

HEARING REPORT

From: Patton Boggs LLP
Date: February 2, 2010
Subject: Senate Banking Committee Hearing *“Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies”*

On February 2, 2010, the Senate Banking Committee held a hearing entitled, “Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies.” The witness list is below. The hearing was the first of two hearings examining the President’s recently announced proposal to limit the scope of proprietary trading activities and the size of bank holding companies via a “Volcker rule.”

I. Witness List

- The Honorable Paul Volcker, Chairman of the President’s Economic Recovery Advisory Board; and
- The Honorable Neal S. Wolin, Deputy Secretary, U.S. Department of the Treasury.

II. Executive Summary

Chairman Christopher Dodd (D-CT) expressed support for the Volcker rule but cautioned that the late timing of the Administration’s proposal could further impede progress on a regulatory reform bill. Ranking Member Shelby (R-AL), among other Republicans, expressed skepticism about whether proprietary trading activities even pose a systemic threat. After the hearing, it remained unclear whether sufficient political traction exists to insert the Volcker rule into a regulatory reform bill in the Senate.

III. Discussion of Key Issues

Key issues discussed at the hearing included: (1) Democratic support for Volcker rule, qualified with frustration over limited time remaining to add such a provision to the regulatory reform bill; (2) Republican criticism of proprietary trading as not getting to root of problem of systemic risk; (3) Consumer Financial Protection Agency; (4) definition of excessive growth; (5) banks domiciled overseas; (6) size constraints; (7) Basel II / capital requirements; (8) firewalls already existing in commercial banks; (9) the need for specificity of detail and legislative language for the “proprietary trading” proposal; (10) whether Volker is comfortable with the current size of banks; and (11) GSE reform.

- (1) **General Democratic Support for the Volcker Rule, Qualified With Frustration Over Limited Time Remaining to Add Such a Provision to Regulatory Reform Bill.** Chairman Dodd (D-CT) voiced support in his opening remarks for the Administration's proposal to limit the size and scope of banks. He did not, however, provide a specific time frame for moving forward on the Volcker rule or regulatory reform in general. Further, in his closing remarks Chairman Dodd informed Deputy Secretary Wolin that the Senate needs to get their work done and that the Administration cannot add ideas to the debate weekly. Chairman Dodd cautioned Wolin that the Administration is getting precariously close to biting off more than they can chew. Chairman Dodd indicated that he does not want to be in a position of not being able to do anything because they tried to do too much; he wants to move the regulatory reform legislation in a bi-partisan manner and does not want to go to the Senate begging for the 60th vote. Chairman Dodd also said he expects answers, noting that "when we make the calls we expect good answers and we aren't getting them." Volcker responded they had a first round and need a second round. Volcker didn't believe this would be a "60th vote" issue, but rather that this is a bi-partisan issue both parties will support.
- (2) **Republican Criticism of Proprietary Trading as Not Getting to Root of Problem, But Willingness to Consider Proposals.** Ranking Member Shelby (R-AL) indicated willingness to consider any proposal that would strengthen the regulatory framework. He expressed the need to gain an understanding of the specific activities that would be banned and the costs and benefits. Ranking Member Shelby was critical of aspects of the proposal but noted the need to reach a consensus and get it right. Ranking Member Shelby noted there is no evidence proprietary trading caused the problems leading up to the economic crisis and questioned whether restricting proprietary trading would have saved the financial system from the last crisis or any future crisis. He further questioned the emphasis on proprietary trading, noting that Bear and Lehman were not commercial banks yet were more interconnected and posed systemic risk. Ranking Member Shelby also indicated he was disturbed by the manner in which the Administration had gone about bringing up this proposal. He noted that the proposal was "air dropped" into the debate seven months after the Administration's financial regulatory concepts were first introduced. The Ranking Member emphasized the need for thoughtful analysis versus what the President might think up on any given day.
- (3) **Consumer Financial Protection Agency.** Chairman Dodd (D-CT) indicated in his opening statement he would like to hear more on how the Administration's proposals will be applied to help consumers. Sen. Schumer (D-NY) expressed strong support for a Consumer Financial Protection Agency (CFPA). Similarly, Sen. Schumer raised the issue of consumer protection and compared the U.S. system with the system in Canada. Sen. Schumer pointed out Canada has a consumer protection agency and a less than 1% foreclosure rate as compared to a 10% rate in the U.S.. Volcker noted that in Canada the mortgage market is dominated by commercial banks and thus they have an incentive to apply more conservative practices. Additionally, there is no Fannie or Freddie in Canada and no political pressure to push down mortgage rates. Volcker also indicated he did not know much about Canada's Consumer Protection agency and its past effects on the Canadian mortgage market. Sen. Schumer interpreted this answer as an indication Volcker is neutral on the CFPA proposal.

- (4) **Definition of Excessive Growth.** Ranking Member Shelby inquired what constitutes “excessive growth.” The term arose in the context of the Administration’s recent proposal for a limit on consolidation in the financial sector, and in particular to place limits on the excessive growth of the market share of liabilities at the largest financial firms to supplement existing caps on the market share of deposits. Volcker declined to give a precise definition and responded that “you know it when you see it.”
- (5) **Banks Domiciled Overseas.** Ranking Member Shelby noted there are many banks domiciled overseas that also operate in the U.S. Volcker indicated he hoped that banks in other regions would have similar regulatory framework regimes and noted that ideally competition should be on similar grounds.
- (6) **Size Constraints.** Wolin noted that the deposit cap is insufficient because it only applies to the safest kinds of liabilities. Ranking Member Shelby noted what appeared to be disagreement among Administration officials; specifically that Secretary Geithner may have expressed doubts about the utility of size constraints and possible disagreement between the FDIC and Treasury on bans on proprietary trading. Ranking Member Shelby proceeded to ask whether there is, in fact, consensus on proposals on limiting size. Wolin responded that President Obama’s proposals were announced after consultation with his team, but that he was uncomfortable expressing the views of the regulators as they are independent.
- (7) **Basel II/ Capital Requirements.** The need for more concrete limits for capital requirements arose in the question and answer period. Volcker stated that Basel II needs to be rethought with greater clarification and more binding enforcement measures. He noted that previously enforcement has rested largely on bank’s internal risk management procedures and on credit rating agencies. Volcker conceded that finding agreement among countries would be challenging. Wolin indicated he is supportive of Basel II and highlighted the need for further work on core prudential standards.
- (8) **Firewalls Exist in “Commercial Banks” and None Have Failed As Result of Proprietary Trading.** Sen. Corker (R-TN) noted that Volcker is not just talking about banks, but also the bank holding companies and the affiliates. He noted that firewalls exist and that no commercial bank has failed so far as a result of proprietary trading. Volcker said that he does not know how far back in history Sen. Corker wants to go, but did not cite an example of a commercial bank causing an economic problem.
- (9) **Need for Specificity of Detail/Legislative Language for “Proprietary Trading” Proposal.** Sen. Crapo (R-ID) suggested that drawing a bright line to define proprietary trading would prove challenging. He noted that if the government makes it too difficult for banks to take positions they will limit liquidity in the market and limit robust economic activity. Sen. Crapo asked if Congress can expect to receive more specific legislative language with respect to proprietary trading. Volcker said that this was Wolin’s responsibility. Wolin indicated that draft legislative proposals will be sent to the Committees for consideration “soon.” The Administration will want to embed in statute the proprietary trading principles articulated in some detail, but a lot of the specifics will be left for the rulemaking process. Wolin said he is presently working with regulators to craft language in greater detail and will work with the Banking Committee as well

- (10) **Whether Volker Comfortable With Current Size of Banks.** Sen. Menendez (D-NJ) noted the Volcker rule does not limit the size of banks and asked whether that means Volcker is comfortable with the current size of banks? Volcker responded he was not particularly concerned with size and is sympathetic with the Administration's efforts not to limit organic growth. Wolin said the size cap is not the only proposal that deals with size. Rather other elements the President has announced such as leverage standards and capital standards create positive economic incentives for firms to shrink
- (11) **Government Sponsored Enterprises (GSEs) Reform.** Sen. Crapo (R-ID) questioned Wolin about why the financial transactions of GSEs had not been included in the President's 2011 Budget. Wolin responded that GSEs are not owned by the U.S. government but are rather under the conservatorship of the FHFA. Sen. Crapo further inquired when Congress will receive details on the Administration's proposals for GSE reform. Wolin side-stepped the question, responding that the Administration is focused on the stability of the housing markets and is focused on long-term options for GSEs without providing further detail on the exact plans for recommendations.

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