December 11, 2013

First take
A publication of PwC's financial services regulatory practice

Ten key points from the final Volcker Rule's trading provisions

You no longer need "a lawyer and a psychiatrist" to comply with the rule – just strong, well-documented processes

1. At first blush, the rule looks manageable. You no longer need "a lawyer and a psychiatrist" to comply with the rule - just strong, well-documented processes.
2. The rule takes a Fed-style "safety and soundness" approach by placing faith in the banks to design and implement controls and in the supervisory process to evaluate those controls. This is likely the reason for the late in the game hand wringing by the SEC and CFTC - who wanted more of a black and white "pass/fail" approach instead of the gray area that the final rule allows for.
3. Puts the onus on banks to demonstrate that they are operating their trading activities in compliance with the rule. Essentially requires banks to document their approach to market making and hedging at the desk-level, and to demonstrate that they are limiting, monitoring and managing their activities to operate within that strategy. The word of the day is "demonstrable" - banks have to be able to prove that their trading activities comply with the requirements of the rule and the CEO must certify to the effectiveness of the compliance program.
4. Reduces the number of metrics from 17 to 7, but requires reporting of those metrics to start in June 2014 for banks with trading books of $50B or more (banks between $10-50B won't be subject to metrics reporting until 2016).
5. Most of the metrics and other risk controls that are required at the desk level are consistent with current approaches to managing the risks of a trading business - requiring a retro-fitting of those controls to the requirements of the rule rather than an overhaul.
6. A big win for foreign banks with the more risk-based exemption from the rule's extraterritorial reach (i.e., the SOTUS exemption). It will allow foreign banks more freedom to conduct their non-US trading activities AND continue to have access to the US infrastructure and US counterparties. The changed approach largely ignores the competitive equality arguments of US banks who will continue to be covered by Volcker across their global operations.
7. No specific mention of "portfolio hedging," but the rule does permit hedging against aggregate positions. Banks must demonstrate that their hedges reduce or significantly mitigate specific, identifiable risks. Requires "ongoing recalibration" of the hedging strategy to ensure that it is effective.

8. Desk-level market making strategies must include documented limits on financial exposure and market-maker inventory that are consistent with "demonstrable" near-term customer demand (based on the historical liquidity, maturity and depth of the market).

9. The sovereign debt question is answered by allowing the US branches and agencies of foreign banks (but not insured banks) to exempt the sovereign debt of their home country from the requirements of the rule. The non-US bank or broker-dealer affiliates of US banks are also permitted to trade in the sovereign debt of their host countries.

10. Extends the conformance period to July 21, 2015, allowing regulators more time to review how the rule has been implemented and refine their supervisory approach.

Additional information

For additional information about PwC's Financial Services Regulatory Practice and how we can help you, please contact:

Dan Ryan
Financial Services Regulatory Practice Chairman
646 471 8488
daniel.ryan@us.pwc.com

David Sapin
Financial Services Regulatory Practice Leader
646 471 8481
david.sapin@us.pwc.com

Armen Meyer
Director of Regulatory Strategy
646 531 4519
armen.meyer@us.pwc.com

Contributors: Christopher Scarpati, Gary Welsh, Elizabeth Thedford, Tom Anguilla, Christopher McGee, Yowei Li, Shweta Jain, and Roozbeh Alavi.

To learn more about financial services regulation from your iPad or iPhone, click here to download PwC's new Regulatory Navigator App from the Apple App Store.

Follow us on Twitter @PwC_US_FinSrvcs