

2014

The Volcker Rule: A Regulatory Vice Under the Guise of Consumer Protection

Shay Raoofi

Follow this and additional works at: <http://lawcommons.luc.edu/lclr>

 Part of the [Consumer Protection Law Commons](#)

Recommended Citation

Shay Raoofi *The Volcker Rule: A Regulatory Vice Under the Guise of Consumer Protection*, 26 Loy. Consumer L. Rev. 301 (2014).
Available at: <http://lawcommons.luc.edu/lclr/vol26/iss2/5>

This Student Article is brought to you for free and open access by LAW eCommons. It has been accepted for inclusion in Loyola Consumer Law Review by an authorized administrator of LAW eCommons. For more information, please contact law-library@luc.edu.

THE VOLCKER RULE: A REGULATORY VICE UNDER THE GUISE OF CONSUMER PROTECTION

Shay Raoofi^{*}

I. INTRODUCTION

The Dodd-Frank Wall Street Reform and Consumer Protection Act¹ (“Dodd-Frank”)² is the most significant regulatory reform of the financial industry since 1933.³ In brief, Dodd-Frank places major regulations on the financial industry⁴ and affects almost every part of our nation’s financial sector. Dodd-Frank grew out of the Great Recession of 2008, intending to prevent another collapse of a large financial institution.⁵ The stated objective of the legislation is: “to promote the financial stability of the

^{*} J.D. Candidate, May 2015, Loyola University Chicago School of Law.

¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o [hereinafter “Dodd-Frank”]).

² *The Dodd-Frank Act: A Cheat Sheet*, MORRISON & FOERSTER 1, 2 (2010), available at <http://www.mofo.com/files/uploads/images/summarydoddfrankact.pdf>.

³ Kimberly Amadeo, *Dodd-Frank Wall Street Reform Act*, ABOUT.COM (Apr. 3, 2013), available at <http://useconomy.about.com/od/criticalissues/p/Dodd-Frank-Wall-Street-Reform-Act.htm>. The New Deal-era Banking Act of 1933, better known as Glass-Steagall, created deposit insurance and to prevent those newly insured funds from being put at risk on Wall Street, barred banks from owning stock brokerages. However, that ban was dropped in 1999 after an intense campaign by bank lobbyists, led by Sanford I. Weill, who was in the process of building Citigroup into one of the world’s largest financial institutions. *What Others Say: Dodd-Frank Regulations May Not Be Enough to Reign-In Mammoth Banks*, DESERET NEWS (Jul. 31, 2012, 12:00 a.m.), available at <http://www.deseretnews.com/article/765593469/Dodd-Frank-regulations-may-not-be-enough-to-reign-in-mammoth-banks.html>.

⁴ Mark Koba, *Dodd-Frank Act: CNBC Explains*, CNBC (May 11, 2012), available at <http://www.cnb.com/id/47075854>.

⁵ *Id.*

United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”⁶

One main purpose of Dodd-Frank is to protect consumers by preventing banks from engaging in abusive lending and mortgage practices.⁷ Yet many on Wall Street view Dodd-Frank as an overreaction to the recession of 2008, one that will push investors to the sidelines, burden financial institutions with cumbersome rules, and restrict overall economic growth.⁸ On the other hand, some on Wall Street view Dodd-Frank as a way to safeguard investors, reduce unnecessary risks, and protect consumers.⁹ Such proponents believe that the recession could have been avoided had the Dodd-Frank provisions been in place sooner.¹⁰ Conversely, many critics contend there would not have been a financial collapse had the markets, Congress, and regulators followed the rules that already existed at the time.¹¹ Still others believe the Dodd-Frank regulations do not go far enough to reign in an out-of-control Wall Street bent on risk-taking and subsequently using public tax dollars to bail them out.¹² At present, Dodd-Frank is an impassioned and contentious debate: too much regulation for some while not enough for others.¹³

⁶ Dodd-Frank, *supra* note 1.

⁷ Koba, *supra* note 4.

⁸ *Id.*; See also Ted Kaufman, *Set Up To Fail: Dodd-Frank Leaves Bank Regulators Overwhelmed, Underfunded*, FORBES (Jul. 19, 2013), <http://www.forbes.com/sites/tedkaufman/2013/07/19/set-up-to-fail-dodd-frank-leaves-bank-regulators-overwhelmed-underfunded/> (stating “I believe failure was baked into Dodd-Frank from the beginning, when the President and Congress decided against writing a law with specific provisions that would solve the problem. Instead, Dodd-Frank provided vague guidelines to the federal financial regulators. It was up to them to produce the actual rules. And, as always, the devil is in the details.”).

⁹ Koba, *supra* note 4.

¹⁰ *Id.*

¹¹ *Id.*; See generally Jeff Merkley, *The Wild, Off the Mark Arguments Against the Volcker Rule*, HUFFINGTON POST (Apr. 3, 2012, 2:07 p.m.), http://www.huffingtonpost.com/jeff-merkley/banks-volcker-rule_b_1400403.html (presenting and disproving the big banks’ host of arguments in opposition of the Volcker Rule).

¹² Koba, *supra* note 4.

¹³ *Id.*; Compare George Pieler & Jens Laurson, *Dodd-Frank Is Much More Than Regulatory Overreach*, FORBES (Jul. 23, 2013, 8:00 a.m.), <http://www.forbes.com/sites/laursonpieler/2013/07/23/dodd-frank-is-much-more-than-regulatory-overreach/> (stating “a grossly ill-defined law, assigning massive authority over the entire financial sector (banking firms with assets

The Volcker Rule,¹⁴ which is named for former Federal Reserve Chairman Paul Volcker, is premised on the belief that speculative trading activities partially contributed to the financial crisis.¹⁵ The Obama Administration endorsed the Volcker Rule in January 2010.¹⁶ The current version of the Volcker Rule is much more expansive than original House Bill, which merely limited questionable activities, such as proprietary trading that poses systemic risk.¹⁷ The Senate Bill entirely prohibited U.S. banks from engaging in most proprietary trading and restricted covered institutions from owning, sponsoring, or investing in hedge funds or private equity funds.¹⁸ Since the House and Senate Bills were vastly different, debates between legislators over the Volcker Rule were among the most heated.¹⁹

In particular, the Volcker Rule prohibits an insured depository institution and its affiliates from: (1) engaging in proprietary trading; (2) acquiring or retaining any equity, partnership, or other ownership interest in a hedge fund or private equity fund; and (3) sponsoring a hedge fund or a private equity fund.²⁰ In layman's terms the Volcker Rule, a centerpiece of Dodd-Frank, is an attempt to protect the financial system and consumers from

\$50 billion or more, plus nonbank financial firms as subjectively determined by the Fed, FDIC, et al.), is much more than a problem of regulatory overreach. It is a direct assault on the notion that government must have defined limits. What is more, the 'systemically important' strictures of Dodd-Frank put the Federal Reserve—probably the institution of the federal government least accountable to the public—in the driver's seat." *with Mike Konczal, Dodd-Frank Is Finally Being Implemented. Will That Be Enough?*, WASH. POST (May 6, 2013, 11:08 a.m.), <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/05/06/dodd-frank-is-finally-being-implemented-will-that-be-enough/> (emphasizing "[m]ore and more people are arguing that leverage ratios, which many had hoped would be a more important part of the regulatory rules, won't meet the need for a properly capitalized banking system. The question is now how Congress should react.").

¹⁴ Title VII of Dodd-Frank implements the Volcker Rule. Securities and Exchange Commission, 77 Fed. Reg. 8, 332 (proposed February 14, 2012) (to be codified as 17 C.F.R. Part 75).

¹⁵ *The Dodd-Frank Act: A Cheat Sheet*, *supra* note 2, at 18.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ William J. Sweet & Brian D. Christiansen, et al., *Financial Institutions: The Volcker Rule*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, 1, 1 http://www.skadden.com/newsletters/FSR_The_Volcker_Rule.pdf.

risk.²¹ The notion is simple: banks are barred from making risky investments.²²

Further, the Volcker Rule seeks to curb the audacity of institutions that rely on federal guarantees (e.g., deposit insurance), by disallowing them from investing the firm's money for profit, a practice known as proprietary trading.²³ The writers of the regulation had the challenge of distinguishing between proprietary trading and other types of trading,²⁴ such as hedging, the act of taking a position to protect against losses.²⁵ While banks worry that overly restrictive rules may ultimately hinder their ability to serve clients,²⁶ proponents of the Volcker Rule are concerned banks could circumvent regulations that are loosely scripted.²⁷

Despite the conflicting perspectives, five U.S. financial regulators adopted a final rule, effectively implementing the Volcker Rule on December 10, 2013.²⁸ While the Volcker Rule is intended to protect consumers, many believe it will have a negative effect on consumers. To reduce the financial risks to customers, the Volcker Rule aims to have banks compete on the core services of banking, checking, and lending services, rather than on the revenue they are able to generate from proprietary trading.²⁹ Critics of the Volcker Rule's ban on proprietary trading and

²¹ Scott Patterson and Deborah Solomon, *Volcker Rule to Curb Bank Trading Proves Hard to Write*, WALL ST. J. (Sep. 10, 2013, 7:55 P.M.).

²² *Id.*

²³ *Id.*; See Neil Irwin, *Everything You need to Know About the Volcker Rule*, WASH. POST (Dec. 10, 2013, 10:34 a.m.) available at <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/12/10/everything-you-need-to-know-about-the-volcker-rule/> (explaining that the Volcker Rule is premised on the belief that while it is the banks' role to support the economy by lending to consumers and businesses, when they get into the realm of making bets in exotic financial markets (known as proprietary trading), they are not doing anything to support the economy).

²⁴ See generally *Finally, The Volcker Rule*, N.Y. TIMES (Dec. 12, 2013), http://www.nytimes.com/2013/12/13/opinion/finally-the-volcker-rule.html?_r=0 (explaining the requirements for banks under the Volcker Rule and the ambiguity in the rule language that creates loopholes).

²⁵ Patterson, *supra* note 21.

²⁶ *Id.* ("We are concerned that the Byzantine regulatory regime envisioned by the proposed Volcker [R]ule may force financial institutions to curtail their participation in markets in order to avoid accidentally violating the rule, a group of financial organizations wrote to regulators last year").

²⁷ *Id.*

²⁸ Kobi Kastiel, *The Volcker Rule: A First Look at Key Changes*, HARV. L. SCH. (Dec. 18, 2013, 9:02 a.m.), available at <http://blogs.law.harvard.edu/corpgov/tag/volcker-rule/>.

²⁹ Katherine Reynolds Lewis, *Volcker Rule: Why It Matters to Consumers*,

sponsoring or investing in hedge funds and private equity funds, suggest possible unintended consequences, yet unknown, that will prevent banks from effectively serving their customers.³⁰

This Note discusses the purpose of the Volcker Rule and its ultimate impact on consumers. To begin, this Note provides an overview of the Volcker Rule and an introduction to the financial crisis. Additionally, this Note will discuss the role of banks in the financial system, including the use of high-risk speculation and derivatives and the suggestion that these activities partly contributed to the recent financial crisis. In addition, this Note explains the limitations outlined in the Volcker Rule and legislative efforts to promote bank stability.

Part II discusses the federal government's position that the Volcker Rule will positively impact consumers, specifically by making banks focus on their core services, rather than generating profits from exotic trading strategies and complex derivatives. Part III will discuss the banks' position that the Volcker Rule will negatively impact consumers because an insufficient understanding of trading operations and a strict interpretation of the rule is going to make it difficult for banks to meet the needs of consumers. Part IV will weigh the purpose of the rule against the concerns from banking institutions, and determine that the Volcker Rule will have a negative impact on consumers.

II. POSITION OF THE FEDERAL GOVERNMENT

One of the underlying policies of the Volcker Rule is that a bank is distinct from other entities because it accept deposits.³¹ A bank's monetary function is one of the key reasons why institutions that accept deposits are subject to heavier regulation than institutions that do not accept deposits.³² This is premised on the idea that banking entities play a special role in the stability of the

BANKRATE (2013), *available at* <http://www.bankrate.com/finance/banking/volcker-rule-1.aspx>.

³⁰ Letter from Bank of America to Sec. Exch. Comm'n (Feb. 13, 2012) *available at* <http://www.sec.gov/comments/s7-41-11/s74111-297.pdf>.

³¹ Julie A.D. Manasfi, *Systemic Risk and Dodd-Frank's Volcker Rule*, 4 WM. & MARY BUS. L. REV. 181, 195 (2013).

³² *Id.*; See generally Bill Mitchell, *The Role of Bank Deposits in Modern Monetary Theory* (May 26, 2011), <http://bilbo.economicoutlook.net/blog/?p=14620> (explaining the role of deposits in Modern Monetary Theory and specifically, clarifying that banks do not function in such a way that their ability to lend is constrained by the reserves they hold).

U.S. financial system.³³ Hence, proponents of the Volcker Rule argue that banks should be prohibited from engaging in risky activities.³⁴

The contention behind these restrictions is that it is risky for a bank to engage in proprietary trading because it could cause the bank to fail or reduce its liquidity, effectively disrupting credit channels.³⁵ A similar outcome may result if a bank invests in a hedge fund or private equity funds and these funds fail.³⁶ In addition, the limitations on hedge funds and private equity funds ensure that banking entities cannot circumvent the ban on proprietary trading and eliminate incentives for banks to bail out funds they sponsor or in which they are significantly invested.³⁷

Although high finance and hedge fund investment are seemingly far removed from the average consumer's daily life, analysts argue the stakes are high for the new law.³⁸ Specifically, the Volcker Rule's aim is to promote stability in the banking system by preemptively lowering the risk of bank failure to benefit consumers.³⁹ By prohibiting banks from trading for their own ac-

³³ Manasfi, *supra* note 31, at 195; *See generally* Erlend Walter Nier, *Financial Stability Frameworks and the Role of Central Banks: Lessons from the Crisis* (Int'l Monetary Fund, Working Paper Apr. 4, 2009) (seeking to clarify the proper role of the central bank in the overall framework in the context of effective systemic risk mitigation in pursuit of financial stability).

³⁴ *Id.*; *See also* Senator Jeff Merkley & Senator Carl Levin, Policy Essay, *The Dodd-Frank Act Restrictions on Proprietary Trading and Conflicts of Interest: New Tools to Address Evolving Threats*, 48 HARV. J. ON LEGIS. 515, 533 (2011) and Fin. Stability Oversight Council, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with hedge Funds & Private Equity Funds (2011), <http://www.treasury.gov/initiatives/documents/volcker%20sec%20%20619%20study%20final%201%2018%2011%20rg.pdf>.

³⁵ Manasfi, *supra* note 31.

³⁶ *Id.*

³⁷ *Id.*; *See also* Fin. Stability Oversight Council, *supra* note 34, at 66.

³⁸ Lewis, *supra* note 29; *See generally* John W. Kauffman & Michael W. Wong, *U.S. Financial Reform: The Volcker Rule and Improvements in the Regulation of Banking Entities and Nonbank Financial Companies Supervised by the Board of Governors of the Federal Reserve System*, DUANE MORRIS (Aug. 24, 2010) (explaining the intended purposes of the Volcker Rule and the respective exceptions), *available at* http://www.duanemorris.com/alerts/financial_reform_volcker_rule_bank_regulation_3750.html; *See also* Sally Greenberg, *In a Win for Consumers, Volcker Rules Take Effect*, NCL'S SAVVY CONSUMER BLOG (Dec. 13, 2013), <http://savvyconsumer.wordpress.com/2013/12/13/in-a-win-for-consumers-volcker-rules-take-effect/>.

³⁹ Lewis, *supra* note 29.

counts, the Volcker Rule will limit the amount of risk that large institutions can take on and effectively will make another financial scandal less likely.⁴⁰

The Volcker Rule attempts to direct banks to focus on their core products and services rather than on creating excessive profits from exotic trading strategies and complex financial products.⁴¹ Consumers will benefit if banks compete on the services of banking, checking, and lending services, as opposed to the revenue they can generate from proprietary trading.⁴² If the Volcker Rule proves to be successful, that effort could improve services for consumers and lessen the risk of lost deposits due to the volatility of high finance practices.⁴³ Consumer advocates believe that before the 2008 banking crisis, traders and investment bankers were too focused on boosting profits and reaping fat annual bonuses, rather than concentrating on core banking functions.⁴⁴

Another key goal of the Volcker Rule is to eliminate conflicts of interest at financial institutions by separating proprietary trading from customer trading and by making top executives responsible for ensuring that the bank follows the regulation.⁴⁵ For example, during the housing boom, certain investment banks selected loans to package into securities, sold the securities to customers as low-risk investments, and subsequently bet against customers by making trades that would pay off if the value of those securities decreased.⁴⁶ The Volcker Rule seeks to hold high-ranking executives accountable for similar episodes in the future

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.* (David Min, Associate Director for Financial Markets Policy at The Center for American Progress has argued that “this speculative activity drives a bit of a ‘heads I will, tails you lose’ approach”).

⁴³ *Id.*

⁴⁴ *Id.* (Lisa Donner, Executive Director of Americans for Financial Reform explained it as this: “What is the financial system’s job? Is it to provide capital for business, homeownership and economic growth, or is it to generate extremely high bonuses for its senior employees? [...] We had moved to a world where the latter was much too much the case.”).

⁴⁵ *Id.* However, there was concern over whether the exemptions permitted by Dodd-Frank would turn out to be so broad that they would lessen the impact of the rule. For instance, the proposed Volcker Rule would allow banks to trade, provided they meet the short-term needs of clients, subject to monitoring programs aimed at spotting banned proprietary trading. Additionally, there are exemptions for commodities and certain fixed-income products with an objective to maintain the vital liquidity of U.S. Treasuries and debt issue by Fannie Mae and Freddie Mac.

⁴⁶ *Id.*

and in effect, protect consumers from related attacks from banks.

In addition, the Volcker Rule encourages Boards of Directors to actively participate in the oversight of banking entities, requiring public disclosure of information related to the bank's investments and risk exposure.⁴⁷ This requirement includes the type and amount of investments, returns, and leverage.⁴⁸ As a result, directors theoretically can no longer claim ignorance towards a bank's expansive investments.⁴⁹ Moreover, the disclosure requirement will allow regulatory agencies to better recognize the interconnectedness and weaknesses within the system, thereby making it better equipped to intervene and prevent a domino effect.⁵⁰

From the federal government's perspective, the Volcker Rule will benefit consumers by preventing bank failures and subsequent economic turmoil, refocusing attention on consumer banking, reducing conflicts of interest, and increasing transparency.

III. POSITION OF THE BANKS

In contrast, banks believe the Volcker Rule will not benefit consumers.⁵¹ The American Bankers Association⁵² contends that its members fear the Rule is overly broad and its complexity will not only make it impossible for banks to comply, but will also

⁴⁷ Alison K. Cary, Comment, *Creating a Future Economic Crisis: Political Failure and the Loopholes of the Volcker Rule*, 90 OR. L. REV. 1339, 1385 (2012).

⁴⁸ *Id.*

⁴⁹ *Id.*; See generally Laurence J. Kotlikoff, Jimmy Stewart Is Dead xvii (2010).

⁵⁰ Cary, *supra* note 47, at 1385.

⁵¹ Halah Touryalai, *Volcker Rule is Out, How Much Will It Hurt?*, FORBES (Oct. 12, 2011, 5:25 p.m.), available at <http://www.forbes.com/sites/halahtouryalai/2011/10/12/volcker-rule-is-out-how-much-will-it-hurt/>; "The comments from financial institutions almost uniformly predicts dire consequences if the Volcker Rule is broadly implemented – higher borrowing costs for business, less investment, lower job creation, the loss of banking business to overseas competitors. They tend to hew closely to remarks made by Jamie Dimon, chairman of JPMorgan Chase, in an earnings conference call in October." Michael Hiltzik, *Bankers' Opposition to Volcker Rule is No Surprise*, THE LOS ANGELES TIMES (Jan. 10, 2012), available at <http://articles.latimes.com/2012/jan/10/business/la-fi-hiltzik-20120110>.

⁵² See generally AM. BANKERS ASS'N, <http://www.aba.com/Pages/default.aspx> (last visited Dec. 29, 2013).

affect the ability of banks to compete globally.⁵³ Ultimately, banks interpret the Volcker Rule as a regulatory siege that will cost banks nearly two billion dollars and the economy tens of billions more in lost output.⁵⁴

While the banks concede the principles behind the Volcker Rule are complicated, the length of the rule seems to expand exponentially as the rule passes through each level of government.⁵⁵ Chairman Volcker outlined his proposal to the President in three pages; section 619 of the Act, which codifies the Volcker Rule, is ten pages; the proposed regulations consume 298 pages;⁵⁶ and the explanation is an incredible 892 pages.⁵⁷ Due to the staggering density of the rule, the law firm of Davis Polk created a “rule map” in order to help clients understand the Volcker Rule, in 355 distinct steps.⁵⁸

According to the American Bankers Association, regulators estimate that banks will have to spend nearly 6.6 million hours to implement the Volcker Rule, of which more than 1.8 million hours will be required every year in perpetuity.⁵⁹ This translates into 3,292 years, or more than 3,000 bank employees whose sole job will be to comply with this rule.⁶⁰ Moreover, the banks argue that bank employees will be transferred to a role that does not provide any form of customer service, generates zero revenue,⁶¹ does nothing for the economy,⁶² and ultimately harms con-

⁵³ Touryalai, *supra* note 51. (ABA president Frank Keating’s thoughts: “Only in today’s regulatory climate could such a simple idea become so complex, generating a rule whose preamble alone is 215 pages, with 381 footnotes to boot. How can banks comply with a rule that complicate, and how can regulators effectively administer it in a way that doesn’t make it harder for banks to serve their customers and further weaken the broader economy?”).

⁵⁴ *Id.*; See generally Aaron Elstein, *A Wall Street Veteran Speaks Out Against the Volcker Rule*, CRAIN’S (Feb. 11, 2013, 6:52 p.m.) (summarizing the rebuttal entitled “Setting the Record Straight” from Dick Bove, a banking analyst at Rochdale Securities), available at <http://www.crainsnewyork.com/article/20120612/BLOGS02/306129997>.

⁵⁵ Cary, *supra* note 47, at 1375.

⁵⁶ *Id.* at 1375-76.

⁵⁷ Allan Sloan, *The Volcker Rule: Complexity Trumps Common Sense*, CNN MONEY (Dec. 18, 2013, 5:00 a.m.), available at <http://finance.fortune.cnn.com/2013/12/18/volcker-rule-2/>.

⁵⁸ Cary, *supra* note 49, at 1376.

⁵⁹ Touryalai, *supra* note 51.

⁶⁰ *Id.*

⁶¹ See generally Silla Brush, *Volcker Rule Costs Banks \$1 Billion, U.S. Government Says*, BLOOMBERG NEWS (Oct. 28, 2011) (explaining the various costs associated with the implementation and compliance of the Volcker Rule), available at <http://www.businessweek.com/news/2011-10-28/volcker-rule->

sumers. Such a large regulatory burden actually diverts resources away from consumers. Banks have the ability to fund families and businesses, the economy, and the U.S. going forward.⁶³ Moreover, not all customers look to banks for only a loan.⁶⁴ For instance, entrepreneurs want to protect against their losses and they need a bank to help them do that in order to expand and grow.⁶⁵

In addition, the banks maintain that the ban on proprietary trading will actually impact less than a dozen banks: “only the biggest of the big.”⁶⁶ The banks further explain that the reckless trading and investment divisions that created big revenue and immense bonuses have nothing to do with providing loans, market making, and hedging for the business of the country and to grow the economy.⁶⁷ There is no way to reasonably separate reckless trading from legitimate trading, such as market making and business hedging. The difference between proprietary trading, as defined in terms of the bank taking risks on its own money, and providing services to its customers is a true mixture.⁶⁸

With the Volcker Rule, regulators attempt to distinguish between proprietary trading and customer services. Banks can clearly tell the difference between the two activities, but the issue in dispute is whether the regulators can.⁶⁹ It is erroneous for regulators to assert that banks cannot distinguish between risking their own capital or clients’ capital.⁷⁰ Furthermore, banks would be continually breaking laws if they could not tell the difference between the two activities.⁷¹

costs-banks-1-billion-u-s-government-says.html.

⁶² Touryalai, *supra* note 51.

⁶³ Interview by Jeffrey Brown with Wayne Abernathy, Am. Bankers Ass’n, and Dennis Kelleher, Better Markets (Dec. 10, 2013), *available at* http://www.pbs.org/newshour/bb/business/july-dec13/volcker_12-10.html [hereinafter “Interview”]; *see generally* Hester Pierce, *How to Really Rein in the Banks*, US NEWS (Dec. 9, 2013) (discussing the Volcker Rule’s “less direct and more destabilizing approach” of having the government micro-manage banks’ trading activities), *available at* <http://www.usnews.com/opinion/blogs/economic-intelligence/2013/12/09/the-volcker-rule-isnt-the-best-way-to-prevent-risky-bank-trading>.

⁶⁴ Interview, *supra* note 63.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ Interview, *supra* note 63.

⁷⁰ *Id.*

⁷¹ *Id.*

Ultimately, it will be up to a small number federal regulators to interpret and apply the Volcker Rule during the review and auditing process of banks. The banks are concerned that an insufficient understanding of trading operations and a strict interpretation of the rule is going to make it difficult for them to meet the needs of consumers.⁷² Therefore, according to the banks, the Volcker Rule will have a negative impact on consumers.

IV. ANALYSIS AND CONSUMER IMPACT

Understandably, banks should be in the business of serving customers by their primary banking functions, including taking deposits from and making loans to families and businesses.⁷³ Likewise, speculative investing should be left to hedge funds, private equity funds, and other private investors that, if they get in trouble, will not imperil the lending which is so critical to the economic growth of the U.S.⁷⁴ In fact, with the passage of Dodd-Frank, banks have already been unwinding their proprietary trading operations; yet the Volcker Rule creates a complicated and burdensome compliance system that calls into question all trading that a bank undertakes.⁷⁵ Effectively, the ambiguity and implementation issues surrounding the Volcker Rule are likely to have a chilling effect on many legitimate services that banks provide to their customers.⁷⁶ The vagueness of the definition of “proprietary trading” in addition to the lack of precise descriptions of

⁷² *Id.*; Also see Ted Knutson, *Private Bankers Fear Volcker Rule Impact On HNW Offerings*, FIN. ADVISORS MAGAZINE (Dec. 12, 2013), available at <http://www.fa-mag.com/news/private-bankers-fear-voicker-rule-iimpact-on-hnw-offerings-16304.html> (stating “Banking industry analyst Bert Ely said the restrictions will have some effect on high-net-worth customers, but the greater impact will be on how banks serve corporate customers and how they manage their own balance sheet. In addition to the banks, private funds could be impacted significantly by the Volcker Rule”).

⁷³ *Volcker Rule: Each Ending Is A New Beginning For Banksters And Their Lobbyists* (Dec. 12, 2013), <http://downwithtyranny.blogspot.com/2013/12/volcker-rule-each-ending-is-new.html>.

⁷⁴ *Id.*; See generally Phillip Swagel, *A Modest Volcker Rule*, THE NEW YORK TIMES (Dec. 13, 2013) (discussing the potential impacts of the Volcker Rule on financial markets), available at <http://economix.blogs.nytimes.com/2013/12/13/a-modest-volcker-rule/>.

⁷⁵ *The Volcker Rule*, CTR. FOR CAPITAL MARKETS 1, 1 (2012), available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2012/01/2.-The-Unintended-Consequences-of-the-Volcker-Rule.pdf>.

⁷⁶ *Id.*

what a bank is allowed and not allowed to do have produced an immense gray area polluted with loopholes, allegedly exploited by big banks and criticized by consumers.⁷⁷

As a simple explanation, Congress advised the drafters of the Volcker Rule to write a rule saying: (1) banks cannot engage in proprietary trading (trade securities for their own account); but (2) banks can make markets (trade securities for their own account, but for the purpose of providing liquidity); and (3) banks can hedge their risk (trade securities for their own account, but for the purpose of mitigating other risk).⁷⁸ Hence, banning proprietary trading may be an inane endeavor, but the regulators could impose a much harsher regulation upon banks.⁷⁹ Further, the difficult part is distinguishing “proprietary trading” from “market making” and “hedging” which, ironically, Congress did not attempt to do in the initial proposal of the Volcker Rule.⁸⁰ In its final form, the Volcker Rule provides that the market maker’s business is to provide market liquidity for customers, requiring that they simultaneously consider the book’s proprietary risk and customer service.⁸¹ In essence, the Volcker Rule requires good management: banks must make markets for customers in a rational and risk-managed way.⁸² With respect to hedging, banks would be required to figure out what they meant to hedge, and then check on them periodically and ask if they are working, in an effort to mitigate losses.⁸³ The Volcker Rule has become an over-engineered set of regulations when its initial purpose was simply to require banks to think about what they were doing⁸⁴ and ensure they were aligned with their intended purpose: customer service.

⁷⁷ See generally William Alden, *Enforcing the Volcker Rule*, NEW YORK TIMES (Dec. 11, 2013, 7:59 a.m.) (explaining the challenges behind the drafting, implementation, and enforcement of the Volcker Rule), available at <http://dealbook.nytimes.com/2013/12/11/morning-agenda-enforcing-the-volcker-rule/>.

⁷⁸ Matt Levine, *Now There Is A Volcker Rule*, BLOOMBERG (Dec. 10, 2013, 12:27 p.m.), available at <http://www.bloomberg.com/news/2013-12-10/now-there-is-a-volcker-rule.html#footnote-ref-5>.

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.*

⁸³ Levine, *supra* note 78.

⁸⁴ *Id.*; See also Sally Greenberg, *In a Win for Consumers, Volcker Rules Take Effect*, NCL’S SAVVY CONSUMER BLOG (Dec. 13, 2013), <http://savvyconsumer.wordpress.com/2013/12/13/in-a-win-for-consumers-volcker-rules-take-effect/>.

The question remains whether consumers are beneficiaries of the Volcker Rule. Critics of the rule contend that consumers will be harmed with the implementation and enforcement of the Volcker Rule.⁸⁵ Critics believe that even if a large number of consumers are not directly harmed, they will certainly realize additional costs because of the Volcker Rule.⁸⁶ For instance, the banks are required to hire approximately 3,000 employees, likely salaried, to monitor and ensure compliance with the provisions of the Volcker Rule.⁸⁷ As a result, consumers will likely be subject to higher banking fees in order for banks to generate more revenue to cover said salaries.⁸⁸ Moreover, some critics believe the cost of trading stocks could rise and trading volumes will decrease as a result of less institutional buying, which will in turn create less efficient markets.⁸⁹ With less income from trading activities, the lost revenue will have to be recouped somehow.⁹⁰ As customers previously experienced with the Credit Card Accountability Responsibility and Disclosure Act of 2009, when banks lose income, they often raise consumers' fees to recapture the loss.⁹¹

Therefore, while the Volcker Rule is the climax of Dodd-Frank (characterized by the intention to reform financial markets and protect consumers) in actuality, consumers have become victims of the unintended consequences of the Volcker Rule.⁹²

⁸⁵ See generally Tim Parker, *How The Volcker Rule Affects You*, INVESTOPEDIA (Feb. 17, 2012), available at <http://www.investopedia.com/financial-edge/0212/how-the-volcker-rule-affects-you.aspx>; and see Kasia Klimasinska & Ian Katz, *Volcker Rule Critic Raskin Seen as a Voice for Consumers*, BLOOMBERG (Dec. 5, 2013, 11:00 p.m.) (criticizing the Volcker Rule's efforts to protect consumers and arguing the rule is not strict enough), available at <http://www.bloomberg.com/news/2013-12-06/volcker-rule-critic-raskin-seen-as-a-voice-for-consumers.html>.

⁸⁶ *Id.*; See also Alida S. Skold, *Intended and Unintended Consequences of the Proposed Volcker Rule 3* (Munich Personal RePEc Archive, Working Paper No. 50103, 2011) (reiterating the 3,000 employees required for compliance with the Volcker Rule provisions), available at http://mpa.ub.uni-muenchen.de/50103/1/MPRA_paper_50103.pdf.

⁸⁷ Parker, *supra* note 85.

⁸⁸ *Id.*

⁸⁹ Parker, *supra* note 85.

⁹⁰ *Id.*

⁹¹ *Id.*; See generally Nancy Trejos, *Credit Card Issuers Raising Rates, Fees Ahead of New Laws*, THE WASH. POST (Jul. 2, 2009) (discussing different credit card companies raising interests rates and fees months before the Credit Card accountability Responsibility and Disclosure Act of 2009 goes into effect), available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/07/01/AR2009070103868.html>.

⁹² Mike Conover & Howard Margolin et al., *A Disputed Proposal: An*

Judged by the thousands of formal responses submitted to the Agencies by the financial services industry, it appears the primary focus of their opposition to the Volcker Rule is not on the proposed regulation's premise, but rather on its ability to actually achieve the intended objectives while simultaneously mitigating a host of potentially negative and unintended consequences.⁹³ Theoretically, since banks are prohibited from engaging in proprietary trading, they will restore their focus on customer service activities.⁹⁴ This perception, however, is skewed. The final version of the Rule provides exceptions (or as some critics see it, loopholes), whereby banks can still take part in market making and hedging.⁹⁵ Moreover, this results in a greater amount of regulation and supervision, which in turn requires more employees. This cost burden, in addition to the one billion dollar annual expense to banks,⁹⁶ will shift to consumers.

This necessitates a cost-benefit analysis: will the minimal and indirect benefit to consumers, through prohibiting banks from engaging in proprietary trading,⁹⁷ outweigh the costs of implementing, regulating, supervising, and enforcing the Volcker

Overview of the Financial Industry's Response to the Volcker Rule, KPMG 1, 11 (Apr. 2012), available at <http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/volcker-rule-overview.pdf>.

⁹³ *Id.*

⁹⁴ Melanie Waddell, *Regulators Approve Volcker Rule, The Core of Dodd-Frank*, THINKADVISOR (Dec. 10, 2013), available at http://www.thinkadvisor.com/2013/12/10/regulators-approve-volcker-rule-the-core-of-dodd-f?t=theory-strategy&page_all=1.

⁹⁵ See generally Silla Brush & Cheyenne Hopkins et al., *Volcker Rule Ushers in Era of Increased Oversight of Trades*, BLOOMBERG (Dec. 10, 2013, 2:17 p.m.) (discussing the Volcker Rule's prohibition of proprietary trading with exceptions for market - making and hedging), available at <http://www.bloomberg.com/news/2013-12-10/volcker-rule-eases-market-making-while-hedges-face-new-scrutiny.html>.

⁹⁶ Brush, *supra* note 64.

⁹⁷ Some may be skeptical as to whether this is really a concern. A patchwork of nearly 30 companies – from industries as disparate as retail, energy, and medical research – communicated their own anti-Volcker Rule sentiments. Specifically, the companies, organized by the United States Chamber of Commerce, sent a letter to regulators that outlined their objectives. At the root of their disdain is fear: Corporate America is worried the Volcker Rule will suck liquidity out of the financial system, which provides financing to companies big and small. See Ben Protess, *The Volcker Rule's Unusual Critics*, THE N.Y. TIMES (Feb. 15, 2012, 3:17 p.m.), available at <http://dealbook.nytimes.com/2012/02/15/the-volcker-rules-unusual-critics/>.

2014

The Volcker Rule

315

Rule?⁹⁸ The answer is simple and evident: no.

V. CONCLUSION

The Volcker Rule, a centerpiece of Dodd-Frank, designed with the intention to mitigate risk and protect consumers, has been the topic of many vehement discussions. On the one side, the federal government argues that banks have a principal purpose to serve customers, and involvement in dangerous and risky trades is not in pursuit of that purpose. In contrast, banks argue their trading activity is a legitimate service they provide to more effectively serve customers and thus, is consistent with their principal purpose. The debate is ongoing but one thing is for certain: despite the opposition and hostility, banks are required to be in compliance with the Volcker Rule by July 2015.

This financial reform, which was primarily intended to protect consumers, has a questionable impact. The Volcker Rule actually creates a larger burden on consumers in the form of higher fees and a less efficient market. This burden outweighs the potential benefit of trying to ban proprietary trading. In its current and final form, the Volcker Rule harms consumers. The drafters of the Volcker Rule sought to have banks pursue their principal purpose but have lost sight of the principal purpose of Dodd-Frank: to protect consumers, as the full title implies.

⁹⁸ See generally Michael Santoli, *Is the 900-Page Volcker Rule Too Much and Too Late?*, YAHOO FINANCE (Dec. 10, 2013, 11:41 a.m.) (taking the position that the Volcker Rule is designed to express a particular view on an underlying market for the benefit of one bank or one particular client, as the expense of other customers), *available at* <http://dealbook.nytimes.com/2012/02/15/the-volcker-rules-unusual-critics/>.