Agency Lobbying and Financial Reform: A Volcker Rule Case Study

By Kimberly D. Krawiec

Background

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)—a mammoth 848-page statute that amends dozens of existing laws, significantly reshapes the derivatives markets, and creates new federal agencies, while eliminating others. Undoubtedly, Dodd-Frank will have significant regulatory and legal consequences for banks, other financial institutions, and the economy at large for many years to come.

Of particular note is section 619 of Dodd-Frank, popularly known as the Volcker Rule, which restricts certain risky activities, including proprietary trading and fund investment, by banking entities and systemically important firms. Hailed by President Obama as a "simple and common sense reform" in the face of "an army of industry lobbyists from Wall Street," the Volcker Rule had the potential to seriously undermine profits at many of America's largest and most profitable financial institutions.

Yet the hard-fought Volcker Rule battle did not end with Dodd-Frank's passage.

One of the most persistent criticisms of Dodd-Frank, and of the Volcker Rule particularly, is its many gaps and ambiguities, which leave a host of meaningful issues to subsequent interpretation and implementation by federal agencies. Many worry that, largely freed from public scrutiny, special interests can capture the Dodd-Frank rulemaking process, generating favorable interpretations of the statute's numerous incomplete and contested provisions. Others, in contrast, point to impediments to special interest capture at the agency level, including the policy preferences of regulators, judicial review, and procedural checks designed to enhance transparency and accountability.

This debate raises the question: What happened to major Dodd-Frank provisions once lawmaking power shifted from Congress to federal agencies? More specifically, are industry groups attempting to influence outcomes? Is there a meaningful counterbalance to influential industry voices? What is the public salience of the reform? Are relevant public interest groups engaged in the issue?

This article employs the Volcker Rule to examine agency-level activity during the pre-proposal rulemaking phase—a time period about which little is known, despite its importance to policy outcomes. By capitalizing on transparency efforts specific to Dodd-Frank, I am able to access information on agency contacts whose disclosure is not required by the Administrative Procedure Act (APA) and, therefore, not typically available to researchers.

I analyze the roughly 8000 public comment letters received by the Financial Stability Oversight Council (FSOC) in advance of its study regarding Volcker Rule implementation and the meeting logs of the Treasury Department, Federal Reserve, Commodity Futures Trading Commission (CFTC), Securities and Exchange Commission (SEC), and Federal Deposit Insurance Corporation (FDIC) prior to the Notice of Proposed Rulemaking (NPRM). This analysis reveals significant public activity but also a stark difference in investment by financial institutions versus other actors in influencing Volcker Rule implementation. It also reveals a greater unity of interest among financial market participants than would be suggested by press reports and the provision's legislative history. Finally, the data shed light on the efficacy of the notice and comment process as a means for federal agencies to engage the general public and solicit relevant information in advance of rulemaking. In ongoing work, I extend this research to the period between the NPRM, on October 11, 2011, and the present.

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The Volcker Rule

Subject to important exceptions, the Volcker Rule prohibits "banking entities" (a defined term) from engaging in proprietary trading and from acquiring or retaining any equity, partnership, or other ownership interest in or sponsoring a hedge fund or a private equity fund. Both parts of the rule—the ban on proprietary trading and the restrictions on fund investment and sponsorship—are subject to substantial ambiguities that require agency definition and rulemaking.

For example, which activities will constitute proprietary trading under the rule is unclear, and more ambiguity is added by the nine exceptions to the ban on proprietary trading explicitly contained in the statute. Of particular importance are the exceptions for transactions in connection with underwriting or market-making activities, risk-mitigating hedging activities, and transactions on behalf of customers. Each of these is a potentially vast exception, with the potential to permit much trading activity previously undertaken under the rubric of proprietary trading. Resolving these uncertainties and implementing workable and enforceable definitions of permitted and prohibited activity falls to the federal agencies charged with Volcker Rule implementation.

FSOC Comment Letters

Dodd-Frank required FSOC to study and make recommendations to the OCC, FDIC, Federal Reserve, SEC, and CFTC—the federal agencies charged with Volcker Rule implementation—within six months of the statute's enactment. In furtherance of that goal, and as required by the statute, the newly formed FSOC's first action was a request for public input on Volcker Rule implementation, on October 1, 2010, which remained open for thirty days. This paper analyzes the roughly 8000 comment letters received by FSOC during that thirty-day period.

To put this number into context, studies repeatedly show limited comment activity in connection with most rulemakings, with the exception of a relatively small number of high-salience issues that generate thousands (in a few cases, hundreds of thousands) of comments.[1] Far more typical, however, are dockets that receive a handful of comments. By this standard, the Volcker Rule is a relatively high-salience issue, particularly for a technical piece of financial reform legislation not yet at the rule proposal stage.

FSOC concluded that, of these 8000 comment letters, roughly 6550 "were substantially the same letter arguing for strong implementation of the Volcker Rule." FSOC gave no further information about these letters and did not make them publicly available. But an analysis of the remaining comment letters (confirmed by conversations with public interest group (PIG) representatives) reveals that the 6550 identical letters are the result of an action campaign by a PIG consortium—Citizens for Financial Reform, Public Citizen, and US PIRG.

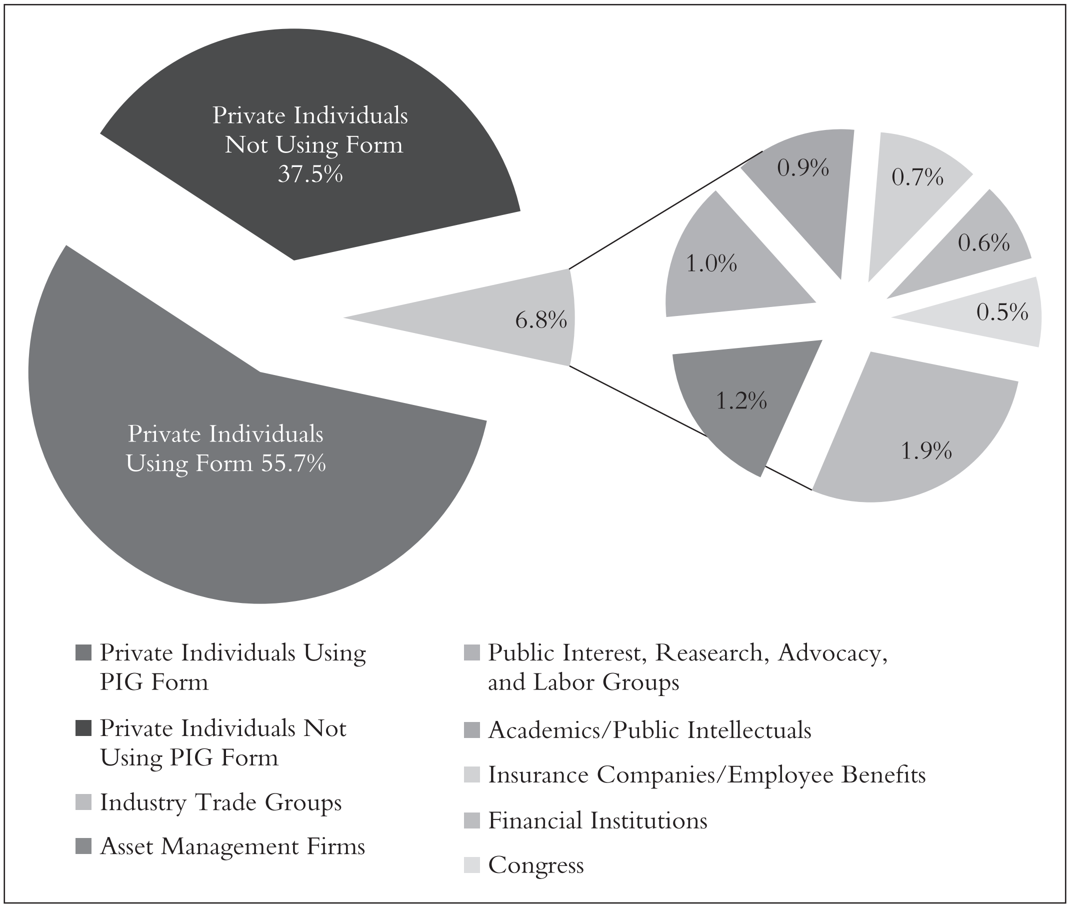
With the help of three research assistants, I analyzed and hand coded the remaining, roughly 1450, comment letters. FSOC concluded that these "remaining 1450 comments each set forth individual perspectives from financial services market participants, Congress, and the public." However, this is not the case.

Figure *A* provides summary statistics on these comments, and Figure 1 displays this same information graphically. First, the exclusion of duplicate comment postings left a total of 1374 comments. Of these, as detailed in Figure *A*, 1281, or 93 percent, were submitted by private individuals. The remaining comments were submitted by financial industry members, trade groups, public interest groups, think tanks, academics, and congressional members. At first blush, these numbers seem to confirm an extraordinary public interest in the Volcker Rule—the raw number of comment letters

Figure A: Number of Comments By Submitter

Private Individuals	1281	93.2%
Private Individuals Using Public Citizen Form	766	55.7%
Private Individuals Not Using Public Citizen Form	515	37.5%
Industry Trade Groups	26	1.9%
Asset Management	16	1.2%
Public Interest, Research, Advocacy, and Labor Groups	14	1.0%
Academics/Public Intellectuals	12	0.9%
Insurance Companies/Employee Benefits	10	0.7%
Financial Institutions	8	0.6%
Congress	7	0.5%
Total	**1374**	**100.0%**

Figure 1: Number of Comments by Submitter



from private individuals dwarfs the number submitted by all other categories of actors combined, including industry actors.

Yet a breakdown of the 1281 letters submitted by private individuals reveals several interesting patterns. Contrary to setting forth an individual perspective, over half (nearly 56 percent) of these comments from private individuals use the same form letter, with some slight variations, as the other 6550 identical letters received by FSOC. These letters often add a sentence or two outlining a personal hardship arising from the financial crisis or use only a portion of the form (typically, the demands), thus escaping whatever recognition software or rough exclusion methods FSOC employed. Yet, they are the same—*nearly* identical—substantive letter. Thus, of the 8000 letters received by FSOC on the Volcker Rule, 7,316 (or 91 percent) are a form letter. This is roughly consistent with prior findings on individual citizen comment activity.[2]

In addition to asking the question "what type of individuals and entities sent in comment letters and in what numbers?" it is also revealing to know something about the quality of those letters. Although length alone is not a perfect measure of the sophistication or substantive content of a comment letter, it nonetheless provides some insight into letter quality and is thus a common proxy employed by researchers. Especially with a rule as complex and lengthy as the Volcker rule (the proposed rule numbered 127 pages in the Federal Register and contained 383 questions), it is unlikely that comments of less than 50 words provide specific substantive guidance to the federal agencies charged with Volcker Rule implementation.

Figure *B* breaks down the comments by group and word count. Figure 2 displays this information graphically, showing the distribution of word count by private individual not using the PIG form (in dot), private individuals using the form (in line), and all others (in dash).

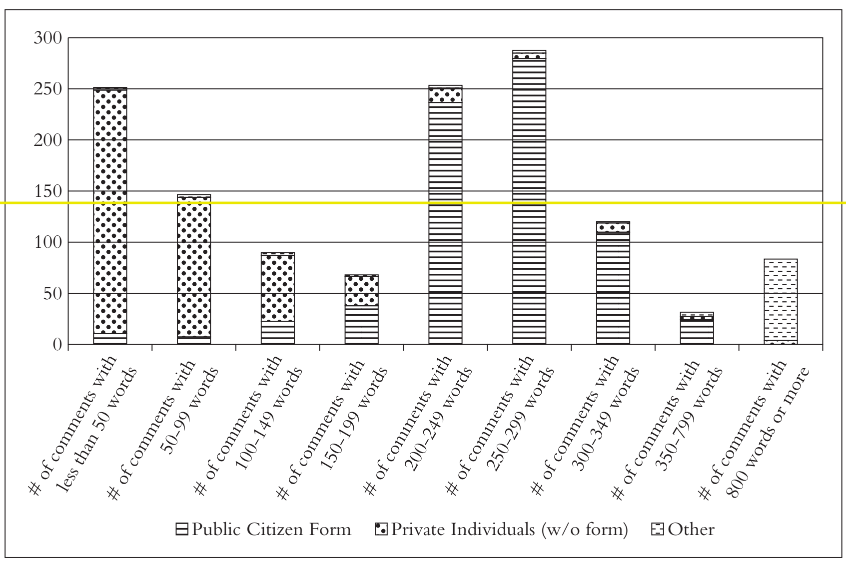
Figure B: Word Count Statistics

	Average Comment Length (Words Per Comment)	Total Words
Longest Comment		19,500
Shortest Comment		1
All private individuals	187	239,547
Private Individuals Not Using PIG Form	86	44,290
Academics/Public Intellectuals	1522	18,264
Asset Management	2055	32,880
Congress	2651	18,557
Insurance Companies/ Employee Benefits	2761	27,610
Public Interest, Research, Advocacy, and Labor Groups	3465	48,508
Financial Institutions	3852	30,816
Industry Trade Groups	4027	104,702
All	379	520,884

There are three spikes in the data, at less than 50 words, at 200–249 words, and at 250–299 words (note the larger sizes of the two bins at far right, representing comments with 350–799 words and those with 800 words or more). The spikes at 200–249 words and 250–299 words represent the PIG form letter and its slight variations, discussed above (in its original form the letter is 244 words.) The spike at comments of less than 50 words represents only letters from private individuals.

The shortest comment—only a single word, "regulate"—was submitted by a private individual. The longest comment, received from SIFMA (the Securities Industry and Financial Markets Association) measures 19,500 words. The industry and trade group comments are, as a general rule, lengthy and contain cogent arguments in support of a generally narrow interpretation of the Volcker Rule's scope of prohibited activity; advance detailed legal arguments relying on numerous statutes and cases; reference the Dodd-Frank legislative history; and often contain thorough empirical data. They are meticulously argued and carefully drafted. This does not mean, however, that industry and trade group letters necessarily contain unique information and arguments. In fact,

Figure 2: Word Counts By Submitter



Robert, since we produce black & white proofs, we have made the color into patterns. Please confirm if this holds good.

consistent with prior research, a close substantive read of these comments suggests that, within each industry subgroup, the arguments and evidence are quite similar.[3]

In contrast, comments from the general public tend to be short—the average word count, excluding the PIG form letters, is only 86, and roughly half of the comments, again excluding those using the PIG form letter, are less than 50 words. Elsewhere, I analyze the content of these unique individual letters at some length.[4] In brief, however, these public comments, by and large, lack specific suggestions or recommendations for interpreting and implementing the Volcker Rule; generally urge that the rule be "enforced" or "adopted"; contain many grammatical, punctuation, and typographical errors; and express extreme anger at the banks and, often, at the political system as well. People are angry about the economy, about the plight of working people, and about the politicians they hold responsible for these outcomes. Importantly, however, the citizen letters provide no substantive guidance to FSOC on how to interpret and enforce the Volcker Rule's complex and ambiguous provisions. Indeed, the letters provide little evidence that commenters even understand, or care, what proprietary trading or fund investment is, much less the ways in which the Volcker Rule might govern such activities. The contrast with the meticulously drafted, argued, and researched—though far less numerous—letters from financial industry members and trade groups is stark.

Pre-NPRM Agency Contacts

As part of the new transparency efforts associated with Dodd-Frank implementation, the Treasury Department, Federal Reserve, CFTC, SEC, and FDIC began disclosing their contacts regarding Dodd-Frank shortly after the bill was signed into law in July 2010. These logs give some insight into the work of Dodd-Frank statutory interpretation and implementation that goes on behind closed doors and provide valuable new information to researchers interested in agency activity during the pre-proposal phase, as the APA typically requires the publication of such contacts only after the NPRM. In the case of the Volcker Rule, an NPRM was not published until October 11, 2011.

Figure *C* shows the federal agency meetings in which the Volcker Rule was discussed. These meetings occurred between July 21, 2010, the date of presidential signing, and October 11, 2011, the date of the NRPM. JPMorgan Chase, Goldman Sachs, and Morgan Stanley met with federal agencies most frequently on the Volcker Rule, with 27, 22, and 19 meetings, respectively. These three organizations together comprise nearly 20 percent of financial institution meetings with federal agencies on the Volcker Rule. In total, there were 351 financial institution meetings with federal regulators regarding the Volcker Rule during this time period, which account for 78 percent of all such meetings during the relevant time period, as shown by column 1 of Figure *C* and Figure 3**.**

Column 2 shows federal agency meetings with law firms in which the Volcker Rule was discussed. Each of these law firms represents financial institutions or financial industry trade groups, and representatives of those institutions or trade groups were typically also in attendance at each meeting. In total, these law firms met with the relevant federal agencies 35 times during the time period under study. Sullivan & Cromwell, Davis Polk, and Debevoise met most frequently with federal regulators, with 11, nine, and eight meetings each.

Column 3 shows federal agency meetings with financial industry trade associations, lobbyists, and policy advisors to discuss the Volcker Rule—a total of 33 meetings. SIFMA and the Financial Services Roundtable met most frequently with federal agencies—eight and five times, respectively.

Column 4 shows federal agency meetings with public-interest, labor, research, and advocacy groups to discuss the Volcker Rule—a total of 19 meetings, nearly 40 percent of which are with labor union representatives. Finally, column 5 shows a total of 12 meetings by other persons and organizations, namely, Senators Merkley and Levin and their staffs and Paul Volcker and his staff.

In sum, whereas financial industry representatives met with federal agencies on the Volcker Rule a total of 351 times, meetings with entities or groups that might reasonably be expected to act as a counterweight to industry representatives in terms of the information provided and the types of interpretations pressed (those listed in columns 4 and 5) numbered only 31. This is nearly the same number of times that a single financial institution—JPMorgan Chase—met with federal

Figure C: Federal Agency Meetings to Discuss the Volcker Rule: July 26, 2010 to October 11, 2011

Financial Institutions		Law Firms		Financial Industry Trade Associations, Lobbyists, or Policy Advisors		Public Interest, Research, Advocacy, and Labor Groups		Other Persons and Organizations	
J.P. Morgan Chase	27	Sullivan & Cromwell	11	SIFMA	8	Americans for Financial Reform	5	Senator Carl Levin and/or Staff	5
Goldman Sachs	22	Davis Polk	9	Financial Services Roundtable	5	AFL-CIO	3	Senator Jeff Merkley and/or Staff	5
Morgan Stanley	19	Debevoise & Plimpton	8	American Council of Life Insurers	3	AFSCME	2	Paul Volcker and/or Staff	2
Bank of America	15	WilmerHale	2	ABA Securities Association	2	Demos	2		
Barclays	14	Barnett, Sivon & Natter	1	Alternative Investment Management Association	2	Public Citizen	2		
Other Financial Institutions	254	Other Law Firms	4	Other	13	Other	5		
Total **%**	**351** **78**		**35** **7.8**		**33** **7.3**		**19** **4.2**		**12** **2.7**

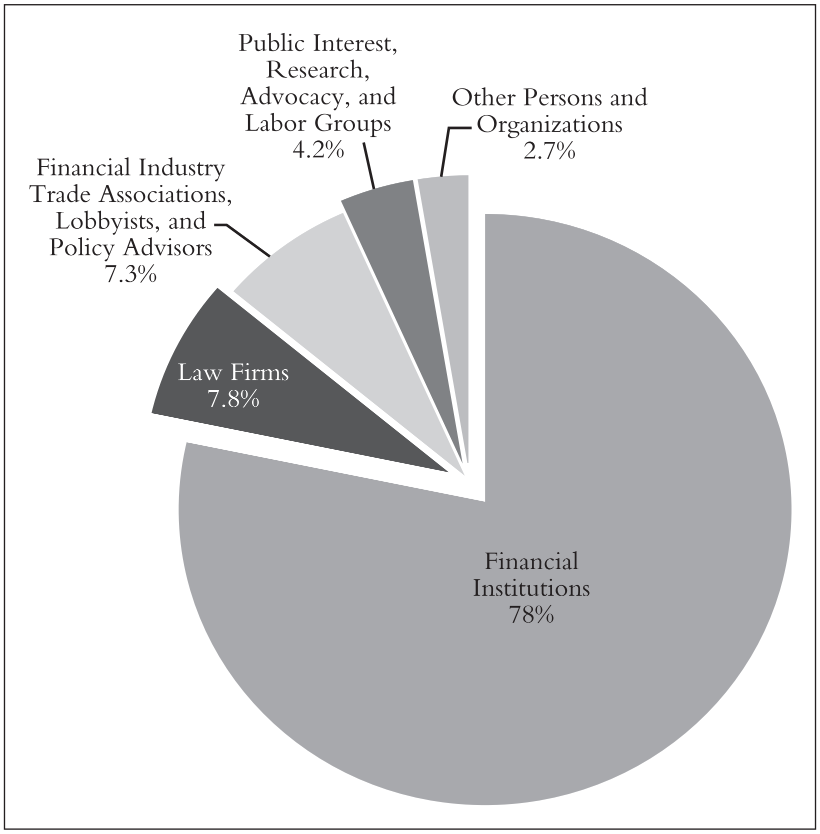
agencies on Volcker Rule interpretation and implementation. As shown by Figure *C* and Figure 3, financial institutions, financial industry trade groups, and law firms representing such institutions and trade groups collectively accounted for 93.1 percent of all federal agency Volcker Rule meetings, whereas public interest, labor, research, and advocacy groups and other persons and organizations accounted for only 6.9 percent.

By classifying a broad array of organizations under the single rubric of "financial institution" I do not mean to suggest that these very different types of financial industry members raised identical concerns at every meeting. To the contrary, the exact subject matter of the meetings appeared to differ, as one would expect, according to the particular regulatory concern faced by each group. The important point for these purposes, however, is that nearly all of the industry representatives that met with federal agencies on the Volcker Rule were seeking clarifications on the rule's application to their activities—most often, a clarification that the Volcker Rule would not prohibit the activities in question. This latter observation is an important point, as dissension among important industry actors ensures that agencies will receive competing views and information on the Volcker Rule, even in the absence of effective participation by public interest groups and other potential watchdogs. Such dissension appears absent on the Volcker rule, however, at least during this early stage of administrative activity.

Finally, not all agency meetings are created equal. Many of the meetings in Figure *C* are group meetings, often part of an industry trade association meeting. For example, 27 separate financial institution representatives were listed in attendance at an April 7, 2011, SIFMA-SEC meeting with Chairman Shapiro.

Perhaps more tellingly, nearly all of the column 4 contacts are group meetings of this type. For example, representatives of AFL-CIO, Laborer's International Union of America, AFSCME, and SEIU are logged for an October 13, 2010, SEC meeting with Kayla J. Gillan and Jim Burns. These are four of the five meetings by public interest, labor, and advocacy groups with the SEC (Americans for Financial Reform met separately with

Figure 3: Federal Agency Meetings to Discuss the Volcker Rule: July 26, 2010–Oct. 11, 2011



the SEC on April 13, 2011). And all of the CFTC meetings with public interest, labor, and advocacy groups on the Volcker Rule took place together, on March 16, 2011.

In addition, the identity (or number) of agency representatives at certain meetings may signal something about the importance of the event. For example, the log for an August 3, 2010, CFTC meeting with SIFMA and ISDA at which the Volcker Rule was discussed (along with other Dodd-Frank provisions) lists 53 SEC and CFTC staff members in attendance. But Goldman Sachs' CEO, Lloyd Blankfein, is logged as meeting alone with SEC Chairman Mary Shapiro, Chief of Staff Didem Nisanci, and Robert Cook, Director of Trading & Markets, on March 9, 2011. Mr. Blankfein met with Ms. Shapiro again on October 8, 2010, at an SEC-Financial Services Roundtable meeting, at which Jamie Dimon of JPMorgan, Robert H. Benmosche (President and CEO of AIG), Richard K. Davis (President and CEO of U.S. Bancorp), and other major financial institution CEOs are logged as being in attendance.

Conclusion

Statutes will inevitably have some gaps and ambiguities, which courts or agencies must fill. Moreover, there are many salutary reasons why lawmakers may choose to delegate such discretionary authority to other governmental branches. For example, statutory incompleteness may allow lawmakers to harness the expertise of courts and agencies, provide the flexibility to adapt the statute to changing circumstances, or reduce the transaction costs associated with lawmaking. Proprietary trading and fund investment are technical questions of financial regulation about which federal agencies have substantial expertise and experience. Understandably, Congress relied on that experience and expertise for much of the definitional work of the Volcker Rule.

The Volcker Rule, however, is not by any means the type of low-salience rule that characterizes the bulk of daily administrative work. Instead, the political conditions surrounding Dodd-Frank's passage suggest unusual populist pressure to address the perceived power and problems posed by large financial institutions, which the public blamed for the financial crisis, the bailouts that followed it, and the continuing economic woes of the average working American. This populist pressure was met with intense lobbying by affected financial institutions in an effort to, if not stave off regulation entirely, at least minimize the damage that financial reform would cause. As evidenced by the data, that populist pressure and industry interest continued into the rulemaking phase.

Against this economic and political background, Dodd-Frank arose, purportedly to stop "too big to fail" and to "protect the American taxpayer by ending bailouts."[5] But the Volcker Rule—largely an afterthought by the Obama administration, which considered the rule unworkable and unnecessary—was an essential concession to gain political support from Dodd-Frank critics who argued that the law did too little to restrict risky banks. As a result, the Volcker Rule—like many other Dodd-Frank provisions—entered the rulemaking process both highly incomplete and highly contested, thus ensuring the importance of the rulemaking process and of interest-group attempts to influence that process.

Thanks to the Obama administration's new transparency efforts under Dodd-Frank, scholars are able to view that agency-level activity from the moment after presidential signing—well before the NPRM phase that triggers most of the Administrative Procedure Act's docketing and transparency requirements. This information, seldom available to researchers up to this point, confirms what, with the exception of a handful of studies, has been largely an intuition: The pre-proposal phase is a battleground for agenda-setting, and that battleground is dominated by regulated industry.

Countervailing voices, however, were not entirely absent on the Volcker Rule. Angry citizens sent in letters by the thousands, potentially shading FSOC's view of the public salience of the Volcker Rule and of the relative power of relevant PIGs. But the comment letter findings are consistent with much prior research on public comment letters—they are short, angry, duplicative, and provide little, if any, useful substantive information. It is precisely this type of data that has prompted some researchers to question the efficiency and utility of informal notice and comment as a means of generating public input.

Other countervailing voices include PIGs, academics, and three individuals involved in crafting the original legislation—Senators Merkley and Levin and Paul Volcker. This latter group, as suggested by prior research, may hold particular influence, given the congressional role in legislative drafting and its ability to modify or amend statutes through subsequent legislative action.

Finally, there is a notable lack of countervailing voices within the financial industry itself. For example, Senators Merkley and Levin (the Volcker Rule's sponsors), among others, promoted the Volcker Rule as a means to reduce conflicts of interest between banking entities and their customers caused by proprietary trading operations.[6] One might, therefore, predict that large institutional investors would be highly involved in Volcker rulemaking, to ensure that this purported benefit of the legislation is not undercut. Large institutional investors, however, are notably absent from Volcker Rule administrative activity. Whether this is because the legislation's ability to reduce such conflicts was overstated, or because, for whatever reason, banking entity customers have found it unnecessary to join in Volcker Rule administrative activity during the pre-proposal phase is unclear, though ongoing research on later rulemaking stages should shed light on this question.

Notes

1. Cary Coglianese, "Citizen Participation in Rulemaking: Past, Present, and Future," 55 Duke L.J. 943 (2006) (summarizing empirical studies of rulemaking activity).
2. *See, e.g.*, Mariano-Florentino Cuéllar, "Rethinking Regulatory Democracy," 57 Admin. L. Rev. 411, 449 (2005).
3. Stuart Minor Benjamin & Arti K. Rai, "Fixing Innovation Policy: A Structural Perspective," 77 Geo. Wash. L. Rev. 1, 74 (2008).
4. Kimberly D. Krawiec, "Don't 'Screw Joe The Plummer': The Sausage-Making Of Financial Reform," 55 Az. L. Rev. 53 (2013).
5. P.L. 111-203, Preamble, p. 1 (July 21, 2010).
6. *See, e.g.*, Senator Jeff Merkley & Senator Carl Levin, "The Dodd–Frank Act Restrictions on Proprietary Trading and Conflicts of Interest: New Tools to Address Evolving Threats," 48 Harv. J. On Legis. 515, 549 (2011).