Volcker Rule

BACKGROUND

The Volcker Rule was enacted as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. It 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.

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission and the Commodity Futures Trading Commission jointly issued final regulations to implement the Volcker Rule in 2013.

TREASURY REPORT ON VOLCKER RULE

A June 2017 report by the U.S. Department of the Treasury found weaknesses in the Rule and its administration. Treasury concluded, for example, that the Volcker Rule "far overshot its mark" and that the Volcker Rule:

> *Spawned an extraordinarily complex and burdensome compliance regime due to a combination of factors: the scope of the firms subject to the rule's prohibitions, the number of regulators charged with enforcement, the ambiguous definitions of key activities under the rule, and the extensive compliance programs that the rule requires firms to adopt.*
>
> *Most important, the rule has hindered both market making functions necessary to ensure a healthy level of market liquidity and hedging necessary to mitigate risk*.

Treasury recommended significant changes to the statute, regulations and supervision, including the following:

- ***Narrowing the scope of banking entities subject to the Rule,***
- ***Simplifying the definition of proprietary trading*** (e.g., eliminating the rebuttable presumption under the "purpose test") and allowing banks to more easily hedge their risks and conduct market-making activities (e.g., provide more flexibility and discretion with respect to "reasonably expected near term demand" (RENTD)),
- ***Narrowing the definition of "covered funds,"***
- ***Reducing the compliance burden***,
- ***Better coordinating supervision across agencies***, and
- ***Providing an "off-ramp" for well-capitalized banks***.

OCC NOTICE ON POSSIBLE REVISIONS TO VOLCKER RULE

The OCC issued a Notice August 7, 2017 seeking input to help the OCC and the other relevant agencies revise the Volcker Rule, and how they apply and administer it, to better accomplish the Rule's public policy purposes. This included seeking input on the recommendations in the Treasury report.

MBA responded to the Notice in a September 21, 2017 letter. In that letter, MBA highlighted out concern about the adverse impacts the Volcker Rule may have on banks' market making activities, the corresponding impediment to CMBS liquidity and the resulting adverse impacts to commercial real estate financing – particularly arising from the Rule's treatment of market making. We recommended that the agencies shift the design of the Rule in the direction of a principles-based regulation, for example, by providing banks additional flexibility and discretion, and substituting supervisory oversight and iterative processes for prescriptive restrictions and negative presumptions. This would include providing more flexibility around the application of the RENTD standard and narrowing the scope of instruments falling under the definition of "covered funds." We also noted that, it may also be appropriate to retain some bright lines, for example, to delineate institutions or activities that clearly are exempt from the Rule's provisions, or to specify other easing of the restrictions of the Rule.

JOINT PROPOSAL TO MODIFY VOLCKER RULE

On July 17, 2018, all of the relevant agencies jointly issued a notice of proposed rulemaking to amend the Volcker Rule. MBA's comment on the proposal focused in particular on potential impacts on commercial mortgage-backed securities (CMBS). We noted that, as a general matter, we appreciate the intent of the current proposal and its movement in the direction of a supervisory rather than prescriptive approach. However, we expressed out concerned that several aspects of the proposal could have adverse impacts on the liquidity of CMBS, in particular: (1) the proposed accounting-based prong that would replace the short-term intent prong of the "trading account" definition, and (2) the prompt reporting requirements included in the proposed changes to the market making exemption.

We recommended that the agencies not adopt the proposed accounting-based prong. As for the market-making exemption, MBA noted that the proposed approach is generally consistent with MBA's prior suggestions to the OCC that the Agencies move in the direction of relying on supervisory processes rather than imposing prescriptive requirements. However, we recommended that, rather than establishing a new, additional and cumbersome prompt reporting process around Volcker Rule risk limits, a better approach would be for the agencies consider and review risk-limit events in the ordinary course of established supervisory processes. By harmonizing the oversight of Volcker Rule risk limits with supervisory approaches to overseeing risk limits generally, the Agencies would harmonize oversight with the supervisory approach underlying the presumption of compliance and could reduce operational burdens on both banking entities and the Agencies. In effect, this approach would provide additional clarity by leveraging existing processes rather than introducing uncertainty by creating new ones.

The agencies have not yet issued final rules addressing these proposed modifications to the Volcker Rule. News reports indicate the above agencies are exploring withdrawing the proposed rule and issuing a new proposed rulemaking.

S. 2155 AND THE VOLCKER RULE

The Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155), which became law May 24, 2018, effectively amended the Volcker Rule to (1) exclude from Volcker rule restrictions certain firms that have total consolidated assets equal to $10 billion or less and total trading assets and liabilities equal to five percent or less of total consolidated assets and (2) amend the restrictions applicable to the naming of a hedge fund or private equity fund to permit an investment adviser that is a banking entity to share a name with the fund under certain circumstances." The agencies issued a joint notice of proposed rulemaking February 8, 2019 to implement the changes to the Volcker Rule mandated by S. 2155.

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