IX. Proposed Volcker Rule Revisions and Expected Impact

A. Introduction

Enacted at the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank, the Act) in 2010 and named for Paul Volcker, the former Federal Reserve Board Chairman, the Volcker Rule (the Rule, the original rule) is a collection of agency regulations designated by Section 619 of Dodd-Frank to implement Section 13 of the Bank Holding Company Act (BHC Act).[1] The Rule bans banks, or insured depository institutions, from certain types of trading and from engaging in specific relationships with hedge funds or private equity funds.[2] While the text of Section 619 of Dodd-Frank is fairly general, Section 619(b)(2) gives five federal agencies responsibility for adopting a set of regulations that match the intent of Section 13 of the BHC Act and enforcing the Volker Rule; the agencies are the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC) (collectively, the Agencies).[3]

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[1] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5536, 5538 (Jan. 31, 2014) (codified at 12 C.F.R. pts. 44, 248, 351, 17 C.F.R. pt. 255); DAVID H. CARPENTER & M. MAUREEN MURPHY, CONG. RESEARCH SERV., R43440, THE VOLCKER RULE: A LEGAL ANALYSIS 1 (2014) (discussing the namesake of the Volcker Rule).

[2] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 Fed. Reg. at 5538 ("[BHC Act Section 13] generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund ('covered fund'), subject to certain exemptions."); *see also Volcker Rule*, BOARD GOVERNORS FED. RES. SYS., https://www.federalreserve.gov/supervisionreg/volcker-rule.htm [http://perma.cc/9K5Y-4Z77] ("Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, commonly referred to as the Volcker rule, generally prohibits insured depository institutions and any company affiliated with an insured depository institution from engaging in proprietary trading and from acquiring or retaining ownership interests in, sponsoring, or having certain relationships with a hedge fund or private equity fund.").

[3] CONG. RESEARCH SERV., R43440, at 2 ("The statutory language provides only general outlines of prohibited activities and exceptions, while empowering the Office of the Comptroller of the Currency (OCC), the Board of Governors of

The Agencies are tasked with adopting regulations that identify activities detrimental to the industry while permitting activities that promote the strength of capital markets and maintain the business of banking institutions.[4]

Since the Volker Rule was enforced by the Agencies in 2013, the banking industry has not been extraordinarily receptive as the Trump Administration has taken steps to reduce regulations introduced by Dodd-Frank and the U.S. Treasury Department released suggested changes to the rule.[5] On May 30, 2018, the FRB approved a notice of proposed revisions mainly related to proprietary trading, covered funds, and the compliance program requirements.[6] In early June 2018, the Agencies responsible published the proposed revisions.[7] The intent of the revisions is to clarify language of the original rule, reduce the burden of compliance costs on smaller banks, and ensure the restrictions of the Rule only apply to the intended entities.[8] Although the intent is to

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the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the SEC, and CFTC (together, the federal financial regulators or the Agencies) to issue coordinated rulemakings to fill in the details and complete the difficult task of crafting regulations to distinguish prohibited activities from activities considered essential to the safety and soundness of banking institutions or to the maintenance of strong capital markets.").

[4] *Id.*

[5] George W. Madison et al., *INSIGHT: Volcker Rule 2.0: A Significant but Unfinished Proposal*, BLOOMBERG NEWS (Aug. 20, 2018), https://www.bna.com/insight-volcker-rule-n73014481859 (describing government agency and legislative action following the enactment of the original rule).

[6] Derek M. Bush et al., *Volcker 1.5: Highlights of Proposal to Simplify the Volcker Rule*, CLEARY GOTTLIEB 1 (May 31, 2018), https://www.clearygottlieb.com/-/media/files/alert-memos-2018/volcker-15-highlights-of-proposal-to-simplify-the-volcker-rule.pdf [http://perma.cc/3GB8-TRQR] ("Yesterday, the Federal Reserve Board approved a 373-page notice of proposed rulemaking that represents a first step toward simplifying and clarifying the Volcker Rule . . . .").

[7] Memorandum from Cleary Gottlieb Steen & Hamilton LLP, Derek M. Bush et al., Volcker Rule "1.5": Analysis of Key Proposed Changes and Considerations for Comments to the Agencies 1 (June 19, 2018) [hereinafter Volcker Rule "1.5"], https://www.clearygottlieb.com/-/media/files/alert-memos-2018/volcker-rule-1-5-analysis-of-proposed-changes-and-areas-for-comment.pdf [http://perma.cc/CK3W-9BW5] ("On June 5, 2018, the five Volcker Rule regulatory Agencies announced publication of a Proposal to modify the 'Volcker Rule'.").

[8] *Id.* ("The proposed changes are intended to 'simplify and tailor the implementing regulations . . . in order to increase efficiency, reduce excess

address current points of contention, FRB Vice Chair for Supervision, Randal Quarles stated that he viewed the proposed revisions as "an important milestone in comprehensive Volcker Rule reform, but not the completion of our work," indicating further reform is likely.[9] The proposed revisions have been published in the Federal Register and were previously open for public comment on *Regulations.gov*.[10]

This article discusses the proposed revisions to the Volcker Rule and how they relate to the banking industry. Part B provides a brief overview of the original rule, the context of its implementation, and recent activity regarding Dodd-Frank. Next, Part C details the proposed revisions specifically related to proprietary trading, covered funds, and the compliance program requirement. Subsequently, Part D summarizes the Agencies' intent in proposing the aforementioned revisions. Finally, Part E highlights competing interests in politics and the industry, compares critical scholarship to the intent of the revisions, and focuses on the relevance of the revisions as they relate to the industry. This final section highlights the importance of organizations and individuals taking advantage of the current period of public commentary prior to the enactment of any final revisions.

B. Brief History

The original rule, although written into law by Congress in 2010, was adopted through individual regulations[11] by each of the five

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demands on available compliance capacities at banking entities, and allow banking entities to more efficiently provide services to clients'.").

[9] Michelle Price & Pete Schroeder, *Fed Unveils Rewrite of 'Volcker Rule' Limits on Bank Trading*, REUTERS (May 30, 2018, 12:07 AM), https://www.reuters.com/article/us-usa-fed-volcker/fed-unveils-rewrite-of-volcker-rule-limits-on-bank-trading-idUSKCN1IV09Y [http://perma.cc/7GRX-8DE4] (quoting Federal Reserve Board Vice Chair for Supervision, Randal Quarles).

[10] *See* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432, 33,432–605 (July 17, 2018) (to be codified at 12 C.F.R. pt. 248); *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds*, REGULATIONS.GOV (July 17, 2018), https://www. regulations.gov/document?D=OCC-2018-0010-0001 [http://perma.cc/BQ2S-ZDYA].

[11] For the purposes of this paper, I have cited to the Federal Reserve Board's regulation in Title 12 of the Code of Federal Regulations. However, the numbered subsections align among each agencies' regulation. For example, 12 C.F.R. § 248.3 (FRB) is identical to 12 C.F.R. § 44.3 (OCC).

agencies responsible in 2013 and collectively known as the Volcker Rule.[12] The Rule was enacted with the initial intention of promoting sound banking activity and mitigating risk associated with self-regulated banking and inherent in incentivizing traders.[13] Although a set of regulations such as the Volcker Rule would not have prevented the 2008 Financial Crisis, as "[i]t was not designed to solve those particular problems," Paul Volcker, the Rule's namesake, indicated that this Rule would ideally prevent the next one.[14] The original rule contains a comprehensive series of prohibitions and requirements for banking activity, but specifically prohibits proprietary trading, prohibits or restricts the acquisition of or maintaining of ownership interest in covered funds, and requires the development and implementation of compliance programs subject to Section 13 of the BHC Act.[15] In addition, large firms are required to provide the Agencies with quantitative data to assist in monitoring dangerous activity.[16] Because the original language applies broadly to all "banking entities," all banking institutions and any affiliates are subject to the Volcker Rule—a point of contention for the Rule's critics and an issue addressed by the proposed revision, as well as discussed later in this paper.[17]

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[12] DAVID H. CARPENTER & M. MAUREEN MURPHY, CONG. RESEARCH SERV., R43440, THE VOLCKER RULE: A LEGAL ANALYSIS 2 (2014) ("On December 10, 2013 . . . five federal financial regulators published final regulations . . . . Together these are known as the Volcker Rule . . . .").

[13] MICHAEL S. BARR ET AL., FINANCIAL REGULATION: LAW AND POLICY 704 (Saul Levmore et al. eds., 2d ed. 2018).

[14] *Id*. at 705 (citing *Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs*, 111th Cong. 28 (2010) (statement of Paul A. Volcker, Chairman, President's Economic Recovery Advisory Board)) ("His view was that the Volcker Rule would be part of an effort to address the problems that might contribute to the next crisis.").

[15] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5536, 5541 (Jan. 31, 2014) (codified at 12 C.F.R. pts. 44, 248, 351, 17 C.F.R. pt. 255) ("The final rule adopts a risk-based approach . . . and is designed to effectively accomplish the statutory purpose of reducing risks posed to banking entities by proprietary trading activities and investments in or relationships with covered funds.").

[16] *Id.* at 5542.

[17] BARR ET AL., *supra* note 13, at 705 ("[E]ven far-flung affiliates with no direct U.S. nexus are caught under the 'banking entity' definition, although such affiliates may find that their activities conducted 'solely outside the United States' qualify for an exemption . . . .").

Since its publication, the Volcker Rule has been controversial—resulting in House bills intended to repeal the statute entirely.[18] Other government action has been taken as well: in 2017, the U.S. Treasury Department issued a series of recommendations to simplify the Rule and reduce compliance costs to which the OCC responded with a notice seeking formal public input on the proposal.[19] In May 2018, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act, exempting all small banks with limited trade activity from the Volcker Rule.[20] The revisions proposed by the Agencies in June 2018 are in response to these recent developments.[21]

C. Proposed Revisions

1. Proprietary Trading

The proposed revisions to the Volcker Rule center primarily around three areas: proprietary trading, covered funds, and compliance program requirements.[22] As for proprietary trading, the proposed revisions adjust the definition of "trading account."[23] Originally a three-pronged approach to determine which entities qualified as a trading account, the proposal suggests removing the short-term intent prong and sixty-day rebuttable presumption.[24] In the original definition, the first prong applies to any account used by a banking entity that met the

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[18] *Id.* at 708.

[19] Madison et al., *supra* note 5 ("[T]he U.S. Treasury Department issued a report in 2017 that recommended modifications to the Volcker Rule that would reduce compliance burdens and simplify some of the more complex requirements. Following that report, the OCC formally sought public input on potential changes to the Volcker Rule.").

[20] *Id.*

[21] *Id.* ("The agencies have proposed their rule changes in the context of these developments . . . .").

[22] Bush et al., *supra* note 6, at 1.

[23] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432, 33,437 (July 17, 2018) (to be codified at 12 C.F.R. pt. 248) ("Notably, the proposal would revise, in a manner consistent with the statute, the definition of 'trading account' in order to increase clarity regarding the positions included in the definition.").

[24] *Id.* at 33,438 ("[T]he proposal would remove the short-term intent prong from the 2013 final rule's definition of trading account and eliminate the associated rebuttable presumption . . . .").

short-term intent characteristic defined by the Agencies (short-term intent prong).[25] The second prong applies to covered trading positions operating for the purpose of federal banking agencies' market risk capital rules and hedges of covered positions (market risk capital prong).[26] The third prong applies to securities-related accounts (dealer prong). [27] The definition also includes a rebuttable presumption provision which designates a purchase or sale to be for a trading account under the short-term intent prong if "the banking entity holds the financial instrument for fewer than sixty days or substantially transfers the risk of the financial instrument within sixty days of the purchase (or sale)," unless proved otherwise.[28]

The short-term intent prong would be replaced by an accounting test, which is intended to remove the subjective standard from the definition.[29] Rather than assuming a bank's short-term trading is "profit-seeking unless they can prove otherwise," the accounting prong will objectively consider a bank a trading account so long as it "buys or sells a financial instrument . . . that is recorded at fair value on a recurring basis under applicable accounting standards."[30] The 60-day rebuttable presumption provision would be removed entirely.[31] In

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[25] *See* Volcker Rule, 12 C.F.R. § 248.3(b)(1)(i) (2018); *see also* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,437 ("The first prong includes any account that is used by a banking entity to purchase or sell one or more financial instruments principally for the purpose of short-term resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging another trading account position (the 'short-term intent prong').")

[26] *See* 12 C.F.R. § 248.3(b)(1)(ii) (2018); *see also* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,437.

[27] *See* 12 C.F.R. § 248.3(b)(2)(iii) (2018); *see also* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,437–38.

[28] 12 C.F.R. § 248.3(b)(2) (2018).

[29] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,448.

[30] Price & Schroeder, *supra* note 9; Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,438.

[31] Bush et al., *supra* note 6, at 1.

addition, the market risk capital prong would be adjusted to include foreign banking organizations (FBOs).[32] Additional revisions have been suggested to further clarify which trades qualify for safe harbors.[33] Impacting § 248.3, the liquidity management exclusion would be "clarif[ied] and expand[ed]," while transactions made in effort to correct certain errors will become exempt.[34] A new presumption will be introduced which allows trading within "internally set risk limits" to satisfy the § 248.4 "reasonably expected near-term demands of clients" (RENTD) requirement.[35] The proposed revisions reduce § 248.5 restrictions regarding the eligibility of an activity to qualify as a permitted risk-mitigating hedging activity based on trade activity.[36] Lastly, the proposed revisions will remove restrictions associated with § 248.6(e).[37] Specifically, the proposed revisions would remove prohibitions on foreign trading being conducted with or funded by an entity located within the United States, as well as the prohibition on United States personnel participating in foreign banking activity.[38]

2. Covered Funds

Unlike proprietary trading, the Agencies have not proposed significant revisions to the definition or scope of covered funds.[39] The Agencies have instead requested public comment on a series of questions regarding modification of the definition and adjustment of the scope of the prohibitions related to covered funds in § 248.10.[40] Speci-

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[32] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg.at 33,438 ("The proposal would, however, modify the market risk capital prong to cover the trading positions of FBOs subject to similar requirements in the applicable foreign jurisdiction.").
[33] Price & Schroeder, *supra* note 9.
[34] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,438.
[35] *Id.*
[36] *Id.* at 33,438–39.
[37] *Id.* at 33,439.
[38] Bush et al., *supra* note 6, at 3 (elaborating on the proposal to lift certain restrictions on trading outside of the United States).
[39] Bush et al., *supra* note 6, at 2.
[40] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,438.

fic revisions have been proposed, however, to modify § 248.11(c) requirements applicable to underwriting or market making-related activities to allow more freedoms to covered fund ownership interests for third-party covered funds, and to expand the abilities granted in § 248.13(a) to engage in hedging activities involving covered fund ownership interests.[41]

3. Compliance Program Requirements

A major revision proposed by the Agencies relates to the original rule requirement to develop and maintain a compliance program.[42] The proposed revisions replace the original requirement with the creation of a three-tiered oversight framework, thus requiring greater oversight rules for more active banks and progressively less regulations for less active banks.[43] Banking entities subject to the Rule will be divided into three categories as determined by trade activity.[44] The first category would be for entities with "significant trading assets and liabilities" or those with trading assets and liabilities over the previous year equal to or greater than $10 billion.[45] Banking entities falling into this category would be subject to the strictest compliance requirements, including the implementation of a six-pillar compliance program.[46] The second category is for entities with "moderate trading assets and liabilities"—between $1 billion and $10 billion; these entities are subject to a simplified compliance program and less stringent requirements than the first category.[47] Finally, the third category includes entities with "limited trading assets and liabilities"—less than $1 billion; these entities are not subject to any specific compliance requirements, although an agency has the authority to require an entity falling into the moderate or limited category to implement specific compliance requirements typically geared toward more active

[41] *Id.*
[42] *Id.* at 33,436.
[43] Price & Schroeder, *supra* note 9.
[44] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,440.
[45] *Id.*
[46] *Id.*
[47] *Id.*

entities.[48] The proposed revisions to the Rule reflect recent legislation,[49] such as the Economic Growth, Regulatory Relief, and Consumer Protection Act mentioned in Part B.[50]

D. Intent of Proposed Revisions

The Agencies have proposed the revisions with the overall intent of clarifying restrictions, reducing compliance costs, and enhancing "the ability of the Agencies to make supervisory assessments regarding compliance relative to" the original rule.[51] The Agencies individually published their initial analyses of the revisions, including reasons for the proposal and expected costs and benefits.[52]

1. Proprietary Trading: Looser Restrictions and Decreased Ambiguity

The modifications proposed in the Volcker Rule revisions to the definition of proprietary trading would loosen certain restrictions, which would in turn increase the number of short-term trades

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[48] *Id.* at 33,441 ("[T]he relevant Agency would retain its authority to require a banking entity to apply any compliance requirements that would otherwise apply if the banking entity had moderate or significant trading assets and liabilities if such Agency determines that the size or complexity of the banking entity's trading or investment activities, or the risk of evasion, does not warrant a presumption of compliance.").

[49] Madison et al., *supra* note 5 ("The agencies have proposed their rule changes in the context of those developments, following the appointment by the current administration of many of the top officials at those agencies.").

[50] Reena Agrawal Sahni et al., *Volcker Rule 2.0: First Major Rule Revisions Proposed*, SHEARMAN & STERLING: PERSPECTIVES (June 1, 2018), https://www.shearman.com/perspectives/2018/06/volcker-rule-2-first-major-rule-revisions-proposed [http://perma.cc/B9DA-FKXK] ("For example, Congress recently passed a bill that exempted banks with limited trading activity and less than $10 billion in total consolidated assets from the Volcker Rule, a change that would be beyond the regulatory authority of the Agencies.").

[51] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,516.

[52] *Id.* at 33516–52 (reviewing the proposed revisions in terms of costs and benefits from the perspective of each agency).

permitted.[53] First, removing the short-term intent prong would decrease confusion generated by questions surrounding the definition of "trading account."[54] Second, removing the rebuttable presumption provision will decrease the number of trading activities unintentionally included in the definition that do not actually fall within the type of risk or transaction the statutory language seeks to eliminate.[55] Third, including certain FBOs' activities under the market risk capital prong would address the various organizational and regulatory structures attached to FBOs in their native countries, providing greater flexibility for foreign businesses.[56] In addition, implementing an exemption for trading by FBOs will reduce the impact of the Rule on these entities.[57] The overall purpose of the proposed revisions as they relate to proprietary trading appear to mirror the original rule's intent to restrict certain activity, as well as reduce the ambiguity surrounding the original rule.[58] Although this may conflict with the original rule's statutory

[53] Memorandum from Fried, Frank, Harris, Shriver & Jacobson LLP, Nathan S. Brownback & V. Gerard Comizio, *Significant Revisions of the Volcker Rule* 2 (June 18, 2018), http://www.friedfrank.com/siteFiles/Publications/FINAL%20-%2006-01-18%20-%20TOC%20Memo%20-%20Volcker%20NPR%20-%20June%202018.pdf [http://perma.cc/48NM-WYU4] ("Further, the notice would loosen the proprietary trading account restrictions to permit more short term trades by eliminating the current subjective purpose test for a banking entity's holdings of financial instruments, which includes a rebuttable presumption that holding financial instruments for less than 60 days constitutes proprietary trading, with an objective test based on fair value accounting treatment of the relevant financial instrument.").

[54] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,438.

[55] *Id.* at 33,447.

[56] *Id.* at 33,438; Brownback & Comizio, *supra* note 53, at 2 ("Finally, the Notice would provide foreign banking entities with increased flexibility and authority to make proprietary trades and invest in covered funds outside the United States.").

[57] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,439.

[58] Madison et al., *supra* note 5 ("Given the inherent uncertainties related to any inquiry into subjective intent . . . eliminating this element of the definition would make application of the rule more objective and less complex.").

language, the proposed accounting prong is likely to achieve the same objective.[59]

2. Covered Funds: Language Clarity

Although the proposed revisions to the Rule do not specifically alter the definition of "covered fund" or the scope of the regulation's prohibitions, the questions posed to the general public for comment are intended to provide clarity and determine whether changes would be welcomed by those affected by the regulation.[60] In addition to providing greater clarity, the adjustments are aimed at increasing the efficiency of covered fund exemptions and increasing activities that were previously limited.[61] It is believed that placing an emphasis on adjusting existing restrictions as opposed to replacing current limitations with entirely new rules could prevent further confusion or burden associated with adopting new standards.[62]

3. Compliance Program Requirements: Increased Presumption of Compliance

The presumption of compliance for entities with limited trading assets and liabilities is intended to reduce compliance costs for smaller banks that conduct trading activity on a much smaller scale.[63]

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[59] *Id.* ("[A]gencies must overcome a statutory hurdle . . . appear to address this concern by replacing the short-term intent prong with the new accounting prong").

[60] Bush et al., *supra* note 6, at 2 ("[R]equests comment on a number of important revisions—for example, whether to adopt a characteristics-based definition of covered fund and whether to revisit the conditions of various exclusions from the covered fund definition . . . .").

[61] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,436; Bush et al., *supra* note 6, at 3 ("Covered Fund Proposed Revisions . . . [i]ncreases the utility of the underwriting and market-making exemptions by removing the requirement to count interests. . . . [and] [r]estores the exemption from the 2011 proposed rule. . . . [which] mitigates the controversial 'high-risk trading strategy' guidance that severely limited fund-linked products business.") (alteration in original).

[62] Volcker Rule "1.5", *supra* note 7, at 23.

[63] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,440.

Not only will the new tiered oversight method be cost effective, it will relieve smaller trading entities of strict regulatory requirements.[64] The intent of the proposed revisions reflects the intent of the original rule in that it promotes safe banking and compliance measures; however, the new revisions also reflect a need for cost-reducing measures and compliance programs that are less burdensome on smaller entities.[65] Despite seemingly positive revisions, larger institutions with significant trading activity might resist the stringent compliance requirements and six-pillared compliance program, having already dedicated valuable resources to creating programs to comply with the original rule.[66] The institutions may be larger and possess greater assets, but fulfilling the requirements still poses a burden on the entity.[67]

E. Relevance

1. Competing Interests

The proposed revisions are intended to address recurring complaints about the ambiguity and complexity of the Rule.[68] Although these issues have been a source of contention since the original rule was implemented, the revisions were likely proposed now as a result of the current political climate and a push to analyze the current regulatory regime, as opposed to an immediate need for financial regulation to prevent another financial crisis, like the original.[69] The Trump Administration has previously attempted to repeal Dodd-Frank, and these revisions are one of many actions proposed by regulators to remove restrictions placed by the Act.[70] Like most legislative

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[64] *Id.* at 33,439; Brownback & Comizio, *supra* note 53, at 2.

[65] Madison et al., *supra* note 5 ("The agencies can implement the core restrictions of the Volcker Rule . . . without a rule that is as detailed and as prescriptive as the current rule. Reducing compliance burdens, while maintaining the core requirements of the regulations is sensible.").

[66] Volcker Rule "1.5", *supra* note 7, at 49.

[67] *Id.*

[68] Price & Schroeder, *supra* note 9.

[69] Sahni et al., *supra* note 50 ("In October 2017, the U.S. Department of the Treasury issued a report (the 'Treasury Report') in response to an executive order issued by President Trump soon after he took office calling for a study of financial services regulation in the United States. . . . The proposed changes to the Volcker Rule regulations are generally in line with the proposals included in the Treasury Report.").

[70] Price & Schroeder, *supra* note 9.

actions, these revisions will likely face opposition by both supporters of increased regulation and further deregulation.[71] The Agencies even extended the public comment period, likely in an effort to gather the most feedback from financial institutions, other agencies, and individuals alike before finalizing revisions.[72]

The original rule was intended to promote safe banking, mitigate risk stemming from incentivized trading and self-regulation, and prevent a future financial crisis as it was enacted in the wake of the 2008 Financial Crisis.[73] While the market has yet to crash since the Rule was implemented, it is unlikely the banking and financial industries will ever be free of regulation.[74] The Agencies have proposed moderate revisions, with the contingency that increased oversight, specifically in proprietary trading restrictions and compliance programs, can be implemented per agency review.[75] Despite this middle-of-the-road solution intended to apply risk-mitigating restrictions on banking, the proposed revisions are still receiving criticism.[76] Those in favor of the original rule and strict banking regulation, view the revisions as a move to promote the interests of the banking industry in

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[71] Lalita Clozel, *Banks Say No Thanks to Volcker Rule Changes*, WALL ST. J. (Aug. 15, 2018, 1:25 PM), https://www.wsj.com/articles/banks-say-no-thanks-to-volcker-rule-changes-1534353932?ns=prod/accounts-wsj ("In addition to remonstrations from large banks, the proposal has drawn criticism from supporters of postcrisis financial rules . . . .").

[72] *See* Pete Schroeder, *U.S. Regulators Extend Comment Period for Proposed 'Volcker Rule' Rewrite*, REUTERS (Sept. 4, 2018, 10:06 AM), https://www.reuters.com/article/us-usa-regulation-volcker/u-s-regulators-extend-comment-period-for-proposed-volcker-rule-rewrite-idUSKCN1LK1O1 [http://perma.cc/UPN2-9JTC]

[73] BARR ET AL., *supra* note 13, at 704; Clozel, *supra* note 71 (discussing the rule's origination in response to the 2008 financial crisis).

[74] *See* Julie Stackhouse, *Why Are Banks Regulated?*, FED. RES. BANK ST. LOUIS: ON ECON. BLOG (Jan. 31, 2017), https://www.stlouisfed. org/on-the-economy/2017/january/why-federal-reserve-regulate-banks [http://perma.cc/64LH-CP2C] (discussing the four main purposes of banking regulation: financial stability, protection of the Federal Deposit Insurance Fund, consumer protection, and competition).

[75] *See* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432, 33,441, 33,453 (July 17, 2018) (to be codified at 12 C.F.R. pt. 248).

[76] *Id.* at 33,434; Price & Schroeder, *supra* note 9 ("Still, while regulators painted the rewrite as moderate, consumer advocates warned that it would put taxpayers and depositors at risk.").

lieu of protecting taxpayer interests.[77] Public reaction to the revisions is evidence of the political divide over the original rule and the proposed modifications.[78] In an already tense political climate, the revisions only seem to be stirring the pot.

2. Scholarly Criticism Versus the Proposed Revisions

Following the passage of the Rule, there was criticism that the regulations were both under- and over-inclusive, primarily regarding proprietary trading.[79] It is unclear whether the revisions will precisely address the issue of under-inclusion; however, the modifications to the

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[77] Price & Schroeder, *supra* note 9 (quoting U.S. Senator Elizabeth Warren: "Even as banks make record profits, their former banker buddies turned regulators are doing them favors by rolling back a rule that protects taxpayers from another bailout.").

[78] *See* Schroeder, *supra* note 72 ("[C]onsumer group and liberal critics of Wall Street such as Senator Elizabeth Warren have criticized the proposed rewrite for making the rule too weak, potentially inviting banks to engage in riskier activity in pursuit of profits."); *see also* Pete Schroeder & Michelle Price, *Volcker 'Fix' May Cause New Headaches for Wall Street,* REUTERS (June 15, 2018, 1:02 AM), https://www.reuters.com/article/us-usa-regulation-volcker-analysis/volcker-fix-may-cause-new-headaches-for-wall-street-idUSKBN1JB0DX [http://perma.cc/W7QB-8DMM]; *see, e.g.,* National Association of Federally-Insured Credit Unions, Comment Letter on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Oct. 5, 2018), https://www.regulations.gov/document?D=OCC-2018-0010-0028 [http://perma.cc/CLE7-Q4DD] (berating proposed revisions for benefitting large banks); The Systemic Risk Council, Comment Letter on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Aug. 8, 2018), https://www. regulations.gov/document?D=OCC-2018-0010-0016 [http:// perma.cc/JN34-384P] (stating that while revisions are necessary to increase clarity, the current proposal to revise the Volcker Rule gives too much discretion to the banks).

[79] John C. Coffee, Jr., *The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated*, 97 CORNELL L. REV. 1019, 1073–75 (July 2012) (highlighting a lack of evidence pointing to proprietary trading as a major factor in the Financial Crisis, despite it being a focal point of the Volcker Rule restrictions, and the fact that activities known to be responsible for financial institution failure, like principal investments, are exempt from the Rule).

proprietary trading provisions appear to address earlier concerns.[80] Other critics of the original rule argued "'incorrect' implementation of the Rule could result in 'decreased liquidity, higher costs for issuers, reduced returns on investments and increased risk to corporations wishing to hedge their commercial activities.'"[81] The Agencies' explanation of the intent behind the revisions does not explicitly address whether the complexities posed by the original rule resulted in incorrect implementation or harm to industry actors feared by scholars;[82] however, the clear intent to promote clarity[83] and recognition of the potential economic impacts of the revisions[84] appear to imply as much.

Additionally, scholars contended that covered fund market-making-related activities needed greater structure to shape over-the-counter markets.[85] Prior to the Rule's passing, Onnig H. Dombalagian explored the idea that implementation of market-making provisions embracing "expressive synergies" would emphasize the roles of different industry actors and promote long-term competition.[86] However, it does not appear the provisions of the original rule had or the proposed revisions will have this effect.[87] The exact effects will not be clear until the revisions are implemented, but the Agencies have proposed changes related to these activities intended to provide bright-

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[80] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,438–39; Brownback & Comizio, *supra* note 53, at 2 (highlighting increased flexibility for foreign banks).

[81] Onnig H. Dombalagian, *The Expressive Synergies of the Volcker Rule*, 54 B.C. L. REV. 469, 471 (2013) (quoting Letter from the Sec. Indus. & Fin. Mkts. Ass'n, the Am. Bankers Ass'n, the Fin. Services Roundtable & The Clearing House to the Agencies 2 (Feb. 13, 2012) (No. OCC-2011-0014-0174)).

[82] *Id.* at 471–72 (recalling a "loss of reputational and human capital" amongst major banks following the Rule's passage).

[83] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,436.

[84] *Id.* at 33,437.

[85] Dombalagian, *supra* note 81, at 473.

[86] *Id.* at 533.

[87] *See generally* Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,436 (explaining overall revisions and intended effects).

line instructions for banking entities in order to avoid confusion.[88] The proposed revisions do not explicitly promote expressive implementation of the Rule, like the manner suggested by Dombalagian;[89] however, a more specific market-making-related activities exemption could positively impact the industry.[90]

3. Impacts on Financial Institutions

At the time the original rule was drafted, the industry was recovering from the Financial Crisis.[91] The Rule was drafted quickly and was intended to affect a plethora of activities in few words, which resulted in regulation that is much critiqued, difficult to implement, and overbroad.[92] Today, the industry is considerably more stable than it was when Dodd-Frank was drafted and the Agencies have had time to gather information and analyze the impact of the original rule.[93] As a result, the industry will likely see positive change stemming from the proposed revisions in regard to limitations of the overbroad elements, while maintaining the key components of the statutory language.[94]

With respect to proprietary trading restrictions, many of the proposed changes place a degree of risk-monitoring activity back into the hands of the financial institutions themselves, subject to agency review, adopting a more flexible, autonomous approach to compliance.[95] As previously mentioned, the revisions would release foreign

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[88] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,459 ("[T]he Agencies are proposing to modify the market making exemption by providing a clearer way to measure and satisfy the statutory requirement that market making-related activity be designed not to exceed the reasonably expected near term demand of clients, customers, or counterparties.").

[89] *See* Dombalagian, *supra* note 81, and citations therein.

[90] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. at 33,459 (proposing that more narrow requirements will prevent unnecessary limitations on activities beyond those that the Rule was designed to prevent).

[91] Schroeder, *supra* note 72.

[92] Madison et al., *supra* note 5.

[93] *Id.*

[94] *Id.*

[95] *Id.* (regarding underwriting and market-making RENTD requirements, "the regulations would adopt a more principles-based, and less rules-based,

entities participating in transactions outside of the United States from many unnecessary restrictions.[96] This is important because it would limit the impact the Rule currently has on foreign trade activity.[97] In addition, the revisions would reduce costly compliance burdens placed on smaller banks.[98] The small banks do not have the capital of much larger banks to spend on comprehensive regulatory compliance; if the proposals are implemented, these entities would be able to allocate fewer resources to a smaller-scale internal program, which has not been ruled out.[99] Lifting this burden has the potential to allow smaller banking entities to scale back compliance spending, but not necessarily forgo compliance measures entirely.[100]

Although regulators have provided assurance suggesting the proposed revisions will not negatively affect the banking industry, there is fear that changes to the Rule will harm the banking industry and, as mentioned, the revisions have also been criticized by supporters of increased regulation following the 2008 Financial Crisis.[101] Should the proposed revisions be implemented as they currently stand, it is unlikely all parties involved will be satisfied, hence the need for public comment.[102] For example, the transition from a subjective short-term intent and rebuttable presumption standard to an objective accounting standard could expand the already expansive definition the

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approach. . . . [T]he agencies and banks alike would benefit from such an approach").

[96] *Id.*

[97] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432, 33,439 (July 17, 2018) (to be codified at 12 C.F.R. pt. 248) ("Taken as a whole, the proposed amendments to this exemption seek to reduce the impact of the 2013 final rule on foreign banking entities' operations outside of the United States by focusing on where the trading of these banking entities as principal occurs, where the trading decision is made, and whether the risk of the transaction is borne outside the United States.").

[98] Clozel, *supra* note 71.

[99] Volcker Rule "1.5", *supra* note 7, at 48.

[100] *Id.*

[101] Clozel, *supra* note 71.

[102] *Id.* ("The Volcker proposal is in its preliminary stages, with regulators taking comments from banks and the public. They could decide to change the proposal or narrow the scope of this new definition to make it more palatable to the banks.").

revision sought to address and potentially harm banking activity.[103] However, regulators say the Rule can be revised without "negatively affecting the safety and soundness of the financial system" and the proposed revisions would make enforcement easier.[104] The proposed revisions could impact financial institutions, government agencies, and the general public alike, this is why it is vital for entities subject to the Rule to review the changes and issue comments while they have an opportunity to participate in what could be industry-altering regulation.[105] Finally, as mentioned in the Introduction,[106] FRB Vice Chair for Supervision, Randal Quarles made it clear that these revisions are not final, nor will the next set of revisions to the Rule be the last.[107] Continued reform is likely, especially if it means promoting the goals of the original rule.[108]

F. Conclusion

The Volcker Rule was originally designed to prohibit banks from engaging in risky activity.[109] The proposed revisions focus

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[103] *Id.* ("In an attempt to create a 'bright line,' regulators are proposing to replace the 60-day standard with one based on accounting definitions, which encompasses a category bankers say is overly broad: available-for-sale securities. . . . [R]estricting their ability to trade with those asset classes could bog down markets.").

[104] Price & Schroeder, *supra* note 9 ("Industry attempts to persuade Congress to overhaul the Volcker Rule so far have failed, but regulators said on Wednesday that it can be revised without negatively affecting the safety and soundness of the financial system.").

[105] Brownback & Comizio, *supra* note 53, at 6 ("The Notice appears to be a work in progress, and, with 342 questions posed for public comment, is likely to go through further iterations before it evolves into a final rule. Therefore, it is critical for financial services organizations subject to the Volcker Rule or otherwise affected by it to closely examine the Notice to (1) evaluate the aspects of the Notice that most impact their business lines, (2) assess all questions posed in the Notice that may impact them and their business, consult counsel, and consider providing comments on the Volcker Rule to the Agencies.").

[106] *See supra* Part A. Introduction (providing Randal Quarles' comments on Volcker Rule reform).

[107] Price & Schroeder, *supra* note 9 (quoting Federal Reserve Board Vice Chair for Supervision, Randal Quarles).

[108] *Id.*

[109] DAVID H. CARPENTER & M. MAUREEN MURPHY, CONG. RESEARCH SERV., R43440, THE VOLCKER RULE: A LEGAL ANALYSIS 1 (The Volcker Rule "is

mainly on proprietary trading, covered funds, and the compliance program requirements included in the original rule.[110] These are intended to reduce cost and compliance burdens and provide clearer language to remove ambiguity surrounding which activity is truly prohibited, while still maintaining the purpose of the original rule.[111] Another benefit of the revised compliance program requirements, although it has not been raised by scholars yet, could be the opportunity for small banks to use the funds otherwise dedicated to compliance with the Rule for investment and further business expansion. As discussed in this paper, both proponents of deregulation and proponents of increased regulation have voiced concern over the proposed revisions.[112] Despite agreement across many sectors that the language of the original rule is too complex, fear arises among nonbanking and government entities that the revisions will give too much deference to banks.[113] Simultaneously, banks worry that, while the revisions will reduce confusion posed by broad definitions and exemptions, compliance with the proposed revisions may be costly.[114] While the revisions were still undergoing a public comment period, it was crucial for entities affected by the Rule and potentially by the revisions to evaluate the proposed revisions and comment while they could provide valuable input.[115] The comment period has since closed and adjusted revisions are likely.[116]

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designed to prohibit banks and their affiliates from engaging in risky, short-term, speculative trading and investing in private equity and hedge funds.").

[110] *See* Bush et al., *supra* note 6, at 1–3 (reviewing the major areas that the proposed revisions cover).

[111] Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 83 Fed. Reg. 33,432, 33,434 (July 17, 2018) (to be codified at 12 C.F.R. pt. 248).

[112] *See, e.g.,* Clozel, *supra* note 71.

[113] *See supra* note 78 and citations therein.

[114] *Id.*

[115] *See* Brownback & Comizio, *supra* note 53, at 6.

[116] *Id.*; Jon Hill, *Proposed Volcker Rule Definition Change a No-Go, Banks Say*, LAW360 (Oct. 18, 2018, 10:00 PM), https://www.law360.com/articles/1093702/proposed-volcker-rule-definition-change-a-no-go-banks-say.

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