FS Regulatory Brief

Volcker hearing: Continued uncertainty is the only certainty

At the congressional hearing on January 18, 2012, we heard directly from the leaders of the five key regulatory agencies for the first time on the Volcker Rule. The hearing provided limited new information. Instead the regulators generally confirmed what we had previously concluded about the Volcker Rule and validated our existing views on what firms should be doing now. Below are our observations along with related commentary from the hearing and our predictions on what's next.

Where we are

The rule is not workable in its current form.

"Goal is to separate proprietary trading and market making, we don't have enough information to do this now."

"I think we can get it right over time given the long conformance period and firm specific compliance efforts."

"Question is, can we implement the rule and NOT restrict legitimate activity? I am not sure right now."

The rule, if implemented as is, will negatively affect liquidity in the capital markets.

"Yes, at the margin Volcker will negatively impact liquidity. How large an impact will depend on how good a job we do in implementing the rule and the degree to which non-regulated firms step in."

Proprietary trading wasn't a cause of the recent financial crisis—so the rule is experimental.

"Was proprietary trading at the core of this crisis? No. I assume the motivation is to address other issues. The rule is forward-looking."

"The agencies have proposed to use that conformance period to study the effects of the statutory prohibitions on the activities of banking entities before the Volcker Rule is finally implemented."

Currently regulators lack all the expertise, experience and resources needed to advise firms on implementation and to enforce the rule's provisions, so firms need to do their own assessments.

"Standardization of data will be needed and relied upon to monitor and enforce Volcker."

"We don't have enough staff. We will leverage other agencies as much as possible."

"We don't have all the skills now."

Global alignment is not required and US competitiveness is a major concern, so extraterritoriality is not an accident of the rule writing process, but an important theme.

"We will enforce Volcker. With respect to foreign institutions, [enforcement] will occur through US subsidiaries and branches."

"Not every country needs to have the same set of rules."

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Delays are inevitable and conformance will be a process, not a single point in time, so no need to panic, but managing the uncertainty will be a big challenge.

"Goal is to do it right, we will re-propose as often as needed."

"Unless we see a need to change fundamentally, it would benefit everyone to get a final rule and begin."

Comments, comments and more comments—particularly constructive ones—are the answer!!

"We are very open to additional ideas and approaches."

"Feedback will be very important to the final rule."

"Comments will help inform us tremendously."

What firms should be doing now

After a week vetting the several messages of the hearings and the aftermath, we have concluded that our original guidance from October 2011 (*A Closer Look: The Volcker Rule Proposal What Now?*) is still the best guidance.

1. Get organized around your comment response and make sure your voice is heard.
2. Conduct a detailed self- assessment of your trading businesses—desk by desk.
3. Understand what it will take to implement the compliance and reporting requirements.

While time is short, there is still time. At a minimum, we recommend you:

- Know how your business stacks up relative to the rule requirements and most importantly your peers. The regulators will use a relative assessment process. Be objective!
- Develop a plan or alternative plans, which are feasible and actionable, to minimize the impact on your business and pacify what will be the lingering concerns of your traders and front-office personnel.
- While you may not have to implement the full measure of compliance and reporting requirements by July, you should be prepared to demonstrate to regulators your position on how your desks stand up against the rule and describe the metrics that support your position.

Agree now on which groups will "own" the compliance process and define the various roles and responsibilities of the players—business, risk, finance, operations and compliance—it's very complex.

What's next

We do not have a crystal ball, and therefore do not know how Volcker will ultimately play out, but our professional prediction is:

1. The rule will be re-proposed with a new comment period, which will delay the final rule-making for six months.
2. The covered funds section will see the most softening as the current definitions are not fully reflective of the international realities and there is limited appetite to restrict legitimate activities.
3. The extraterritorial provisions will stay.
4. The exempted products definition will be expanded to include certain local sovereign debt for home country banks and other exemptions are possible.
5. The price to pay for the softening of the rule will be enhanced compliance and reporting expectations by the firms.

Additional information

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