Protection and Corporate Valuation*, 57 J. Fin. 1147 (2002).

[10] *See* Release, *supra* note 6, at 275 (pointing out that the "SEC noted that the proposed amendments may enhance trading liquidity and capital formation and that some of the proposed changes need not reduce the efficacy of the regulation or the agencies' regulatory oversight").

Dissenting Statement, 2019 Volcker Rule
SEC Commissioner Allison Herren Lee[1]

September 19, 2019

The Volcker Rule is intended to prevent banks from gambling with taxpayer money.[2] Mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, and adopted in 2013, the rule prohibits proprietary trading and fund investments by taxpayer-backed banks and their affiliates.[3] This is a straightforward and sensible proposition born of both common sense and painful experience.[4] Most purport to agree with this sensible proposition. Unfortunately, as with so many rules affecting financial institutions, "the devil is in the details." This idiom is tailor-made for the final rule amendment adopted yesterday by a majority of the Commission, the details of which seriously undercut the mandate of the rule itself.

The rule amendments reduce, by hundreds of billions of dollars, the scope of financial instruments subject to the Volcker Rule.[5] What's more, for that which remains, instead of ensuring a rigorous compliance regime, we have done the reverse, weakening compliance requirements and regulators' ability to enforce the rule.[6]

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[1] Bank Holding Company Act Rel. No. 7 (Sept. 18, 2019) [hereinafter Final Rule]. Although I cannot support this rule amendment, I do want to express my appreciation to my colleagues in the Division of Trading and Markets, Division of Investment Management, Division of Economic and Risk Analysis, and Office of General Counsel for their work on this rule.

[2] *See, e.g.*, S. Rep. No. 111-176 at 8 (Apr. 30, 2010) ("Section 619 of Title VII prohibits or restricts certain types of financial activity—in banks [and] bank holding companies []—that are high-risk or which create significant conflicts of interest between these institutions and their customers. When losses from high-risk activities are significant, they can threaten the safety and soundness of individual firms and contribute to overall financial instability. Moreover, when the losses accrue to insured depositories or their holding companies, they can cause taxpayer losses.").

[3] *See* 12 U.S.C. § 1851(a); and 12 C.F.R. §§ 248.1 to 248.2.

[4] *See generally* Nat'l Comm'n on the Causes of the Fin. and Econ. Crisis in the U.S., The Financial Crisis Inquiry Report, at xvii-xxiii (2011). The report also noted that, as certain financial instruments became more and more complex, "regulators increasingly relied on the banks to police their own risks." *Id.* at 45 (quoting Paul Volcker: "It was all tied up in the hubris of financial engineers, but the greater hubris let markets take care of themselves.").

[5] *See* Martin J. Gruenberg, Member, FDIC Board of Directors, Statement on Adoption of Changes to the Volcker Rule (Aug. 20, 2019). Director Gruenberg's statement draws from Y-9YC and call report data as of year-end 2018. It demonstrates that $565 billion, or 46% of the financial instruments subject to the 2013 Volcker Rule's trading restrictions for banks, are scoped out of this final rule as amended. For bank holding companies, about $549 billion, or 25% of the financial instruments subject to the 2013 Volcker Rule's trading restrictions, are scoped out. I am aware that much of the additional proprietary trading activity permitted by these amendments may occur outside of the registrants for which the SEC is primarily responsible. However, the agencies are jointly responsible for, and must consider the wisdom of and vote on, the Volcker Rule as a whole. Changes to the definition of trading account remove a large class of financial instruments from the scope of the rule's prohibitions and represent a significant weakening of the rule.

[6] *See, e.g.*, Final Rule, *supra* note 1, at 51 (adopting a presumption of compliance with the prohibition on proprietary trading for banking entities that voluntarily elect to apply the market risk capital prong), 54-55 (eliminating the rebuttable presumption that positions held for fewer than 60 days are proprietary trading and implementing a new rebuttable presumption that positons held for 60 days or longer are not proprietary trading), 93-96 (providing banking entities with flexibility to determine the scope of the "trading desk"), 115-122, 129-133 (establishing a presumption of compliance with RENTD requirements for both underwriting and market-making activities based on compliance with a banking entity's internally set limits), 150-155 (reducing the requirements related to risk-mitigating hedging and eliminating the need for banking entities with moderate or limited trading assets and liabilities to have a separate internal compliance program for compliance with the risk-mitigating hedging requirements), and 190-201 (removing enhanced minimum standards requirements for all banking entities, allowing banking entities with moderate trading assets and liabilities to establish a simplified compliance program that does not require a CEO attestation, and providing banking

We have not supported or justified the choices made with evidence or analysis. Instead, the release speaks of regulators' experience in implementing the rule. But that experience is not documented in the final rule amendment so that the public can gauge whether it actually supports these changes.[7]

Instead, we have reduced the rule's scope and weakened compliance requirements ostensibly in the name of simplicity and clarity.[8] Yes, the Volcker Rule is complex, just as the businesses and operations of large financial institutions are complex. Both could do with some simplification and clarity. But let's be clear—we can just as easily achieve simplicity and clarity with a plainly defined but appropriately broad scope and stronger compliance requirements. A speed limit of 55 is every bit as clear as a speed limit of 95.

The rule amendment significantly increases the risk that large banks will move, by inches and degrees, back toward business as usual—where proprietary trading is intermixed with the other activities large banks undertake to put their massive balance sheets to work, while regulators struggle to keep up. As my colleague Commissioner Jackson has ably pointed out, we can expect this to continue so long as there are financial incentives to do so.[9]

What we have done with this rule amendment is make policy choices that were urged upon us by the banks[10]—give them greater discretion and they will rein in their own behavior despite strong incentives

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entities with limited trading assets and liabilities with a presumption of compliance with the Volcker Rule and no CEO attestation requirement).

[7] *See, e.g.,* Gregg Gilzinis, Center for American Progress, Hollowing Out the Volcker Rule: How Regulators Plan to Undermine a Pillar of Financial Reform 3 (Oct. 3, 2018) ("On 30 separate pages of the proposal, regulators merely cite their experience implementing the rule as the reason why the changes are appropriate.").

[8] *See, e.g.,* Letter from Paul A. Volcker to Jerome H. Powell, Chairman, Bd. of Governors of the Fed. Reserve Sys. (Aug. 20, 2019) (stating that credible studies show strong overall market liquidity and that "[t]hese facts belie any justification for the new rule. It bolsters the view of skeptics who believe that the 'simplification' effort was merely a ploy to weaken the core elements of reform."). *See also* Final Rule, *supra* note 1, at 45 ("The agencies have provided further clarity to the trading account definition in the final rule by adding additional exclusions from the 'proprietary trading' definition."), 55-56 ("Replacing the 2013 rule's rebuttable presumption with a rebuttable presumption that financial instruments held for sixty days or longer are not within the short-term intent prong will provide clarity for banking entities with respect to such positions, without imposing the burden associated with the 2013 rule's rebuttable presumption."), 86 ("The agencies have determined to explicitly exclude [mortgage servicing asset hedging] from the definition of 'proprietary trading' to provide greater clarity to banking entities that are subject to the short-term intent prong."), 88 ("The agencies have determined to exclude the purchase or sale of assets that would not meet the definition of trading asset or trading liability from the definition of 'proprietary trading' to provide greater clarity to banking entities that are subject to the short-term intent prong."), and 89 ("Excluding any purchase or sale of a financial instrument that would not be classified as a trading asset or trading liability on [the applicable bank report] . . . is expected to provide additional clarity to banking entities subject to the short-term intent prong.").

[9] *See* Robert J. Jackson, Jr., Comm'r, U.S. Securities and Exchange Comm'n, Statement on Volcker Rule Amendments (Sept. 19, 2019) (dissenting to adoption of changes to the Volcker Rule).

[10] A review of the adopting release reveals that all of the significant policy choices, where there was disagreement among commenters, were made uniformly in favor of comments provided by banks and banking interests. These policy choices include: 1) rejection of limits on compensation arrangements; 2) rejection of penalties for rule violations; 3) raising the floor for entities with significant trading assets and liabilities from $10 billion to $20 billion; 4) limiting the short-term intent prong by scoping out banks relying on the market risk capital rule; 5) eliminating the rebuttable presumption that positions held less than 60 days are in the trading account; 6) establishing a new rebuttable presumption that positions held for 60 days or more are outside the trading account; 7) expansion of the scope of activities covered by the liquidity management exclusion; 8) adding an exclusion for error trades; 9) adding an exclusion for financial assets that are not listed trading assets or liabilities on an applicable banking report; 10) adding a presumption of compliance for underwriting and market-making activities based on banks' internally set limits; 11) eliminating the requirement for an internal compliance program for firms with less than $20 billion in trading assets and liabilities; 12) easing the compliance and documentation requirements for risk-mitigating hedging permitted activity; 13) changes to foreign banking entity permitted activity to allow arranging, negotiating, and executing trades by U.S. personnel and eliminating the financing and counterparty tests; 14) changes to the covered fund provisions to drop the requirement that a banking entity aggregate the value of any ownership interests of a third-party covered fund acquired or retained in accordance with the underwriting or

to the contrary. Both logic and the sobering experience of recent history demonstrate this to be a risky proposition at best.[11] I sincerely hope, as the release suggests, that banks will remain diligent in identifying and mitigating their own risks, but the families and businesses whose wellbeing would be threatened by another financial crisis deserve more than our hope. Accordingly, I must respectfully dissent.

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market-making exemptions; 15) changes to the covered funds provisions to allow a banking entity to acquire or retain an ownership interest in a covered fund as a hedge when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund; 16) changes to the covered funds provisions to remove the financing prong of the foreign fund exemption; 17) implementing the three-tiered compliance requirements and dropping the Appendix B enhanced compliance program requirements; and 18) dropping the CEO attestation requirement for firms with less than $20 billion in trading assets and liabilities.

[11] *See, e.g.*, *The Financial Crisis and the Role of Federal Regulators: Hearing before the H. Comm. On Oversight and Gov. Reform*, 110th Cong. 45 (Oct. 23, 2008) (testimony of Alan Greenspan, Chairman, Bd. of Governors of the Fed. Reserve Sys.) ("I made a mistake in presuming that the self-interest of organizations, specifically banks and others, were such is that they were best capable of protecting their own shareholders and their equity in the firms."); U.S. Gov't Accountability Off., GAO-11-696, Federal Reserve System: Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance 1 (July 21, 2011) ("From late 2007 through mid-2010, Reserve Banks provided more than a trillion dollars in emergency loans to the financial sector to address strains in credit markets and to avert failures of individual institutions believed to be a threat to the stability of the financial system."); *id.* at 15 ("Between late 2007 and early 2009, the Federal Reserve Board created more than a dozen new emergency programs to stabilize financial markets and provided financial assistance to avert the failures of a few individual institutions."). *See also* Letter from Paul A. Volcker, *supra* note 8 ("[T]he new rule amplifies risk in the financial system, increases moral hazard and erodes protections against conflicts of interest that were so glaringly on display during the last crisis.").

Dissenting Statement, 2019 Volcker Rule
CFTC Commissioner Rostin Benham

September 16, 2019

I respectfully dissent as to the Commission's decision to approve revisions to the Volcker Rule. In June 2018, when I voted against the proposed rule, I expressed that my biggest concern was that our action would encourage a return to the risky activities that led to the financial crisis, and perhaps further consolidate trading activity into a few institutions.[1] My concern last June was that we were weakening the Volcker Rule around the edges, and I raised specific issues regarding unnecessary complexity, lack of clarity, and a flawed process that chilled dissent. Unfortunately, today's final rule does not do anything to assuage these concerns. To make matters worse, while the proposal merely threatened to kill Volcker through a thousand little cuts, the final rule goes for the throat. It significantly weakens the prohibition on proprietary trading by narrowing the scope of financial instruments subject to the Volcker Rule. What remains is so watered down that it leaves one questioning whether it should be called the Volcker rule at all. To that point, Paul Volcker himself recently sent a letter to the Chairman of the Federal Reserve criticizing the rule and stating that the rule "amplifies risk in the financial system, increases moral hazard and erodes protections against conflicts of interest that were so glaringly on display during the last crisis."[2]

In my dissent last June, I pointed out that the proposal further complicated the Volcker rule while calling it simplification. We do the same thing in the final rule. Where once there was one set of rules for all banking entities, there will now be three categories of banking entities with different rules for each: Banking entities with Significant trading assets and liabilities, banking entities with Limited trading assets and liabilities, banking entities in between with Moderate trading assets and liabilities. While numerous commenters expressed concerns with this three-tiered compliance framework, we nonetheless are finalizing this needlessly complex system. In addition, the majority today makes "targeted adjustments" that further complicate matters. In some instances, these adjustments are at least requested by the commenters. In others, they are invented seemingly out of whole cloth.

The most troubling aspect of today's rule, though, is something new. The final rule includes changes to the definition of "trading account" that will significantly reduce the scope of financial instruments subject to the Volcker Rule's prohibition on proprietary trading. This change is described in the preamble to the final rule as avoiding having the trading account definition "inappropriately scope in" certain financial instruments, almost as if they were included in the proposal's scope by mistake. However, these financial instruments were within the scope of the 2013 rule, and they were within the scope of the proposal. Removing them now limits the scope of the Volcker rule so significantly that it no longer will provide meaningful constraints on speculative proprietary trading by banks. As such, I cannot vote for the rule.

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[1] Opening Statement of Commissioner Rostin Behnam Before the Open Commission Meeting on June 4, 2018 (Jun. 4, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement060418.

[2] Jesse Hamilton and Yalman Onaran, "Vocker the Man Blasts Volcker the Rule in Letter to Fed Chair," Bloomberg (Sep. 10, 2019), https://www.bloomberg.com/news/articles/2019-09-10/volcker-the-man-blasts-volcker-the-rule-in-letter-to-fed-chair.

Dissenting Statement, 2019 Volcker Rule
CFTC Commissioner Dan M. Berkovitz

September 16, 2019

Congress adopted the statute commonly known as the "Volcker Rule" in the wake of the 2008 financial crisis to prevent banks that benefit from federal depository insurance or other government support from taking excessive risks that could lead to future taxpayer bailouts. The Volcker Rule prohibits proprietary trading and the owning of hedge funds and private equity funds by banks and their subsidiaries ("banking entities"), with certain exceptions and exemptions. In 2013 the Commission and other financial regulators adopted regulations to implement the Volcker Rule. The final rule before the Commission today ("revised Volcker Rule") substantially weakens these implementing regulations.

The revised Volcker Rule eliminates or reduces a variety of substantive standards in the current rule. The revised Volcker Rule will render enforcement of the rule difficult if not impossible by leaving implementation of significant requirements to the discretion of the banking entities, creating presumptions of compliance that would be nearly impossible to overcome, and eliminating numerous reporting requirements. The revised Volcker Rule also substantially reduces the bank trading activity covered by the rule. Finally, the revised Volcker Rule includes a number of changes and additions not contemplated or adequately discussed in the notice of proposed rulemaking (NPRM) in violation of the Administrative Procedure Act ("APA") requirements for public notice and comment for rulemakings.

For these reasons, I dissent.

Weak Regulation and Enforceability Concerns

Nearly every amending provision of the revised Volcker Rule adopts the weakened provisions from the NPRM, further weakens the proposed changes, or makes new changes that weaken or eliminate existing requirements and standards. New presumptions of compliance favoring the banking entities, regulatory determinations left to the banking entities, and reductions in reporting requirements by the banking entities will make the revised Volcker Rule more difficult to enforce. The cumulative effect of this myriad of changes is a set of regulations that is ineffective and unenforceable. Although a single chip off a sculpture, by itself, may not create a noticeable blemish, widespread chiseling will disfigure the object. Such is the result here.

The "trading account" definition and related regulatory exclusions in the 2013 rule determine which financial transactions are subject to the restrictions on proprietary trading. Financial transactions of banking entities are subject to the Volcker regulations if they fall within certain "prongs" established in the trading account provision. The revised Volcker Rule rejects the "accounting prong" proposed in the NPRM and effectively jettisons the existing "short-term intent prong" for most entities.[1] In addition, there are a number of newly created outright exclusions of whole types of transactions and broadening of existing exclusions under the revised Volcker Rule.

FDIC Commissioner Martin Gruenberg provided an analysis of how these changes will significantly reduce the banking activity subject to Volcker oversight. "By excluding these financial instruments from the

[1] While the short-term intent prong remains for a limited number of banks not subject to the market risk capital rules in banking regulations, compliance with the short-term intent prong is now optional if those banking entities instead elect to comply with the market risk capital rules for Volcker compliance.

Volcker Rule, the final rule . . . opens up vast new opportunity –hundreds of billions of dollars of financial instruments – at both the bank and bank holding company level, for speculative proprietary trading funded by the public safety net."[2]

The 2013 Volcker rules define the "trading desk" as the "smallest discrete unit of organization" that purchases and sells financial instruments. The revised Volcker Rule removes the quoted text, and instead provides four broad criteria for designating a trading desk. The rule then allows the banking entities to designate the trading desks for purposes of Volcker.

The new trading desk designation criteria appear to be broad enough that a "trading desk" could include whole business lines, divisions, or an entire swap dealer. The opportunities for undertaking greater amounts of proprietary trading expand significantly when the limits (which are set by the banking entities themselves), the desk-specific positions being hedged, and reporting requirements are applied to much larger trading portfolios. Because the revised Volcker Rule effectively presumes that these trading desk designations by the banking entities are valid, it will be more difficult for the applicable regulator to reign in proprietary trading undertaken by more expansively designated trading desks.

How much proprietary trading can occur under the market making exemption in the revised Volcker Rule will be determined by the risk limits set for each trading desk. The risk limits are to be established at the discretion of each banking entity and, as noted above, the scope of a trading desk also will be determined by the banking entity within broad criteria. "Reasonably expected near-term demand" ("RENTD") of customers is included in the Volcker statute to establish the level of market making permissible. While the RENTD concept is still in the revised Volcker Rule, a presumption has been added that the RENTD levels set by each banking entity are correct.

Because these determinations will be established by the banking entity and presumed to be compliant, it will be difficult for any regulator to challenge them or take any enforcement action – even if a banking entity experiences large losses from proprietary trading – so long as the trading is found to be within the set limits.

These concerns about enforcement and oversight are exacerbated by the reduced metrics and other reporting, documentation, and compliance requirements. Numerous changes are made both as proposed and added on in this final rule. To name a few, stressed value at risk, daily risk factor sensitivities, and risk limit breaches need not be reported. In some cases, changes to reporting requirements make sense if experience shows a metric has little or no regulatory value. But most of these changes in the revised Volcker Rule are purportedly justified because they reduce the burden on banking entities and the cumulative effect on the ability of a regulator to monitor for compliance and potential significant issues is not addressed.

Logical Outgrowth Concerns

The revised Volcker Rule includes a number of new rules and amendments that were not mentioned or adequately described in the NPRM. The APA requires that a proposed rulemaking be published in the Federal Register and that interested persons be given an opportunity to comment.[3] A "notice of proposed

[2] Statement by Martin J. Gruenberg, Member, FDIC Board of Directors, *The Volcker Rule* (Aug. 20, 2019) at 3, available at https://www.fdic.gov/news/news/speeches/spaug2019b.pdf.

[3] 5 U.S.C. 553(b) and (c).

rulemaking must provide sufficient factual detail and rationale for the rule to permit interested parties to comment meaningfully."[4]

In comparing the revised Volcker Rule to the NPRM, there are a number of changes that were either not addressed in the NPRM or at best are based on comments received in response to general questions. For example, the NPRM included a proposal to replace the short-term intent prong with what is commonly referred to as the "accounting prong." In the revised Volcker Rule, the accounting prong was rejected, but the short-term interest prong also is eliminated for most banking entities.[5] While replacing the short-term intent prong was discussed in the proposal, effectively eliminating the prong without a replacement was not proposed. Similarly the option for certain banking entities to now elect to comply with the market risk capital rule prong rather than the short-term intent prong was not discussed as an alternative. Nor was the replacement of the rebuttable presumption of proprietary trading for positions held shorter than 60 days with the opposite presumption that positions held longer than 60 days are not proprietary trading for purposes of the Volcker Rule. Agencies cannot "pull a surprise switcheroo" in the rulemaking process.[6]

Furthermore, the NPRM appears to not even contemplate excluding government bond assets and liabilities, mortgage servicing rights hedges, or financial instruments that are not trading assets or trading liabilities from counting as proprietary trading. Other changes, such as the elimination of incentive compensation limits, the matched derivatives transaction exclusion, and elimination of risk factor sensitivity metrics reporting appear to be based on general questions in the NPRM. In each case, no draft rule text or adequate discussion of such amendments was provided that would allow the public to have anticipated those amendments. Rather, many of these changes appear to be based on de novo comments made by banks or their trade organizations. "[I]f the final rule 'substantially departs from the terms or substance of the proposed rule,' the notice is inadequate."[7]

Conclusion

Self-regulation failed us in the early part of this century. Dodd-Frank, including the Volcker Rule, has helped this country rebuild a strong and better managed financial sector. To maintain a robust financial sector that benefits the American people, we must maintain strong standards and vigorous oversight. Otherwise, it is only a matter of time before the memory of the huge losses and resulting pressures for a taxpayer bailout fades and excessive risk taking comes home to roost. While the Dodd-Frank regulations may not be perfect and modest adjustments may be appropriate, the wholesale revision of regulations that greatly weaken the enforceability of those regulations such as we have before us today will, in the long run, weaken the financial sector and pose risks to the American public.

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[4] *Honeywell Int'l, Inc. v. EPA*, 372 F.3d 441, 445 (D.C. Cir. 2004) (internal quotation marks omitted).

[5] Firms subject to, or which elect to be subject to, the market risk capital rule prong are no longer subject to the short-term intent prong.

[6] *Environmental Integrity Project v. EPA*, 425 F.3d 992, 996 (D.C. Cir. 2005).

[7] *Chocolate Manufacturers Assoc. of the United States v. Block*, 755 F.2d 1098, 1105 (4th Cir. 1985) (*quoting Rowell v. Andrus*, 631 F.2d 699, 702 n.2 (10th Cir. 1980).

Dissenting Statement, 2019 Volcker Rule
Federal Reserve Board Governor Lael Brainard

October 08, 2019

I supported exempting community banks from the Volcker rule provisions and have voted to implement changes mandated by law. I do not support the final rule because it weakens the core protections against speculative trading within the banking federal safety net. I am concerned the final rule would materially reduce the scope of covered activity, excessively rely on firms' self-policing, and narrow the Chief Executive Officer (CEO) attestation requirement, which together could substantially weaken the Volcker rule prohibition on proprietary trading.

I was surprised that the final rule eliminates, without replacement, the "short-term intent" test for most entities, as this change was not proposed in the notice of proposed rulemaking. By eliminating the standalone "short-term intent" test for firms engaged in higher levels of trading activities, the final rule materially narrows the scope of covered activities.

I am concerned about examiners' ability to assess compliance with the final rule because it relies on firms' internal self-policing to set limits to distinguish permissible market making from illegal proprietary trading, no longer requires firms to promptly report limit breaches and increases, and narrows the scope of the CEO attestation requirement.