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Volcker Rule Regulatory Changes Are Coming

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Federal financial regulators responsible for enforcement of the Volcker Rule are about to embark on a process that will culminate in a significant revision to the regulations that went into effect eighteen months ago. In a March 5, 2018 speech at the Institute of International Bankers Annual Washington Conference in Washington, D.C., Randal K. Quarles, Federal Reserve Board Vice Chairman for Supervision, outlined the expected principal areas of focus. He also endorsed legislative efforts to pull community banks out from under the Volcker Rule.

Where the regulators can make adjustments without Congressional approval, Vice Chairman Quarles stated that a serious effort will be made to address areas where the current regulations make life harder than necessary for regulators and the regulated, as follows:

1. Clarify what is, and what is not, subject to the Volcker Rule, particularly, definitions of key terms like "proprietary trading" and "covered fund." Interpreting these definitions has required hours of legal analysis of complex banking and securities regulations. Regulatory supervisors have been unable to provide clear and transparent guidance. New regulations will seek to provide greater certainty that would benefit market participants as well as the supervisors at the agencies.

2. Clarifying certain exemptions will be another area of focus. Vice Chairman Quarles highlighted difficulty in interpreting the exemption for market making-related activities, which is one of the key exemptions from the prohibition on proprietary trading. The statute provides an exemption for the market making-related activities that are designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties. The regulatory exemption is extraordinarily complex and the regulators will be considering different ways to use a clearer test. Vice Chairman Quarles stated that the Federal Reserve Board also understands that the Volcker rule has had an extraterritorial impact on foreign banking organizations. With respect to foreign banks, he said, there are at least a few places where the Federal Reserve Board would like to revisit the application of the final rule based on concerns raised by market participants and others over the past four years of implementation.

3. Non-U.S. financial institutions may get a reprieve from the rule. Foreign funds organized outside the United States by foreign banks in foreign jurisdictions and offered solely to foreign investors may be subject to the Volcker Rule due to Bank Holding Company Act control principles. Last summer, the banking agencies, in consultation with the Securities and Exchange Commission and the Commodity Futures Trading Commission, issued guidance that effectively stayed enforcement of the Volcker Rule to these foreign funds in light of the technical and complex issues they raise. Expect that stay to remain in force while the regulators consider revisions.

4. The regulators also appear ready to re-examine the ease with which non-U.S. banks may qualify for an exemption that permits them to trade outside the U.S. without the Volcker Rule strictures. The revision could provide U.S. banks with the ability to qualify for the non-U.S. trading exemption, an exemption for which they are currently ineligible.

5. Most importantly, perhaps, is the prospect of revisions to the Volcker Rule compliance regime.

The speech by Vice Chairmen Quarles will be cheered by the industry. Amending regulations will take time, but the speech signals that the process will commence in the near term.

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