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Volcker Rule Tops List of Banking Regs To Watch This Fall

By Evan Weinberger

Law360, New York (August 30, 2013, 3:42 PM ET) -- Regulators are facing mounting pressure to complete their Dodd-Frank Act rulemaking as the fifth anniversary of Lehman Brothers Holdings Inc.'s collapse looms — and several key regulations, including the long-awaited Volcker Rule, could emerge this fall.

Dodd-Frank, the 2010 law that constituted the U.S. government's regulatory response to the 2007-2009 financial crisis, called for regulators to write more than 400 new rules, and slightly less than 40 percent of those have been completed as of mid-July, according to a study by the law firm Davis Polk & Wardwell LLP.

Both President Barack Obama and Treasury Secretary Jack Lew have cajoled the regulatory agencies to speed up the rulewriting process, with Lew going so far as to say all of the key rules would be completed by the end of the year.

That goal seems unlikely.

“With all due respect to the Treasury secretary, I just don't see that happening,” said Paul Hastings LLP partner Kevin Petrasic.

However, there are several key rules that could be either wrapped up or introduced between September and the end of the year, attorneys say.

The Volcker Rule

The most eagerly anticipated rule that remains unfinished is the Volcker Rule, Dodd-Frank's ban on proprietary trading for financial institutions, including sponsorships of hedge funds and private equity vehicles.

The controversial rule actually took effect in July 2012, but when the regulators charged with writing it failed to agree on a final version they gave banks and other affected firms two years to come into conformance with its general principles.

That conformance period ends in July 2014, and the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corp., the U.S. Securities and Exchange Commission and the U.S. Commodity Futures Trading Commission are running out of time to get the rule done, said Shearman & Sterling LLP partner Donald Lamson.

“It's incumbent on the regulators to try to get this out as soon as they can just so the industry has more time to react,” said Lamson, who helped craft the Obama administration's version of the Volcker rule while detailed to the Treasury Department in 2009 and 2010.

However, the issues that have bogged down regulators responsible for writing the Volcker Rule, named after former Fed Chairman Paul Volcker, have not gone away.

If anything, the toughest sledding still remains.

“When you really get down toward the end in an interagency rulemaking process, there are a few issues remaining. And those are often the most difficult and the ones people are most passionate about,” Petrasic said.

Which is why there is doubt that the rule will be ready in time, despite general consensus that it needs to come out by the end of 2013 — and several promises of progress from regulators.

“I'm already hearing that this could bleed into 2014,” Lamson said. “I hope that's wrong.”

The Fed's Foreign Bank Rules

The Fed in December unveiled a rule outlining how it would apply U.S. capital, liquidity and other prudential standards to units of foreign banks operating inside the U.S.

The rule, which more or less establishes a ring-fence around the U.S. operations of all foreign banks with $50 billion in assets and $10 billion in U.S. operations and stricter provisions applying to those banks with $50 billion or more in U.S. operations, provoked threats of retaliation from foreign regulators and warnings that some global banks might exit the U.S. market altogether.

“The Fed's been pulled in a couple of different directions. The industry's made it clear, at least from the foreign bank side, that they view the rule as quite difficult to comply with,” Lamson said. “And there are a number of structural impediments that the Fed has to take into account."

But the Fed has shown little inclination to significantly change its proposal when it releases a final version, which some have speculated will come this fall.

Even if the Fed decides to move forward with only a few tweaks to its initial proposal, that does not mean a rule will be quick to write.

“The issues are complicated, and they've taken such political heat internationally for the proposal that even if they don't make significant accommodations, they will probably feel like they've got to explain themselves and do their best to make sure that their counterparts understand where they're coming from and what they're doing,” said Scott Anenberg, a partner with Mayer Brown LLP.

However, the Fed still has to get through a similar proposal for domestic banks first.

“One would think that they might act first on the domestic proposal, which has been pending for a year longer and arguably raises fewer broad policy concerns, and the foreign proposal would follow,” Anenberg said.

Additions to Existing Capital Rules

The Fed, the FDIC and the OCC in July finalized their rules for implementing the Basel III international banking accords, which require banks to maintain 4.5 percent in Tier 1 capital — the type most able to absorb losses — against their risk-weighted assets. The rule also requires banks to hold back an additional 2.5 percent of risk-weighted assets as a so-called capital conservation buffer, bringing the total required Tier 1 capital level to 7 percent.

Soon after, they proposed a maximum leverage ratio of 6 percent on the largest federally insured depository institutions and a 5 percent leverage ratio on their bank holding companies, effectively capping how much a bank can borrow to fund its operations.

The rule would only apply to banks with $700 billion in combined total assets or $10 trillion assets under custody, meaning that only eight companies would be subject to it as of now.

But the banking industry's prudential regulators are unlikely to stop there, and could bring in a host of new rules this fall, Petrasic said.

In particular, he said to look out for a mandatory liquidity ratio that would require banks to have a minimum level of easily accessible equity or debt securities that they can draw on during a crisis.

“The stars are somewhat aligned,” Petrasic said.

Other capital rules that could be on the way include a capital buffer for the largest banks as well as capital surcharges.

New Rules for Consumer Financial Companies

One agency that has met its Dodd-Frank-mandated deadlines is the Consumer Financial Protection Bureau, despite questions over whether its director was properly appointed hanging over the fledgling agency until earlier this summer.

The CFPB in January introduced a host of rules governing the mortgage market that are set to take effect early next year. But that does not mean they're done with their work, said Morrison & Foerster LLP partner Donald Lampe.

“The bureau is continuing its efforts in a very high-energy fashion,” he said.

And that means the industry could see new disclosure rules under the Home Mortgage Disclosure Act as well as new rules for debt collectors, Lampe said.

The CFPB is also charged with creating a unified disclosure form that would tackle the confusing areas where the Truth In Lending Act and the Real Estate Settlement Procedures Act overlap. While those are eagerly anticipated, Lampe said not to expect them until after lenders have a chance to adapt to the new mortgage rules.

“If you drop that on the mortgage industry, then you're talking about regulatory overkill,” he said.

--Editing by John Quinn and Melissa Tinklepaugh.