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Statement on the Volcker Rule Proposal
by Governor Lael Brainard

The core regulatory framework put in place since the crisis is vital for safeguarding the resilience of the U.S. financial system through the cycle. Prudence would argue for waiting until we have tested how the new framework performs through a full cycle before we make judgments about its performance. At this point in the cycle, it is premature to revisit the calibration of core capital and liquidity requirements for the large banking institutions. Although I do not currently see a case for changes to the core capital and liquidity framework, I support efforts to implement the Volcker rule more effectively.

The premise of the Volcker rule is compelling: banks should not engage in speculative trading activity for which the federal safety net was never intended. Since the Volcker rule was enacted, banks have closed their stand-alone proprietary trading desks and substantially reduced the overall market and liquidity risk profile of their trading books. Moreover, in reviewing the research, it is hard to see compelling evidence that the Volcker rule has materially disrupted liquidity provision in key markets.

While the purpose of the Volcker rule is compelling, our experience with its implementation over the past few years suggests that the interagency rule has turned out to be needlessly cumbersome in practice. As Paul Volcker has said, “If they can do it in a more efficient way, God bless them.”¹ I support today’s proposal because it is crafted to implement

¹ See Yalman Onaran (2017), “Volcker Says Trump Changes to Volcker Rule Won’t Erode Principle,” Bloomberg, July 7, <https://www.bloomberg.com/news/articles/2017-07-07/volcker-says-trump-changes-to-volcker-rule-won-t-erode-principle>.

the core purpose of the Volcker rule in a more efficient way. There are two proposed changes that I would highlight in this regard.

First, the proposal would tailor the Volcker compliance regime to focus on the firms with trading operations of greater than \$1 billion in assets that account for an estimated 98 percent of total U.S. trading activity by banking entities. The application of the Volcker rule to firms with little trading activity results in compliance costs without a commensurate benefit to financial stability. For this reason, I support the proposed rebuttable presumption of compliance for firms with less than \$1 billion in consolidated gross trading assets and liabilities.

Second, the compliance mechanism developed by the agencies to distinguish between proprietary trading, on the one hand, and underwriting and market making, on the other hand, has been difficult to implement and supervise in practice. Rather than requiring banking institutions to undertake specific quantitative analyses prescribed by the regulators, the proposed revisions would require banking institutions to establish internal risk limits to achieve the principle of not exceeding the reasonably expected near-term demands of customers, subject to supervisory review. The requirement of CEO attestation is critical for this to work, in my view.

I appreciate the hard work that has gone into the proposed revisions, and I look forward to receiving feedback from stakeholders. That said, it is extremely important to finalize the rules of the post crisis regulatory framework that are still outstanding. For example, the comment period on proposals for the single counterparty credit limit (SCCL) and the net stable funding ratio closed in 2016, so I would hope to finalize those two rules soon, especially as they are well anticipated by those likely to be most affected. In particular, I am hopeful we will make progress on the SCCL in the next few weeks.