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Volcker post mortem or has the fight just begun?

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The Volcker proprietary trading ban deadline (July 21, 2015) is now behind us. The remaining covered fund requirements won't be due until July 2017. Many have shifted focus to other regulatory priorities (e.g. BCBS-239 in Jan 2016, tick-size pilot project in May 2016, etc.), except smaller banks that have metric reports due in 2016. In fact, the industry shouldn't start to do a post-mortem on Volcker Rule just yet. There are still the CEO attestation for Volcker by March 31, 2016 and the ongoing independent testing!

It's a big deal to require annual written attestation by the CEO because failure to provide the attestation can amount to 'professional misconduct' rather than 'unsatisfactory professional conduct'. It may be considered as dishonesty for disciplinary actions if banks state that they have "a system of internal controls reasonably designed to monitor compliance with and to prevent the occurrence of activities or investments prohibited by the regulations" when they really don't have or don't know how to build a "preventive" system.

CEOs' hesitations are understandable because there are questions left unanswered since the Rule was introduced 5 years ago. For these unanswered questions, how do banks:

1. **DETERMINE** 'reasonableness' in securities inventory?
2. **DISTINGUISH** trade 'intents'?
3. **DEFEND** against anything that 'may become threats' to US financial stability?

Banks ***lack understanding*** of what is considered 'reasonable' when there is no regulatory guideline to measure that specifically. Banks also ***lack confidence*** that their trading operations will remain profitable when compliance costs and requirements keep climbing. Moreover, they ***lack the priority*** to drag on with this seemingly unsolvable rule, or they are too busy combatting other regulatory priorities. They presume that it will be equally challenging for regulators to enforce the rule as well. Hence, some may make a convenient choice to put this Rule on the backburner until they are faced with regulatory accusations. They will use any accusations as 'lessons learnt', so they can get the specifics on what needs to be done, just like treating any settlement cost as payment for consulting services. Anything that the regulators didn't mention in the initial accusation indeed turns into the banks' favor to confine scope of improvements.

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Not all banks are as slick to pursue the above tactics. Many, if not all, want to take this Volcker opportunity to improve enterprise risk management (ERM) and governance controls. They focused on what they do best in articulating on ***documents*** (policies and procedures), ***divest*** from certain trading businesses (shutdown proprietary desks and shrink risk appetite), and ***digress*** (point to other regulatory activities such as CCAR/DFAST, TLAC). Banks did an amazing job juggling with stress tests, living wills, Basel III and whatnot. Also, banks ***brag*** about their risk culture and conducts because the Rule does call for related improvements. Although these other regulatory priorities have some relationship with Volcker, they are not a substitute to preventive risk controls called for by the Volcker Rule. Don't be side tracked by the ***babbling*** of these minor actions, banks still have a long way before they'll be ready with a true "preventive" risk management system.

Be merciful with the banks because insufficient improvement in risk controls does not mean they have committed any wrong doing at all. Banks indeed are very cooperative to ***beg*** for clearer guidance to perfect the implementation of Volcker compliance. Instead of keep fighting against it (as compare to their critical comments before the Rule becomes final), they ***beseech*** the regulators to give them reasonable exemptions and extensions.

Let's be frank, banks only want to do the bare minimum for compliance and be on par with their peers. No bank wants the regulator to use one bank's best practices to go against another bank. The slick tactics mentioned earlier is indeed quite practical from banks' perspective because all costs (including lawsuit settlements) are already factored in as a calculated business expense. However, this story may be one-sided. Regulators have not been expressing ***how they'll enforce the rule***, except the OCC issued an interim exam procedure. It may well be the quiet before the thunder storm.

Banks should not perform a post mortem on Volcker yet. Remember, ***hammer hits the nail and the nail hits the wood***. Politicians have waited long for this Volcker deadline and they'll be pushing the regulators if the Rule cannot yield their desire outcomes. The fight has just begun. You may calculate the regulatory fines for your passive slick tactics to address the regulators, but you can never estimate the losses from the next crisis. ***The real fight is against the rogue traders***. So, hurry-in, do what the Rule has called for (and also for the sake of CEO attestation) – build a "preventive" system to achieve compliance and win the fight over rogue traders!