BETTER MARKETS

THE KEY WINS FOR WALL STREET IN THE WEAKENED VOLCKER RULE

From comments in this morning's FDIC meeting, it is clear that the Volcker Rule will hand Wall Street its biggest victory since the 2008 financial crisis. The new rule may ultimately finalize every major reckless, short-sighted, and legally baseless change proposed last year but not the one responsible change that was opposed by Wall Street.

It is clear that the weakened Volcker Rule will give Wall Street's largest banks at least two very significant wins:

- **First: Narrowing Scope of Financial Instruments Covered**. The new Volcker Rule substantially narrows the scope of financial instruments subject the Volcker Rule relative to the 2018 proposal. In short, the final rule does not include proposed changes that would have better ensured Wall Street includes all statutorily required prop trading positions in risk management and compliance frameworks. The FDIC's Volcker Rule thereby 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.

While it is unclear from the statements made at the FDIC meeting, two other significant wins for Wall Street may be revealed:

- **First: Non-hedging May Be Characterized as Hedging.** It is unclear from the meeting whether the new Volcker Rule will permit, in essence, hedging that does not hedge. The 2018 proposal would have eliminated all documentation necessary to demonstrate that hedging activities are, in fact, hedging—and not prop trading. We are hopeful that the agencies' will not tie hedging to conceptually non-sensical or unrelated controls, like establishing risk limits, which do not necessarily constrain hedging in the manner contemplated by the statute or the already-too-malleable existing Volcker Rule.

- **Second: Loopholes for Foreign Banks.** It is unclear from the meeting whether the new Volcker Rule will provide foreign banks a number of unnecessary and reckless special accommodations included in the 2018 proposal. For example, the proposal would have eliminated restrictions on (1) U.S. personnel being involved in exempted foreign trading, (2) U.S. financing of exempted non-U.S. proprietary trading, and (3) trading with U.S. counterparties. Eliminating these restrictions would be 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.

It will be no defense when the next economic downturn occurs and inevitable prop trading losses are revealed that the FDIC's final rule today supposedly "clarifies," "simplifies," or "streamlines" the existing Volcker Rule. Those are merely unsupported industry assertions that are contradicted by the facts and are intended to mislead the American people into believing that Wall Street's wish list is reasonable and appropriate. In reality, it is neither. It is reckless and short-sighted and the American people are again going to be forced to pay the bill for Wall Street's reckless activities.

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