Statement by FDIC Board Member Martin J. Gruenberg

Meeting of the FDIC Board of Directors

Notice of Proposed Rulemaking: Volcker Rule Small Bank Exemption

December 18, 2018

Included on the Summary Agenda for today's FDIC Board meeting is a Notice of Proposed Rulemaking (NPR) that would exempt from the Volcker Rule small banks that have total consolidated assets equal to $10 billion or less and total trading assets and liabilities equal to five percent or less of total consolidated assets. This NPR would implement provisions of the Economic Growth, Regulatory Relief, and Consumer Protection Act.

While recognizing that this proposal to provide an exemption from the Volcker Rule is pursuant to a statutory mandate, I believe it is important to note for the record that it could invite significant speculative activity into community banks.

It is true that most community banks do not engage in speculative proprietary trading. The current Volcker Rule recognizes this by limiting the compliance burden on community banks to simply requiring them to recognize the rule in their policies and procedures. If further relief were needed, I have favored a safe harbor which would provide community banks not engaging in risky activities covered under the Volcker Rule with a presumption of compliance. Such an approach would preserve the application of the rule to the small percentage of community banks that do engage in covered activities.

As noted in the banking agencies' report to Congress that was required by Section 620 of the Dodd Frank Act, depending on the state, permissible banking activities for state chartered banks can include corporate debt and equity securities underwriting, proprietary trading, merchant banking activities, and insurance underwriting – activities that the Volcker Rule was intended to restrict.

Further, under the new law, community banks, their holding companies, and their affiliates are no longer subject to the Volcker Rule's prohibition on holding hedge funds and private equity funds. These types of funds have limited financial disclosures. This makes it difficult to assess their risks, to determine their true fair value, or to assess the ability of the investor to sell or transfer their shares. These can be highly risky and speculative investments, such as synthetic collateralized debt obligations (CDOs) which were a contributing cause of the financial crisis, and should not be supported by the public safety net.

As I noted, under the new statute, in order to be exempt from the Volcker Rule, a bank must meet two requirements: (1) have total consolidated assets of $10 billion or less and (2) have total trading assets and liabilities equal to five percent or less of total consolidated assets.

It has been argued that the trading asset and liability limitation prevents community banks from being able to meaningfully engage in the types of activities covered by the Volcker Rule. However, this has limited practical effect because a community bank can invest in hedge funds, private equity funds, synthetic CDOs, and similar funds in its available-for-sale account rather than its trading account. Similarly, a bank can engage in proprietary trading from its available-for-sale account as easily as it can from its trading account.

This leads to my final point. There has been some discussion that the new statute can be read in a way that would allow any bank, regardless of asset size, to be exempt from the Volcker Rule if its trading assets and liabilities are five percent or less of its total consolidated assets. If this were true, not only would large regional banks qualify for exemption from the Volcker Rule, but one or more banks that have been designated as Global Systemically Important Banks or G-G-SIBs could become exempt with a modest restructuring of their trading portfolios.

This was not the intent of the new statute as I understand it. Indeed the heading of the provision in the statute is "Community Bank Relief." I believe it is clear that this statutory exemption, and the proposed implementing regulation that is before the FDIC Board today, apply only to banking organizations with $10 billion or less in total consolidated assets and that the limitation on trading assets and liabilities is an additional limitation placed on this defined group of banking organizations.