Statement by FDIC Chairman Jelena McWilliams on the Notice of Proposed Rulemaking: Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; FDIC Board Meeting

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Section 619 of the Dodd-Frank Act – commonly referred to as the Volcker Rule – generally prohibits large banks from engaging in proprietary trading and owning hedge funds or private equity funds. The primary objective of this statute was simple: prevent banks from engaging in short-term speculation and encourage activities such as providing long-term credit. However, in the six years since issuing a final rule to implement the statute, regulators and banks have faced many challenges regarding the rule's scope and prohibitions.

The original rule – nearly 1,100 pages long with over 2,800 footnotes – turned out to be so complex that it required regulators to issue 21 sets of frequently asked questions (FAQs) within three years of adoption. In addition to its complexity, the rule proved to be inefficient and overly restrictive. To make it workable required hiring lawyers – in house and from outside law firms –consultants, and additional compliance staff. Even after all of their analysis, a firm could still not be 100% sure whether it was in full compliance with the Volcker Rule.

Last year, the five agencies responsible for the Volcker Rule issued a new rule to provide greater clarity regarding the proprietary trading restrictions. That rule made sure that proprietary trading would remain impermissible and that banks with significant trading activity would remain subject to the most stringent compliance requirements, while increasing transparency and streamlining compliance by clarifying the activities that are prohibited.

Today, we consider a proposal to revise the restrictions on fund investments in a way that similarly provides greater clarity and addresses over-breadth of the rule, while remaining faithful to the statute. As currently implemented, these restrictions cover a wide variety of funds.

Congress required the agencies to exclude certain funds from its scope and provided further authority to permit investments in certain funds that do not violate the statutory prohibition.[1]

To facilitate capital formation and provide banks greater flexibility to provide credit in the economy, the proposal before us today would create or modify several exclusions to the rule's covered fund provisions.

The proposal would allow banks to invest in qualifying venture capital funds, subject to certain conditions. These long-term investments benefit the broader financial system by improving the flow of financing to small businesses and start-ups. In addition, such investments may enable banks to allocate resources to a more diverse array of long-term investments in a broader range of geographic areas, industries, and sectors.

In order for a venture capital fund to qualify under the proposal, the fund must adhere to several important safeguards, including a ban on proprietary trading. In addition, any bank that invests in a venture capital fund would be required to ensure that the fund's activities are consistent with safety and soundness standards that are substantially similar to those that would apply if the bank engaged in the activities directly. This is exactly the type of investment that was never intended to be banned by the Volcker Rule. As Senator Dodd acknowledged, "properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it."[2]

The proposal would also allow banks to invest in credit funds that make loans, invest in debt, or otherwise extend the type of credit that banks may provide directly. Again, several restrictions would apply to credit funds – including a ban on proprietary trading – to ensure that such investments are safe and sound.

The proposed rule would permit increased bank investments in venture capital funds and credit funds. However, these investments would remain subject to prudential safety and soundness regulation and supervision. In addition, these investments would continue to be subject to robust risk-based and leverage capital requirements under the agencies' regulatory capital regulations.

The proposal does not weaken the Volcker Rule. In fact, the proposal exercises the agencies' discretionary authority envisioned and enacted into law by Congress to improve the rule's clarity and efficiency and properly tailor its scope. In addition, the proposal maintains strong safety and soundness and financial stability protections by not allowing banks to engage in any activity through a fund that is not permissible if conducted on its own balance sheet. Finally, and importantly, the proposal includes protections that restrict a bank's ability to conduct certain transactions with funds, thus limiting the bank's exposure to potential risks.

Any adjustments to the Volcker Rule seem to elicit criticism that just about any change – no matter how many guardrails are put in place – would somehow create a gaping hole in our regulatory framework. Such criticism is unfounded. For non-community banks:

- The Volcker Rule remains the law of the land.
- Proprietary trading remains prohibited.
- Investments in hedge funds and private equity funds remain prohibited.
- The rule maintains restrictions on a bank's ability to bail out funds.

I would like to close by thanking the staffs at the five agencies responsible for the Volcker Rule who worked on this proposal. For some of them, this proposal follows on the tails of another 30joint interagency issuances – including proposed rules, final rules, and FAQs – to implement the Volcker Rule and make it workable. In particular, I would like to thank the staff of the FDIC for all of their hard work and continued diligence, including over the recent holiday period. I know this has been a tremendous undertaking and I greatly appreciate your efforts.

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[1]*See* 12 U.S.C. 1851(d).

[2]*See* 156 Cong. Rec. S5905 (daily ed. July 15, 2010).