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Volcker enforceability: backburner or bazooka?

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Before we put year 2015 on the backburner, let turn our attention once again to the Volcker Rule, a controversy law implemented in July this year. The "guilty until proven otherwise" clause makes the Volcker Rule one of the most significant rules ever in the history of US financial regulations. Regulators have been given so much discretionary power to enforce the Volcker Rule that it's like a bazooka ready to fire at non-conformance banks. No matter how tactful banks think their preparations may be, there does not seem to be an easy way around it. Giving in to put the more challenging tasks on the backburner can't be wrong when it's so hard to keep banks' trading business profitable (see this related article). So, what makes this Volcker compliance journey worth striving for?

It starts with what bank management sees in their minds. Stop pretending that paying big fees to law/ advisory firms will relieve banks from regulatory burden. There are countless cases where risk policies and procedures have failed to catch crisis situations. It is not because the documents aren't articulated well. Not because metric reports have incorrectly calculated Value-at-Risk. It's the impending problem that banks lack real-time intelligence to defend against rogue traders. It's the lack of diligence to determine reasonable trade activities and detect violators' intents.

The reason why banks fail to timely identify violators' wrong doing (and the reason why when I say machine learning and crowd computing is needed, some look at me like I'm crazy) is because banks don't have the drive to pursue risk management excellence. They undermine the rule as a 'spirit of the law' similar to Sarbanes Oxley, and doubt its enforceability. They treat regulatory fines as a learning cost to confine to a bare minimum what they have to do. They lack the guts to restrain front-office traders from using any instruments they like, because management bonuses depend on front-line revenues.

Compliance is seen as costs detrimental to profits rather than an investment. They don't have the 'big-kick' that pushes them to do anything extra. It takes extra skills to perform daily forecast of reasonable inventory by instruments (see this related article). There are extra administrative steps to qualify risk mitigating hedges to conform with §_5(b) of the rule. It requires extra money to build and support the on-going operations of a real-time trade surveillance system (while this cost should already be budgeted for per OCC). The biggest challenge among all is the extra effort to shift from after-the-fact investigations to real-time preventive risk management. Risk and compliance professionals are accustomed to deciphering cases slowly and are uncomfortable with the time pressure to monitor quarantine trades in a queue.

Banks need reasons in order for them to have the desire to do these extras. It's time for bank management to decide if they want to give in to fate and passively wait for examiner's enforcement actions. Decide if they will become completely self-absorbed in their struggle to survive, or will rise above their circumstances to consider the banking industry as a whole during a time of great adversity. Think about the damages that rogue traders have harmed banks' reputation. Think about losses that were sparked by small trading algorithm glitches. Banks have been condemned by the public as regulators keep hitting banks with substantial fines over and over again. These recurring traumas and the loss of market confidence are the results of backburner mentality.

It's time for banks to band together and step up. Are they allowing the media and politicians to bombard them with negative news? Would they like to become insignificant in the financial industry, i.e. be strategically challenged by the buy-side encumbrances and/or Silicon Valley? Banks serve an important role in the economy to transform risk and provide liquidities. The reality is the environment/ market structure has changed. Banks know being tactful is not enough to please the regulators because examiners have vulnerability scan tools to enforce the rule and identify non-conformance. It's time to abandon the backburner mentality. Right now is the time to act upon what true bankers are supposed to do strategically.

Find out what it is in order to achieve real-time preventive risk management (see this related article). Go after it as if banks' future is dependent on it. So that means those who undermine this risk control improvement effort will be eliminated, those who said they don't have the time for it will be redeployed. Those who are afraid of their jobs being replaced by automation will be reassured that crowd collective intelligence is about combining the best of risk and compliance professionals with machine learning.

Challenge the hearts to pursue risk management excellence. The heavy lifting is worth striving for because risk and compliance professionals will always have jobs to make this preventive risk management system more powerful than a bazooka to exterminate violations. Banks are on a mission to win the race over rogue traders. This is more than meeting the eyes of compliance, and for the banking profession to continue to thrive in all it glories!