BETTER MARKETS

HERE ARE THE KEY WINS FOR WALL STREET IN THE WEAKENED VOLCKER RULE

Based on a quick reading of the new Volcker Rule, the FDIC fact sheet, Director Marty Gruenberg's dissent, and comments made at the FDIC meeting, financial regulators handed Wall Street its biggest victory since the 2008 financial crisis. In addition to not finalizing the Fair Value Accounting Test—which was vehemently opposed by Wall Street-- the new rule delivers the following wins for Wall Street's biggest banks:

- **First: Narrowing Scope of Financial Instruments Covered**. The new Volcker Rule substantially narrows the scope of financial instruments covered by the Volcker Rule.

    - The new Volcker Rule does not include proposed definitional changes to the Trading Account that would have better ensured Wall Street is prohibited from putting on statutorily covered prop trading positions.

    - The new Volcker Rule instead changes the Trading Account definition to create a new presumption that financial instruments held more than 60 days are not in scope for the Volcker Rule, placing the burden on bank supervisors, not the banks, to rebut the presumption and demonstrate otherwise. Very difficult.

    - The new Volcker Rule also, in essence, deletes the short-term trading intent prong of the Trading Account definition for banks subject to the market risk capital regulations. The new rule additionally permits banks not subject to the market risk capital rules to, in essence, opt out of the short-term trading intent prong of the Trading Account definition.

    The new Volcker Rule thereby substantially narrows the scope of the Volcker Rule and weakens a core pillar of the Dodd-Frank Act's effort to prevent the Wall Street gambling using financial instruments that have repeatedly impaired financial stability.

- **Second: Self-Policing Presumption of Self-Compliance.** The new Volcker Rule establishes a so-called "presumption of compliance" for market-making and underwriting activities. Those "presumptions" are a truly radical departure from longstanding supervisory practices and represent a return to the same failed industry self-policing policies and philosophies that led to the 2008 financial crisis.

    The presumptions permit Wall Street's largest banks to avoid or evade prop trading limits, and they do so by dressing up exemptions in seemingly complex but conceptually non-sensical or unrelated frameworks, like permitting all trading activities conducted within risk limits established by the banks themselves. Thus, banks will set their own limits and then determine that they are in compliance with their own limits, which they are allowed to change without reporting to bank supervisors.

- **Third: Non-Hedging Can Be Hedging.** The new Volcker Rule will permit hedging that does not hedge—or what might be termed, "Humpty Dumpty Hedging": a hedge is whatever the bank says it is[1] (which the new Volcker Rule will not

[1] "'When I use a word,' Humpty Dumpty said, in a rather scornful tone, 'it means just what I choose it to mean – neither more nor less.' 'The question is,' said Alice, 'whether you can make words mean so many different things.' 'The question is,' said Humpty Dumpty, 'which is to be master – that's all.'" LEWIS CARROLL (Charles L. Dodgson), *Through the Looking-Glass,* chapter 6, p. 205 (1934). First published in 1872.

then apply to). The new Volcker Rule, like the 2018 proposal, apparently eliminates documentation necessary to demonstrate that hedging activities are, in fact, hedging—and not prop trading. As we explained in our comment letter, hedging cannot be tied to conceptually non-sensical and unrelated controls, like establishing internal risk limits, which simply do not constrain risk-mitigating hedging as required by the statute.

- **Fourth: Loopholes for Foreign Banks.** The new Volcker Rule will provide foreign banks a number of unnecessary and irresponsible special accommodations from the 2018 proposal. The new Volcker Rule apparently eliminates restrictions on (1) U.S. personnel being involved in exempted foreign prop trading, (2) U.S. financing of exempted non-U.S. prop trading, and (3) trading with U.S. counterparties. Eliminating these restrictions is unlawful and especially ill-advised, given the precarious financial condition of certain systemically important foreign banks that will be beneficiaries of the rule change (e.g., Deutsche Bank) and the fragility of the global economy at this stage of the business cycle.

While Wall Street and the regulators voting for the new Volcker Rule claim that it merely “clarifies,” “simplifies,” or “streamlines” the existing Volcker Rule, those claims will ring hollow when the next economic downturn occurs, and inevitable prop trading losses are revealed. Those unsupported assertions are contradicted by the facts and are intended to mislead the American people into believing that handing Wall Street this huge win and licensing their high-risk and dangerous prop trading is reasonable and appropriate. In reality, it is neither. It is short-sighted and once again privatizes gains while socializing losses as the American people will be forced to pay the bill for Wall Street’s reckless activities.

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