August 20, 2019

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chairman Powell:

When I became aware last year that regulators wished to simplify the Volcker Rule, I welcomed the effort. I trusted that the new rule would preserve the reform's core principle—that taxpayer supported banking groups be prohibited from engaging in proprietary trading at odds with the basic public and customer interests.

Today, I was disappointed to learn that the rule the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency have finalized—and that the Federal Reserve and other agencies may soon adopt—undermines this central tenet. In doing so, the new rule amplifies risk in the financial system, increases moral hazard and erodes protections against conflicts of interest that were so glaringly on display during the last crisis.

The new rule substantially narrows the proprietary trading prohibition, enabling banks to speculate freely for their own profit with financial instruments previously under the Volcker Rule's constraints. This includes instruments held by a firm's deposit subsidiaries, which benefit directly from government subsidies. Changes to ease restrictions on bank investments in hedge funds and private equity funds may also be forthcoming. These measures appear far afield from the regulators' stated objective of mere simplification.

I understand that well compensated industry lobbyists have long sought to weaken the Volcker Rule, claiming that it has reduced market liquidity and gravely damaged the prospects for economic growth. Yet credible studies show that overall market liquidity

remains strong and has increased in recent years. Ironically, the potential risk that regulators should address is too much liquidity, which can give rise to speculative activity and can prove illusory in a financial crisis.

Put simply, the U.S. is in its longest economic expansion in recorded history. Bank profits are strong, as banks pay out billions of dollars in dividends and share buybacks. Bank loan growth has outpaced nominal gross domestic product growth and the unemployment rate is the lowest it has been in more than 50 years.

These facts belie any justification for the new rule. It bolsters the views of skeptics who believe that the "simplification" effort was merely a ploy to weaken the core elements of the reform. It also serves as a reminder of the insidious nature of lobbying in regulation and should trouble anyone concerned with the eroding public trust in government and the role of the Federal Reserve as the principle guardian of financial stability.

Sincerely,

Paul A. Volcker

cc: Randal Quarles, Vice Chair for Supervision
Board of Governors of the Federal Reserve System