Too Many Chiefs: The Delayed Implementation of the Volcker Rule

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Abstract:

Though the Volcker rule passed as Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July of 2010, and was slated for completion no longer than two years after that date, the rule was not published until December of 2013. An analysis of the dynamics that went into the rule writing process couched in extant Political Science theories of regulatory and bureaucratic politics provides for a robust understanding of the inefficiencies of the duplicative United States financial regulatory system.

Theory

- **What makes Bureaucracies inefficient?**
  - **James Q. Wilson (1989)**
- **Why would they be unlikely to cooperate?**
  - **Harold Seidman (1998), Aberbach and Rockman (2000)**
- **To what extent do they respond to political pressure?**
  - **Terry Moe (1989)**

Research Question:

Why did the Volcker rule take so long to be approved by the regulatory agencies, and why did it pass when it did?

Case

The Volcker Rule:

- **Proposed immediately following Scott Brown's victory in MA**
- **Ban on proprietary trading by banking entities**
- **Limitations on the relationships with hedge funds and private equity funds**
- **Additional restrictions on nonbank financial companies (i.e. higher capital requirements)**
- **Referred to SEC, CFTC, Fed, OCC, FDIC to draft rule, must all agree**
- **Reincarnation of Glass Steagall, or solution in search of a problem?**

Timeline

- **January 2010- Volcker Rule proposed**
- **July 2010- Dodd-Frank Passes**
- **February 2011- FSOC study published**
- **October 2011- Proposed rule published**
- **December 2011- comment period extended**
- **February 2012- regulators signal deadline will be missed**
- **May 2012- London Whale**
- **July 2013- Secretary of Treasury Jack Lew demands rule completed by 2014**
- **10 December 2013- Rule passed**

The Agencies

-Market Regulators (SEC/CFTC)

Goes to Congress for funding

Investor/shareholder protection-oriented

-Bank Regulators (Fed, OCC, FDIC)

Self Funded

Safety and Soundness of the banks/ financial system-oriented

-Disagreements Over:

Market-making exemption

Risk-mitigating hedging exemption

Conclusion

The fact that the Volcker rule was tasked out to five different agencies with five different missions, cultures, and roles in the marketplace set the rule up for precisely the kind of gridlock that it encountered. Specifically, debates between the market and bank regulators were animated by diverging opinions regarding their role in the marketplace. Additionally, other factors played into the delay.

- **London Whale**
- **Complexity**
- **No new funding to draft/implement 400 rules pursuant to Dodd-Frank**

The rule passed when it did because it had taken on a highly publicized role that made its presence in regulatory purgatory embarrassing for the Obama administration.