https://www.nytimes.com/2018/05/21/business/volcker-rule-fed-banks-regulation.html?hp&action=click&pgtype=Homepage&clickSource=story-heading&module=second-column-region&region=top-news&WT.nav=top-news

Bankers Hate the Volcker Rule. Now, It Could Be Watered Down.

By **Emily Flitter** and **Alan Rappeport**
May 21, 2018

It was one of the most significant actions by the federal government to prevent a repeat of the financial crisis.

The Volcker Rule, named for the former chairman of the Federal Reserve and signed into law, prohibited banks from making their own risky bets with their customers' deposits. Banks loathed the rule and Republicans vowed to undo it.
Now, a decade after the global financial meltdown, banks are on the brink of realizing their dream. The Fed and other federal banking regulators are poised to soften the Volcker Rule, making it easier for giant banks to engage in a wider range of trading that can be highly profitable, but also very risky.
The changes, which are expected to be proposed later this month, are emblematic of the larger deregulatory effort underway in Washington.

This week, Congress is expected to take a significant step toward rolling back parts of the Dodd-Frank law, with the House scheduled to vote Tuesday on a bill that would allow thousands of small and midsize banks to avoid tougher oversight. Similar bipartisan legislation passed the Senate earlier this year, clearing a path for President Trump to sign the bill into law.

And Mr. Trump on Monday signed a law nullifying a consumer rule intended to prevent discrimination in auto lending.
But the real action is at the financial regulatory agencies, like the Fed and the Office of the Comptroller of the Currency, which have broad powers over the banking system. The agencies are now largely run by Trump appointees who are sympathetic to Wall Street institutions' longstanding complaints that they have been hurt by overzealous regulations written after the financial crisis.
Earlier this month, the Fed and the O.C.C. proposed easing limits on how much the largest banks can borrow. The change was opposed by Obama administration appointees at the Fed and the Federal Deposit Insurance Corporation, who argued it was too soon to reduce capital requirements for the biggest banks.
And the Consumer Financial Protection Bureau is in the midst of a wholesale retreat. Since taking over the bureau last November, Mick Mulvaney has halted new investigations; instituted a hiring freeze; stopped the agency from collecting certain data from banks; and proposed cutting off public access to a database of consumer complaints.

The relaxation of the Volcker Rule — which was part of the 2010 Dodd-Frank act and was named for its chief proponent, former Fed chairman Paul Volcker — carries particular weight. The regulation, which has wrought sweeping changes on Wall Street since it took effect in July 2015, is probably the best-known part of the Dodd-Frank act — and the rare provision that people can remember the name of. Watering it down could serve as a valuable example of the Trump administration's success in rolling back regulations.

An alphabet soup of five federal agencies — the Fed, O.C.C., F.D.I.C., Securities and Exchange Commission and Commodity Futures Trading Commission — are coming up with the proposed changes to the rule. They won't go so far as to eliminate the ban on proprietary trading, but they would make it easier for banks to comply and give them more control over defining what constitutes improper trading, according to three people familiar with the regulators' plans.

In practice, the proposed changes could expand the types of trading that banks are permitted to engage in.
Banks and their regulators say the changes are needed because the 71-page rule is too complex and interferes with banks' ability to provide market liquidity. In other words, they claim that the rule is making it much harder for banks to match buyers and sellers of financial products.
"Rather than reducing systemic risk, the Volcker Rule has impeded the efficient operation of the financial system, driving banks away from providing services valued by their customers, reducing competition in affected markets, and overall acting as a drag on the economy," wrote Timothy Keehan, an American Banker's Association lobbyist, in a letter last year to the Office of the Comptroller of the Currency.
Regulators appointed by Mr. Trump appear to agree. "We want banks to be able to engage in market making and provide liquidity to financial markets with less fasting and prayer about their compliance with the Volcker Rule," Randal K. Quarles, the Federal Reserve's vice chairman for supervision, said in a speech to bankers on March 5.
While nobody disputes that the rule has been a headache for banks, there is little evidence that it has stanched market liquidity or is in any way disrupting banks' core functions as custodians of the financial markets.

"I just don't see the market being harmed by an absence of liquidity at this point," said Thomas M. Hoenig, who stepped down as vice chairman of the F.D.I.C. last month.
An analysis published last year by the Securities and Exchange Commission that focused on how financial markets have changed over the past decade found that liquidity in parts of the bond market has actually improved since Volcker took effect. Trading costs declined and volumes rose.
Privately, bankers admit as much. Current and former executives, traders, risk managers and lobbyists of the five largest United States banks, including people responsible for overseeing large trading businesses, said in interviews that the rule had neither starved market participants of trading options nor undermined the stability of the markets.

The banks' real concern is that complying with the rule is very cumbersome and that it hurts profits.
There are loads of paperwork. Bankers have to be ready to prove to regulators that any particular trade serves a legitimate purpose for clients and does not represent a bet by the bank on the future directions of markets. Some of the rule's definitions are fuzzy, making compliance even harder.

Yet banks have not been cited for running afoul of the rule. Only one institution has been penalized for violating Volcker: Deutsche Bank paid nearly $20 million last year for having failed to show it had the proper systems in place to monitor its trading and collect data to comply with the rule.

Most important, the rule has made the trading business, once a key engine of banks' profits, less lucrative. Star bank traders have decamped to hedge funds. By design, the rule has made trading on Wall Street far less interesting.
No one expects — or is promoting — a return to the days where banks often had internal hedge funds that made market wagers with the banks' own money. Senior industry executives say they agree that a ban on trading with depositors' money is helpful for the industry's stability and credibility.
The question is how exactly to distinguish between trading connected to clients, which is permitted, and trading that amounts to speculation, which is banned.
Every time a bank makes a trade with or lends money to a client, the bank tries to protect itself from risks associated with those activities. Those include the risks that the client does not pay back the loan or that interest rates move sharply. To shield itself from those potential problems, a bank can engage in hedging, often using instruments such as derivatives.
But those derivatives aren't used purely for defensive reasons. Until the Volcker Rule, traders inside the banks were also using the same derivatives to make speculative bets on the markets.
So, where do you draw the line between acceptable and unacceptable trading? Bankers say this is a gray area that they are struggling to navigate. And they worry that regulators might pounce if a well-intentioned trade goes wrong, incurring losses or hurting clients.
Critics of the industry — including progressive groups like Americans for Financial Reform — say banks simply want to loosen Volcker's definition of hedging so that they have greater leeway to return to their casino-like activities.
A spokeswoman for Mr. Volcker said he declined to comment.
Less controversial are the expected changes to the data that banks have to provide to regulators under the rule. Banks and the authorities agree that so much information floods regulators every day that it is essentially impenetrable.
"Right now you have reams of data coming in and the presumption is you have to prove you're not prop trading," Mr. Hoenig said. "I haven't seen any issues brought up through looking at that data."
The weakening of the Volcker Rule would add to a growing list of wins for the banking industry.
The bill the House is taking up Tuesday would allow thousands of small and midsize banks to avoid some federal oversight such as stress tests, which gauge a bank's ability to weather an economic downturn. It would raise the threshold that determines if a bank is "systemically important" — and therefore subject to intensive regulation — to $250 billion in assets from the current level of $50 billion. Under the bill, firms with less than $10 billion in assets would be exempt from Volcker.
But the measure does little to aid big banks, which is a priority for the banks as well as for regulators who feel that large companies were victimized by regulations imposed by the Obama administration. Congress, so far, has not shown much appetite for helping the biggest banks.
"The significant reforms, if they come, will be from the regulators themselves," said Justin Schardin, a fellow specializing in financial regulation at the Bipartisan Policy Center.