BURR ALERT

"Interim Final" Volcker Rule Approved

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On December 10, 2013, the Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Securities Exchange Commission announced the "final rules" implementing § 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Volcker Rule, which some call the centerpiece of the Dodd-Frank Act, prohibits banks from engaging in most proprietary trading ("engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments"), while allowing for certain underwriting activities, market making activities, and trading in certain domestic government obligations and foreign government obligations, limits hedging by requiring that hedging be against "specific, identifiable risks to the banking entity," and limits ownership of hedge funds and private equity firms. The rule was designed to limit excessive risk-taking and to end a "too big to fail" mentality.

Immediately after issuance of the final Volcker Rule, the American Bankers Association filed suit in *American Bankers Association, et al v. Federal Deposit Insurance Corporation, et al*, Civil Action No. 1:13-cv-02050-RJL, pending in the United States District Court for the District of Columbia, asking the court to void the final rule's definition of "other similar interest" in order to prevent banks from being required to "divest their holdings in a commonly held debt instrument known as a 'TruPS-backed CDO' by 2015 and, under Generally Accepted Accounting Principles ('GAAP'), [and] take an immediate and irrevocable hit to earnings and capital as a result." The suit sought temporary injunctive relief and a preliminary injunction. At the same time, members of Congress from both sides of the aisle questioned the final rule and some introduced bills to limit or rollback application of the rule.

"Final" is a tricky word, and on January 14, 2014, the Federal Reserve Board, CTFC, FDIC, OCC, and SEC approved an "interim final rule" creating a carve out for collateralized debt obligations acquired before December 10, 2013 and backed primarily by trust preferred securities ("TruPS CDOs") covered by the Collins Amendment (a provision of the Dodd-Frank Act making trust preferred securities no longer count as Tier 1 capital but grandfathering in certain TruPS from banks with less than $15 billion in assets) and established before May 19, 2010. The interim rule, in the words of the agencies, permits banking entities to "retain investments in certain pooled investment vehicles that invested their offering proceeds primarily in certain securities issued by community banking organizations of the type grandfathered under section 171" of the Dodd-Frank Act, effective April 1, 2014.

The interim final rule is expected to aid community banks, which had complained that the final rule issued in December 2013 would have required millions of dollars in unexpected write downs.

Indeed, as the agencies acknowledged explicitly, community banking organizations like the Independent Community Bankers of America had expressed concern that the final rule conflicted with § 171(b)(4)(C) of the Dodd-Frank Act, which grandfathered certain TruPS to allow community banking organizations to use TruPS for "regulatory capital purposes." Pointing to examples like Zions Bancorporation, which had announced that it was taking a charge of $387 million to rid itself of certain CDOs, advocates for revision argued that the final rule was having and would have an immediate negative effect on community banks. The interim final rule was designed to address those concerns.

The response has been mixed but basically positive. The ABA has dropped its request for emergency relief, but it has not dismissed its lawsuit until its constituents have more fully analyzed the interim final rule. And while organizations like the Securities Industry and Financial Markets Association ("SIFMA") have generally welcomed the change, there is also concern that the Volcker Rule still faces issues concerning collateralized loan obligations and that the interim final rule will not help institutions dealing with, for example, CDOs issued by insurance companies. Regardless, the issuance of the interim final rule and the opportunity for comments on the interim rule mean that nothing is yet final about the Volcker Rule.

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