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# Federal Reserve Proposes Rulemaking to Simplify the Volcker Rule


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The Federal Reserve Board (FRB) has taken the first step toward providing banks meaningful relief from the Volcker Rule by soliciting public comment on a proposed rule that would simplify and streamline compliance. The proposed changes are the result of lessons learned by the FRB since the Volcker Rule went into effect four years ago, including the realization that not all financial institutions pose the same level of systemic risk. Publication of the proposed rule in the *Federal Register* is delayed pending comments and/or concurrence from the four other federal agencies that administer the Volcker Rule with the FRB. Those agencies are the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission.

Highlights of the proposed rule include the following:

- Compliance obligations for small and mid-sized firms that do not have large trading operations would be reduced by creating three distinct compliance categories:
  - *Significant trading assets and liabilities* – institutions with trading assets and liabilities above $10 billion, which would remain subject to the "six pillar" compliance program requirements of the existing rule
  - *Moderate trading assets and liabilities* – institutions with trading assets and liabilities between $10 billion and $1 billion, which would be relieved from complying with certain requirements
  - *Limited trading assets and liabilities* – institutions with trading assets and liabilities over the past four consecutive calendar quarters of $1 billion or less, which in the aggregate comprise approximately 2 percent of all trading assets held by banking entities, would be presumed in compliance.
- The revised rule would also eliminate the existing "enhanced compliance program" requirements for banking organizations with more than $50 billion in assets.
- The "short-term intent" prong of the regulatory definition of "proprietary trading," pursuant to which a trading position held for 60 days or less is presumed to be a prohibited proprietary trade subject to rebuttal, would be eliminated.
- A trading desk[1] that does not purchase or sell financial instruments covered by the "market risk capital" or the "dealer" prongs of the rule's definition of "proprietary trading"[2] would be deemed in compliance with the rule.
- The definition of "proprietary trading" would be modified to include an "accounting" prong covering the purchase or sale of financial instruments recorded at fair value on a recurring basis under applicable accounting standards.
- Trades conducted in accordance with "appropriately developed internal risk limits" would be deemed engaged in permissible market making/underwriting.
- The rule would eliminate the condition to the hedging exemption that requires a bank to perform a correlation analysis demonstrating that a potential hedging position,

strategy or technique would demonstrably and substantially reduce the targeted risks. Under the revised rule, it would suffice for the bank to demonstrate that the subject hedging action was designed to achieve such a reduction.

- Coverage of the liquidity management exemption would be expanded beyond securities to include FX forwards, swaps and physically settled cross-currency swaps.

- The "trading outside the United States" exemption would be simplified by removing a number of existing requirements and prohibitions, and would be more focused on actions and risks occurring outside the United States.

- The information on trading activities required to be submitted to the regulatory agencies would be reduced and simplified.

- For banking entities with more than $1 billion in trading assets, the CEO would be required to certify Volcker Rule compliance in writing.

We expect the four other federal agencies that administer the Volcker Rule to approve the proposed rule within the coming days, and that approval process is already underway. The rule will then be published in the *Federal Register*, which will trigger a 60-day notice-and-comment period. The FRB will then analyze the comments it receives and publish a final rule. Once the final rule is published, the FRB will present it to Congress for consideration under the Congressional Review Act. If Congress does not vote to block it, the rule will go into effect on the date specified in the *Federal Register*.

### *Pepper Points*

- Trading activities by banks should substantially increase if the proposed rule is adopted, as a number of the largest investment banks in the United States are subject to the Volcker Rule.

- Easing of the conditions for qualifying for the hedging exemption could trigger a marked increase in such transactions.

- Elimination of the enhanced compliance program requirements for banks with $50 billion or more in assets could spur new mergers and acquisitions, as banks likely would be less reluctant to increase in size.

- This proposed rulemaking from the FRB follows just days after the enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, and continues the trend of rolling back the stringent requirements of the Dodd-Frank Act.

## Endnotes

1. The term “trading desk” does not refer to an actual desk or business function. Rather this term serves to define which types of transactions are subject to the Volcker Rule as a threshold matter.

2. The market risk capital prong covers trading positions that are both covered positions and trading positions for purposes of the federal banking agencies’ market risk capital rules, as well as hedges of covered positions. The dealer prong, in turn, covers any account used by a banking entity that is a securities dealer, swap dealer or security-based swap dealer that is licensed or registered, or required to be licensed or registered, as a dealer, swap dealer or security-based swap dealer, to the extent the instrument is purchased or sold in connection with the activities that require the banking entity to be so licensed or registered.