Negative: Volcker 2.0 – not a problem

By “Coach Vance” Trefethen

***Resolved: The United States Federal Government should substantially reform its banking, finance, and/or monetary policy.***

Summary: The “Volcker Rule” (named after former Federal Reserve Chairman Paul Volcker) was a regulation enacted under the Dodd-Frank reform law 10 years ago. It limits banks from making risky investments with their customers’ deposited funds . It’s supposed to protect the soundness of banks and the safety of depositors’ money, because we don’t want banks taking risks with depositors’ money, and then when they lose it, the federal government (i.e. taxpayers) have to bail out the insured depositors (through FDIC). The Rule was modified slightly in October 2019 to clarify and define more precisely what types of investments are regulated, and this modification is known as “Volcker 2.0.” The 2.0 rule was implemented because the original rule was so complicated and vague about which trades were allowed/prohibited that it caused confusion and massive compliance costs. AFF plan will repeal this modification and go back to the original Volcker Rule, under the theory that 2.0 created some dangerous exemptions that will allow banks to get away with bad things. This is a NEG brief against that case. You will especially have fun noting that Paul Volcker himself supports the Negative position.

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Negative: Volcker 2.0 – not a problem

OPENING QUOTES

Reverse Plan Advocate: Paul Volcker – agrees original Volcker Rule was too complicated

Meraj Allahrakha, Jill Cetina, Benjamin Munyan, and Sumudu Watugala 2019 (Allahrakha, Centina and Watugala – Office of Financial Research, US Dept of the Treasury. Cetina – Federal Reserve Bank of Dallas) The Effects of the Volcker Rule on Corporate Bond Trading: Evidence from the Underwriting Exemption<https://www.financialresearch.gov/working-papers/files/OFRwp-19-02_the-effects-of-the-volcker-rule-on-corporate-bond-trading.pdf>

“It’s much more complicated than I would like to see” – Paul Volcker on the proposed text of the rule that bears his name.

DEFINITION

The Volcker Rule: Limits the kinds of risky trading banks can do with depositors’ money (because they get federal insurance, so we protect the taxpayers from having to bail them out)

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule>

In this post, we briefly describe the Volcker Rule, highlighting its complexity, its tenuous links to risk management, and its apparent negative effects on the financial system. Taking a step back, in the aftermath of the financial crisis, Congress sought to curtail *proprietary trading*—or own-account trading—by banks. The motivation was simple: intermediaries that receive the benefit of the federal safety net—including deposit insurance and access to the lender of last resort—ought not use the resulting subsidy to take greater risk at the expense of taxpayers.

Background on what Volcker 2.0 does

<https://www.bloomberg.com/news/articles/2019-08-20/wall-street-poised-to-get-long-sought-changes-to-volcker-limits>

The revamp, known as Volcker 2.0, is an attempt to simplify the “proprietary trading” ban that forbids banks from making short-term investments with their own capital. It also aims to clarify some limits on banks’ investing in private equity and hedge funds.

TOPICALITY

1. Not “substantial” reform

Volcker 2.0 itself was only a minor reform of the original Volcker Rule

Gibson, Dunn & Crutcher 2019 (law firm) “Dodd-Frank 2.0: U.S. Agencies Revise the Volcker Rule on Proprietary Trading” 9 Sept 2019 <https://www.gibsondunn.com/dodd-frank-2-0-us-agencies-revise-the-volcker-rule-on-proprietary-trading/>

As with most of the revisions to Dodd-Frank since 2016, the revision – proposed in somewhat different form in June 2018 (2018 Proposal) – is a moderate approach that recalibrates the original regulation (Original Rule) and removes certain unworkable excesses.  This “Volcker 2.0” approach also focuses more intelligently on risk than the Original Rule and is more faithful to the statutory text.  At the same time, it still aligns with the most defensible reason for the Volcker Rule, maintaining the nature of banking institutions as customer-serving businesses.  The result is a pruning of some of the excesses of the Original Rule, while leaving the regulation targeted at banks with the largest trading operations.

Violation: Logically, AFF plan cannot be a substantial reform

If Volcker 2.0 was only a minor reform of the banking system, then repealing it can only be a minor reform back to what it was before.

Impact: Negative ballot

Since no one showed up in the room today to affirm a substantial reform to the banking system, no matter who wins you should write Negative on the ballot.

HARMS / SIGNIFICANCE

1. New exemptions/exceptions in 2.0 are insignificant compared to original Volcker rule

AFF is arguing that 2.0 created some exceptions that now allow more risky bank trading than the original rule.

Small banks not off the hook. While it may sound like smaller banks don’t have to comply with 2.0, in fact they still do

NATIONAL LAW REVIEW 2019. (article written by Scott Cammarn and Mark Chorazak, both are financial services attorneys) “Volcker 2.0” 23 Aug 2019 [https://www.natlawreview.com/article/volcker-20 (brackets](https://www.natlawreview.com/article/volcker-20%20(brackets) in original)

Consistent with the 2018 Proposal, banking entities with “limited trading assets and liabilities” are afforded a presumption of compliance with the Volcker Rule regulations “and shall have no obligation to demonstrate compliance with [the Volcker Rule] on an ongoing basis.”  This effectively removes from these banking entities all Volcker Rule compliance requirements.  However, this presumption can be rebutted if an agency determines in an examination or audit that the banking entity has engaged in activities prohibited by the Volcker Rule, subject to notice to and response by the banking entity.  In this case, the banking entity would be treated as a banking entity with “moderate trading assets and liabilities” and would be required to adopt the appropriate compliance procedures.  Thus, banking entities within this category should consider retaining some level of Volcker Rule compliance to prevent a rebuttal of the presumption and a resulting reclassification into the “moderate trading assets and liabilities” category.

2. Exemptions are justified

Considering the risks involved, the exemptions are justified

Arther S. Dunn and James Springer 2019 (attorneys specializing in financial markets) 12 Sept 2019 Gibson Dunn Discusses Volcker Rule Revisions <https://clsbluesky.law.columbia.edu/2019/09/12/gibson-dunn-discusses-volcker-rule-revisions/>

The tiering revision alone is a substantial improvement.  The Original Rule deemed a banking entity worthy of heightened compliance obligations based on total asset size, and set that threshold at an irrationally low number – $50 billion.  Being based on amounts of trading assets and liabilities, the new tiers align more closely to the risks posed.  The Agencies raised the threshold of the “Significant” tier from $10 billion in the 2018 Proposal to $20 billion, but they declined to make changes to the other tiers.

3. Banks not harmed by 2.0

Banks applauded the arrival of Volcker 2.0 because it reduces the massive compliance costs

Katy O’Donnell 2019 (journalist) 20 Aug 2019 “FDIC approves Volcker revamp, in latest move to roll back bank rules” <https://www.politico.com/story/2019/08/20/volcker-rule-joseph-otting-banks-1672620>

The inclusion of the accounting provision in the original Volcker 2.0 proposal had been key in securing the support of Martin Gruenberg, then FDIC chairman and now a regular board member at the agency. Gruenberg, an Obama appointee, voted against the revised rule Tuesday morning, saying it would “effectively undo” the Volcker rule’s ban on proprietary trading. As amended, “the Volcker rule will no longer impose a meaningful constraint on speculative and proprietary trading by banks and bank-holding companies benefiting from the public safety net” of insured deposits, Gruenberg said. Banks, meanwhile, applauded the new rule. “The changes in the new rule will help reduce the incidental damage the original rule has done to responsible banking activity and legitimate market making activity, and the massive and needless compliance costs it imposed,” said Greg Baer, president and CEO of the Bank Policy Institute.

Turn: Banks are better off under 2.0 because it’s easier to understand and comply with

Arther S. Dunn and James Springer 2019 (attorneys specializing in financial markets) 12 Sept 2019 Gibson Dunn Discusses Volcker Rule Revisions <https://clsbluesky.law.columbia.edu/2019/09/12/gibson-dunn-discusses-volcker-rule-revisions/>

Ultimately, the fundamental issue with the Volcker Rule is the statute Congress passed.  In an effort to cover every activity that could be proprietary trading, while at the same time using opaque and imprecise language, Congress ensured a “hard slog” for both banking entities and their supervisors.  The Original Rule compounded this problem by interpreting the statute to expand its reach in virtually all close cases.  The Revised Rule appropriately takes a different approach, focusing on what is the overall purpose of Dodd-Frank:  the reduction of risk to banking entities and the financial system more broadly.  By streamlining overall requirements, and focusing most stringently on the banking entities with the largest trading portfolios, “Volcker 2.0” provides better guidance to banking entities and will be easier for regulators to enforce.

SOLVENCY

1. Won’t solve for risky trades

Prohibited list of trades is generally the same now under 2.0 as in the original Volcker rule

Securities & Exchange Commission 2019 (federal regulatory agency) 8 Oct 2019 “Agencies Finalize Changes to Simplify Volcker Rule” <https://www.sec.gov/news/press-release/2019-207>

Under the revised rule, firms that do not have significant trading activities will have simplified and streamlined compliance requirements, while firms with significant trading activity will have more stringent compliance requirements.  Community banks generally are exempt from the Volcker rule by statute.  The revisions continue to prohibit proprietary trading, while providing greater clarity and certainty for activities allowed under the law.  With the changes, the agencies expect that the universe of trades that are considered prohibited proprietary trading will remain generally the same as under the agencies’ 2013 rule.

2. Won’t solve for market risks

[Writing in June 2019 before 2.0 was implemented] Original Volcker Rule didn’t solve for bond market risk taking

Meraj Allahrakha, Jill Cetina, Benjamin Munyan, and Sumudu Watugala 2019 (Allahrakha, Centina and Watugala – Office of Financial Research, US Dept of the Treasury. Cetina – Federal Reserve Bank of Dallas) The Effects of the Volcker Rule on Corporate Bond Trading: Evidence from the Underwriting Exemption, June 2019 <https://www.financialresearch.gov/working-papers/files/OFRwp-19-02_the-effects-of-the-volcker-rule-on-corporate-bond-trading.pdf>

A reduction of the riskiness of covered dealer trades in this market was one of the intended effects of the Volcker rule. The analysis of the volatility of trade markups suggest no evidence of such a reduction and in fact, we find an increase in volatility for riskless principal trades. We find that markups have significantly increased for trades by covered dealers, even after controlling for other contemporaneous effects. This increase in costs of 20 to 45 basis points per roundtrip trade represents a statistically and economically significant change in corporate bond market liquidity. After controlling for the 16-month transition period immediately following the implementation of the rule, we find these effects to be persistent. We further find that covered dealers are losing corporate bond market share to non-bank dealers as a result of the Volcker rule. The duration of a roundtrip trade may influence the difficulty in demonstrating compliance with the rule’s market marking exemption or whether the trade falls outside the rebuttable presumption period. However, we find no evidence that covered dealers are changing the duration of their trades as a result of the Volcker rule. In this paper, we analyze specific aspects of the Volcker rule’s impact on corporate bond trading. The rule’s intended effects were particularly targeted towards bank affiliated dealer risk-taking that may affect financial stability and the need for government-funded bailouts during a crisis. This paper suggests that the rule in its current form is not reducing dealer risk-taking in corporate bonds and may be increasing the spreads charged by covered dealers.

3. Nearly impossible to enforce

The original Volcker Rule was so vague that it was nearly impossible to enforce or understand. The new 2.0 is much better

Arther S. Dunn and James Springer 2019 (attorneys specializing in financial markets) 12 Sept 2019 Gibson Dunn Discusses Volcker Rule Revisions <https://clsbluesky.law.columbia.edu/2019/09/12/gibson-dunn-discusses-volcker-rule-revisions/>

This simplification of the Original Rule is welcome and is a more reasonable construction of the statute.  First, the Purpose Test – which looked to a banking institution’s intent in purchasing and selling a Volcker instrument – is in many cases duplicative of the Market-Risk Capital Test.  It was also not unreasonably characterized by JPMorgan Chief Executive Officer Jamie Dimon as requiring “a lawyer and a psychiatrist” to analyze every trade.  Second, the Volcker Agencies never had enough staff to engage with banks on rebutting the 60-day presumption – this avenue of compliance was thus effectively read out of the Original Rule.  Finally, for reasons that were never persuasive, the Original Rule did not provide any indication of what period of time would suffice for a banking entity to have certainty that it was not proprietary trading.

Original Volcker Rule was so confusing that it was difficult to enforce

Vinita Tandon 2016 (J.D. candidate, Univ. of N. Carolina law school) The Volcker Rule: Clarifying the Anti-Evasion Provision to Facilitate Compliance 1 March 2016 <https://scholarship.law.unc.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1404&context=ncbi>

While the pillars of compliance themselves are straightforward, the standard by which compliance programs are to assess bank activity is riddled with exceptions. The number of exceptions to the prohibited activities complicates institutions’ ability to clearly determine whether any improper trades were made. Additionally, because the Rule does not provide any definitive criteria for clearly identifying impermissible high-risk assets or high-risk trading strategies, it is unclear how banking entities are expected to know when their trading activity is potentially in violation of the Rule. In addition to a lack of a clear standard for identifying improper activity, the Regulators have even broader discretion in deciding whether certain activity is a violation of the AntiEvasion Provision. This lack of clarity presents the risk that the Rule and its Anti-Evasion Provision will be inconsistently applied and enforced.

DISADVANTAGES

1. Compliance costs

Link: 2.0 reduced compliance costs. Volcker Rule before 2.0 was massively burdensome

Thomas Franck 2019 (journalist with CNBC) 20 Aug 2019 “FDIC approves tweak of Volcker Rule, easing trading regulations for Wall Street banks” <https://www.cnbc.com/2019/08/20/fdic-approves-volcker-rule-overhaul-eases-wall-street-trading-rules.html>

Regulators hope to clear up definitions surrounding “proprietary trading” in response to industry complaints that the rules are too convoluted and burdensome. The Volcker Rule was initially enacted under the Dodd-Frank Act and prevented banks from investing their own money in hedge funds and private equity funds. “The rule has turned out to be so complex that it required 21 sets of Frequently Asked Questions,” says FDIC Chairman Jelena McWilliams.

Link & Impact: Negative net benefits. The original Volcker rule was so burdensome that it was not cost effective. New amendments are solving.

**Analysis: “Not cost effective” means it costs more to do it than the benefit it returns.**

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule>

Implementing the Volcker Rule has required extraordinary regulatory attention. In the run-up to the initial 2014 implementation of the Volcker Rule, regulators conducted nearly 1,400 meetings and received hundreds of (unique) letters (see [Krawiec and Liu](https://scholarship.law.duke.edu/faculty_scholarship/3502/)). That version occupied more than 270 pages in the [Federal Register](https://www.govinfo.gov/content/pkg/FR-2014-01-31/pdf/2013-31511.pdf). Over the past month, four of the five responsible agencies have approved “final amendments” to the existing Volcker Rule. (The fifth agency, the Federal Reserve, is likely to follow soon.)  By expanding exemptions―including for assets that are available for sale and for derivatives not held for trading, as well as for institutions that have no reported trading assets―and by raising the activity threshold for applying the rule, these new changes aim to ease the compliance burden.

Impact: Economic loss. Compliance costs were so high that they created economic losses

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule> (all brackets, parentheses and ellipses in original)

To avoid a loss of liquidity in key markets, the initial implementation of the Volcker Rule excluded a short list of instruments (including government and federal agency debt, municipal bonds and foreign exchange) and activities (including some forms of repo and securities lending). Authorities also made efforts to protect market-making activities more generally. Yet, as [Richardson and Tuckman](https://www.stern.nyu.edu/sites/default/files/assets/documents/The%20Volcker%20Rule%20and%20Regulations%20of%20Scope.pdf) highlight, “justifying that a trade belongs to a permitted category is […] difficult and subjective.”  The need to prove that specific trades are permitted led to an enormous compliance effort, increasing the costs (and the deadweight loss to the economy) imposed by the Rule.

2. Distraction from real threats

Complexity of the original Volcker Rule was distracting the system from dealing with the real threats

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule>

By expanding exemptions―including for assets that are available for sale and for derivatives not held for trading, as well as for institutions that have no reported trading assets―and by raising the activity threshold for applying the rule, these new changes aim to ease the compliance burden. Yet, the Volcker Rule remains a source of great controversy (see, for example, former [FDIC Chairman Gruenberg’s objections](https://www.fdic.gov/news/news/speeches/spaug2019b.pdf) to the latest revisions). Ultimately, the need to focus on this overly complex and relatively ineffective regulation distracts both the government authorities and private sector risk managers from tasks that really would make the system safer.

Impact: Turn the AFF harms. System becomes less safe.

The banking system gets LESS safe when Volcker Rule gets more complex after their plan.

3. Political backlash

Link: 2.0 reduced the complexity of Volcker Rule

Cross apply our evidence from DA-2 about compliance costs.

Link: Complexity of the original Volcker Rule increases pressure to relax bank regulations in general

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule>

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Link: Backlash against complexity of original Volcker Rule leads to too much relaxation of needed regulations elsewhere

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule>

Perhaps the worst impact of the Volcker Rule is to give financial regulation a bad name. Cumbersome and costly rules encourage firms (and their clients) to seek remedies from policymakers. At least since the 2016 election, both elected and appointed officials are clearly listening. Together, they are all looking for ways to ease the burden, even where it is not warranted. As one indicator of this worrisome trend, consider a few recent actions (all opposed by the [Systemic Risk Council](https://www.systemicriskcouncil.org/)): the relaxation of resolution-planning requirements ([July 2019](https://www.systemicriskcouncil.org/2019/07/systemic-risk-council-urges-federal-reserve-and-fdic-not-to-relax-resolution-planning-requirements-for-large-us-regional-banks/)); the marginalization of the nonbank designation authority of the Financial Stability Oversight Council ([May 2019](https://www.systemicriskcouncil.org/2019/05/systemic-risk-council-urges-us-treasury-not-to-marginalize-financial-stability-oversight-councils-power-to-designate-non-bank-financial-intermediaries-as-systemically-significant/)); efforts to ease the enhanced supplementary leverage ratio ([August 2018](https://www.systemicriskcouncil.org/2018/08/systemic-risk-council-opposes-federal-reserve-and-occ-proposals-to-reform-leverage-ratio-and-volcker-rule/)); and the legislated rise in the size threshold for imposing stricter scrutiny on banks ([February 2018](https://www.systemicriskcouncil.org/2018/02/systemic-risk-council-comments-on-the-s-2155-the-economic-growth-regulatory-relief-and-consumer-protection-act/)).

Link: Too much relaxation leaves the banking system more vulnerable

Prof. [**Stephen G. Cecchetti**](http://people.brandeis.edu/~cecchett/) and Prof. [**Kermit L. Schoenholtz**](http://pages.stern.nyu.edu/~kschoenh/) 2019 (Schoenholtz is Professor of the History of Financial Institutions and Markets in the Department of Economics of New York University’s Leonard N. Stern School of Business. Cecchetti is Rosen Family Chair in International Finance at the Brandeis International Business School.) 23 Sept 2019 [The Costs of Inefficient Regulation: The Volcker Rule](https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule) <https://www.moneyandbanking.com/commentary/2019/9/22/the-costs-of-inefficient-regulation-the-volcker-rule>

Worse, the broader pressure to deregulate threatens to undermine financial resilience, consistent with the historical pattern of “[progressive dilutions of core regulatory requirements](https://4atmuz3ab8k0glu2m35oem99-wpengine.netdna-ssl.com/wp-content/uploads/2018/02/SRC-Comment-Letter-to-US-Senate-2.21.18.pdf)” that have left the U.S. banking system vulnerable in the past.

Impact: Turn the Affirmative harms.

The banking system ultimately ends up with more likely to crash again if we go back to the old complex Volcker Rule.