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Regulators Propose Revisions to the Volcker Rule

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On May 30, 2018, the Federal Reserve Board approved a notice of proposed rulemaking aimed at simplifying regulations implementing section 13 of the Bank Holding Company Act (12 U.S.C. 1851), also known as the "Volcker Rule" (or the "Rule"). Enacted as part of the Dodd-Frank Act following the financial crisis of 2008, the Volcker Rule was implemented through final regulations in 2013 and generally prohibits insured depository institutions, foreign banking organizations, and their affiliates from engaging in proprietary trading or investing in or maintaining certain relationships with "covered funds" – specifically, hedge or private equity funds.

The proposed changes to the Volcker Rule were developed jointly by the five federal financial agencies with rule-writing authority over the Rule – the Federal Reserve, the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC"), and the Commodity Futures Trading Commission ("CFTC," and collectively, the "Agencies") – with an eye toward ensuring the continued stability of financial institutions, clarifying compliance requirements, and simplifying certain aspects of the Rule to reduce compliance costs.

The Agencies' proposal would make a number of changes to the Rule, including:

- Tailoring the Rule's requirements based on the amount of a banking entity'

trading assets and liabilities;
- Modifying the Rule's definition of "trading account" by replacing the definition's prong addressing the "purpose" of a trade with a new prong that is based on the accounting treatment of a position;
- Creating a presumption of compliance with the underwriting and market making exemptions for certain trading desks that keep their underwriting or market making activities within certain internal risk limits;
- Changing requirements related to market making, underwriting, and hedging interests in covered funds;
- Removing certain conditions from the exemption for a foreign banking entity's proprietary trading activities conducted solely outside the United States;
- Adapting compliance requirements based on a banking entity's level of trading activity by, among other things, creating a rebuttable presumption of compliance with the Rule for banking entities with gross trading assets and liabilities of less than $1 billion, and revising the scope of application of the existing chief executive officer ("CEO") attestation requirement; and
- Streamlining the trading activity information that certain banking entities are required to report to the Agencies.

The proposal also seeks comment on an unusually large number of questions (342 in total), some of which indicate that the Agencies are considering more extensive changes to the Rule. For instance, the Agencies have sought comment on whether and how to revise the definition of "covered fund"; whether to implement exemptions to so-called "Super 23A" restrictions on relationships between a banking entity and a covered fund; and the how to address so-called "foreign excluded funds" that are not "covered funds" and therefore may fall within the definition of "banking entity" if controlled by another banking entity. The proposal's actual proposed changes to the covered fund provisions of the Rule, however, are quite limited.

The proposal follows last week's passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act, which exempts from the Volcker Rule banking entities with (1) total assets valued at less than $10 billion, and (2) trading assets and liabilities comprising not more than 5 percent of total assets. The Federal Reserve has indicated that it expects the Agencies to implement this new statutory exemption through a separate rulemaking process.