Statement On Implementation Of The Volcker Rule

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WASHINGTON, Nov. 1, 2012 /PRNewswire-USNewswire/ -- The following is being released by the Committee on Capital Markets Regulation:

Section 619 of the Dodd-Frank Act, often referred to as the Volcker Rule, is designed to strengthen the financial system and constrain the level of risk undertaken by banking entities that benefit from FDIC-insurance on customer deposits and access to the Federal Reserve's discount window. The challenge to regulators in implementing the Volcker Rule is to prohibit the proprietary trading that Congress intended to limit, while allowing banking organizations to continue to engage in investments not intended to profit from short-term price movements, and in three forms of other permissible activities: hedging, market making and underwriting.

Proposed Rule

The Proposed Rule generally takes a flexible approach in determining whether an investment is intended to profit from short-term price movements. According to the Proposed Rule, "In considering the purpose for which a covered financial position is acquired or taken and evaluating whether such position is acquired or taken for short-term purposes, the Agencies intend to rely on a variety of information, including quantitative measurements of banking entities' covered trading activities, supervisory review of banking entities' compliance practices and internal controls, and supervisory review of individual transactions."

Alternatively, the Proposed Rule applies a more rigid approach to interpreting the three forms of permissible activities, in order to ensure that they will not be used to disguise proprietary trading. In order for a proprietary trade to qualify for any of the exemptions, seven criteria specific to each exemption must be satisfied. The Proposed Rule sets forth at great length the criteria and the attendant compliance program. The criteria are designed to identify all instances of prohibited proprietary trading in an otherwise permitted activity.

Alternative Proposal

We do not believe that it is possible to define with precision the line between proprietary trading and the three permissible activities. Either one risks too limited or too broad a definition of proprietary trading. A too limited definition would not prevent the trading that Congress sought to prevent, while a too broad interpretation would prohibit activities Congress sought to allow.

We recommend that an approach similar to the flexible approach used with respect to investments be used to determine whether the purpose of a trade is hedging, market making or underwriting. We propose that the Proposed Rule set forth guidelines for making this determination. These guidelines, while recognizing that some "customers" or "market-making trades" may give rise to excessive positions over a more extended period, would enable management and supervisors to determine a pattern of proprietary (or speculative) positions. Metrics should be developed to assist in that determination. Ultimately it would be up to bank supervisors, working with their supervised institutions, to judge whether trades outside the guidelines were permitted given the circumstances under which they occurred.

Bank supervisors would monitor risk limits and controls and over time the guidelines could be further refined based on experience. We agree with Chairman Volcker that "success is strongly dependent on achieving a full understanding by the most senior members of the bank's management, certainly including the CEO, and the Board of Directors, of the philosophy and purpose of the regulation. As the rules become effective, periodic review by the relevant supervisor with the Boards and top management will certainly be appropriate, as a key part of the usual examinations process or otherwise."[1]

The Committee on Capital Markets Regulation is an independent and nonpartisan 501(c)(3) research organization dedicated to improving the regulation of U.S. capital markets. Thirty-three leaders from the investor community, business, finance, law, accounting and academia comprise the Committee's membership. The Committee co-Chairs are Glenn Hubbard, Dean of Columbia Business School, and John L. Thornton, Chairman of the Brookings Institution. The Committee's Director is Professor Hal S. Scott, Nomura Professor and Director of the Program on International Financial Systems at Harvard Law School.

[1] Letter from Paul Volcker to the Fed. Deposit Ins. Corp., Sec. & Exch. Comm'n, Bd. of Governors of the Fed. Reserve Sys., Office of the Comptroller of the Currency and Commodity Futures Trading Comm'n 2 (Feb. 13, 2012).

For Further Information:

Hal S. Scott
Director
Committee on Capital Markets Regulatio
hscott@law.harvard.edu

Jennifer M. Grygiel
Executive Director for Public Affairs & Communications
Committee on Capital Markets Regulation
(617) 384-5364
jgrygiel@capmktsreg.org

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