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Volcker attestation: guilty or not innocent?

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Many banks may put Volcker compliance on the backburner after the 7/21/2015 deadline (see this related article), but allow me to remind you that there is still the CEO attestation requirement on or before 3/31/2016. Even though Volcker covered entities with consolidated assets below $50 billion are not required by law to submit an annual written attestation, but they are still subjected to the independent testing requirements. So, if I said Volcker violators whose consolidate assets is $50 billion or more are considered "guilty" and those below the thresholds are considered "not innocent", would this pique your interest to read on?

According to the regulators' FAQ, "A banking entity may provide the required annual attestation in writing at any time prior to the March 31 deadline to the relevant Agency. This allows the CEO time to review the design and operation of the entity's compliance program after the program is fully implemented to ensure it is reasonably designed to achieve compliance with section 13 and the final rule". Think of this as an annual body-check. Not everyone is required to do it as an employment condition, but it is the right thing to do.

Normally, banks have no problem reviewing their compliance programs' effectiveness. However, Volcker is different. An old article on Bloomberg by Matt Levine suggests, "The problem is a regime where (1) the rule doesn't say what prop trading is, but (2) you do the best you can to figure it out and then certify that you're not doing it, and (3) regulators can decide whether or not they agree with you after the fact, and (4) if they don't agree with you then you go to jail or whatever…" So, it's like "eat right, exercise regularly, and you still die anyway". It seems there is no difference whether Volcker violator is confirmed guilty because of a false attestation, or not able to prove their innocence. This negative mentality is absolutely wrong. Regulators may bring criminal charges against falsified statements; ignorance, misconduct, intentional tort, mal practice, and breach of duty are different degrees of offenses.

As mentioned in my Backburner or Bazooka article, pursuing risk management excellence is more than just meeting the eyes of compliance. It is a mission to win the race over rogue traders and exterminate violations. It begins with eating right. Not only will you need a healthy "risk" appetite, you should also consider what "securities inventories" to take-in. Risk limit is like how much food/ calories in aggregate a person should have for each meal, but that's not enough. Different foods provide different vitamins needed for the body. The same is true to constrain what instruments a trader may use under what conditions (e.g. use options in a fall market is prohibited for underwriting, but permissible for

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risk-mitigating hedge if the trade meets all requirements of §_5(b) of the rule). Please refer to my Too Complicated or Just Unfamiliar article to learn more about the 'instrument approach' to Volcker inventory. Obviously, too much "junk food" is bad for your health.

Next, regarding exercise regularly in the context of risk management. Some are quick to reference their regular review of policies and procedures, on-going recalibration of hedges, and revisiting viability of risk models, etc. All these are good "exercises" and don't forget about the risk management training that is a crucial part of the risk culture and conducts. In fact, what counts is the intensity as you conduct these exercises. It's not going to help if this is done as a perfunctory exercise every year, quarter, or month. There are lessons learned that you accumulate each day. There are lessons learned from the failed experience of others. Have you compiled these daily experiences via machine learning and trained your surveillance systems to be smarter to avoid the same mistakes? Would you go about ensuring your preventive systems are tightly sealed (i.e. not leaving room for circumvention, see this related article)? Have you considered any controls that may be over reliant on people who may just come and go?

No pain no gain. The same is true with the finance industry's crisis defense mechanism. It takes hard work on a daily basis and a balanced diet (reasonable inventory) in order to allow the body (the overall banking system) to properly function. Even though rogue traders were cancer cells that caused numerous traumas in the past. Even though we may not be totally exterminating violations yet because there are bound to be situations with no pre-cautionary signal or risk events that are inexplicable even after-the-fact. We all want to achieve a better score for the annual "body check" (attestation). I remain faithful and believe that we can be closer to our goal each and every single day if we keep trying.