Volcker rule gives free pass for Wall Street speculation

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The so-called "Volcker rule," adopted Tuesday by the main US bank regulatory agencies, is being hailed by the Obama administration as a major reform that will rein in Wall Street speculation and hold bankers accountable. In fact, it is a toothless measure that will do nothing to stop the speculative and fraudulent activities that triggered the financial meltdown of 2008 and have continued unabated since then.

The rule, named after former Federal Reserve chairman and Obama economic adviser Paul Volcker, is among the most contested parts of the Dodd-Frank financial regulatory overhaul that was signed into law by President Obama in July of 2010. The rule ostensibly bars commercial banks, which benefit from federally guaranteed retail deposits and other government backstops, from speculating with bank funds, including customers' deposits, on their own account—a practice known as proprietary trading.

The 1933 Glass-Steagall Act, which established a legal wall between deposit-taking commercial banks and investment banks/brokerage houses, and led to the breakup of major Wall Street firms such as the House of Morgan, was finally repealed under the Clinton administration and then-Treasury Secretary Lawrence Summers (who later became Obama's top economic adviser). There is nothing in the Volcker rule or the Dodd-Frank law as a whole that comes close to establishing similar restraints on the banks.

Unlike the aftermath of the 1929 Wall Street crash, the collapse of 2008 has led to no serious reform of the banking system. On the contrary, the regime of taxpayer bailouts and other government subsidies has been used to make the biggest banks even bigger and to strengthen their grip on the economy.

Wall Street has lobbied furiously to either block or eviscerate the new rule, which is the main reason it has taken nearly three-and-a-half years since the enactment of Dodd-Frank for it to be finalized and approved by federal bank regulators. Nearly two-thirds of some 400 rules mandated by Dodd-Frank have yet to be approved, rendering the already largely token provisions of the financial "reform" a dead letter. The delay in implementation is itself a measure of the domination of the banks over the political and regulatory system.

The document approved Tuesday by the Federal Reserve Board, the Securities and Exchange Commission (SEC), the Office of the Comptroller of the Currency (OCC), the Commodity Futures Trading Commission (CFTC) and the Federal Deposit Insurance Corporation (FDIC), spanning 953 pages, nominally restricts proprietary trading. But it incorporates loopholes and exemptions that will enable the banks to continue to make risky bets on stocks, bonds and other securities for their own profit.

The rule delays the date for compliance by the banks to July 2015, three years after the date laid down in the Dodd-Frank law. This is designed to give the banks and their lawyers ample time to devise ways to evade the rule's provisions and, if they so decide, mount lawsuits to block all or part of the measure.

The government capitulated to the central demand of bankers such as JPMorgan Chase CEO James Dimon, who insisted that the language on proprietary trading permit banks not only to make bets in order to "hedge" their other investments, but to carry out so-called "portfolio hedging." The latter term refers to the practice of speculating under the cover of reducing risk exposure on broad portfolios of holdings, not just a single asset.

On this basis, banks can justify almost any bet on risky assets such as derivatives as a legitimate exercise

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in financial prudence. This is precisely how Dimon and JPMorgan defended the bank's massive bet on derivatives last year that led to a $6.2 billion loss in the so-called "London whale" scandal.

While the rule includes language requiring banks to show that such hedging is tied to specific holdings and is not intended to generate profits, it will not be difficult for banks to get around such caveats.

Moreover, the rule gives banks virtually unrestricted leeway to use "market-making" as a cover for proprietary trading. Banks "make markets" for their brokerage clients by buying and selling stocks, bonds and other securities. In practice, they often acquire large holdings in certain assets even when there is no immediate demand for them from a client.

The new rule allows this practice to continue, as well as activities related to underwriting new stock and bond offerings, by employing deliberately loose language that is more banker-friendly than previous drafts. It states that banks can build up positions to meet "the *reasonably expected* near-term demands of clients, customers, or counterparties." [Emphasis added]

Such "market-making" activities generate $40 billion a year in profit for the major US banks. The rule also exempts from limits on proprietary trading government securities, including Treasury bills, state and local government bonds, securities issued by the government-backed mortgage finance companies Fannie Mae and Freddie Mac, and some foreign government bonds. It exempts as well loan securitizations, such as the mortgage-backed securities and collateralized debt obligations that played the central role in the housing market collapse and 2008 Wall Street meltdown.

Gambling on physical commodities such as oil and gold and speculating on spot foreign exchange contracts is specifically allowed under the new rule.

The rule also imposes certain limits on commercial bank investments in hedge funds and private equity firms, although it does not ban such investments.

The measure requires bank CEOs to affirm annually that they have established programs to ensure that their firms are complying with the rule's provisions. However, in another concession to Wall Street, it does not require that the executives attest that their companies are *actually in compliance* with the rule.

That the banks consider the new rule relatively harmless was shown by the response of key bank stocks on Tuesday. On a day when the Dow Jones Industrial Average declined by 48 points, Goldman Sachs shares rose 1.2 percent and Morgan Stanley ended the day up 1.3 percent. *Bloomberg Businessweek* wrote: "Initial analyses of the hedging and market-making restrictions conclude that Wall Street can live with the rule."

Bloomberg News quoted Richard Kovacevich, the former chairman and chief executive officer of Wells Fargo, as saying, "It appears to be reasonable and one that the industry can live with."

The *Wall Street Journal* in an editorial Wednesday was more blunt. The newspaper wrote: "Rest assured banks will find loopholes. And rest assured some of the Volcker rule-writers will find private job opportunities to help with that loophole search once they decide to lay down the burdens of government service."

In cynically alluding to the incestuous relationship between the banks and the regulatory agencies, and the revolving door between the two, the *Journal* knows whereof it speaks.

Obliquely referencing the porous language of the Volcker Rule, Janet Yellen, Fed vice chairman and nominee to be the next chairman, said, "Given the absence of a lot of bright-line distinctions, I think supervisors are going to bear, going forward, a very important responsibility to make sure this rule really works as intended."

She, the Obama administration and the banks know very well that the regulators will do virtually nothing to enforce even the mild provisions of the new rule.

As the *Wall Street Journal* noted on Thursday, "Consultants wasted no time in starting to work with their banking clients on how to put in place the new rules… Law firm Shearman & Sterling LLP last year hired Donald Lamson, who had been a banking regulator at the OCC [Office of the Comptroller of the Currency] to help focus on Volcker-rule matters… 'We're already getting inquiries from our clients,' said Robert Cook, a partner at Cleary Gottlieb Steen & Hamilton LLP, who until earlier this year was helping write the new financial rules as a lawyer at the SEC."

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