



Business as Usual

99.9 Percent of Banks Would Be Unaffected by Volcker Rule

Acknowledgments

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I. Introduction: The Ride of the Volcker Rule Can Banks Live with It?

There are 7,181 federally insured banks in the United States.¹ After a new rule is implemented to prohibit banks from making risky trades, the business activities of 7,175 of these banks will remain essentially unchanged.

The Volcker Rule, among the most controversial aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act, will prohibit federally insured banks from engaging in proprietary trading, which involves speculation through short-term trades in stocks, derivatives and other securities.²

The financial crash, borne of reckless banking practices, cost the economy about \$12 trillion, give or take.³ But Wall Street lobbyists have succeeded in elevating concerns over the relatively minuscule costs of the Volcker Rule to a paramount position in the debate over how regulations should be crafted to implement it. In reality, the Volcker Rule will mean no change, no closure of business divisions, no costs from foregone financial activity, for more than 99.9 percent of banks.

What follows is an examination of how American banks will adapt to the Volcker Rule. We review three banks—one small, one medium-sized, and one giant—as case studies. This report examines the details of these banks' revenue and earnings, how the Volcker rule might alter them, and how the managers of some of the banks evaluate the effect that the rule will have on them.

The nation's banking regulators are entering the last stages of finalizing the Volcker Rule this month, long after the July 21, 2012, deadline for completion imposed by Congress in Dodd-Frank. In all, 21 individuals nominated by the president and confirmed by the U.S. Senate (serving at the Federal Reserve, Federal Deposit Insurance Corp., Office of the Comptroller of the Currency, Commodity Futures Trading Commission, or Securities and Exchange Commission) must agree to the precise language of this rule. While the regulators undoubtedly understand the impact of the financial crisis, they will inevitably consider the effects on the industry they regulate. These regulators have conducted 4,000 meetings with

¹ FDIC, *Statistics at a Glance* (Sept.) 12, 2012), available at: <http://www.fdic.gov/bank/statistical/stats/2012sep/industry.pdf> These institutions include commercial banks as well as federally insured savings and loan institutions. It does not include the 6,888 federally insured credit unions; none of these institutions engage in Volcker Rule-prohibited activity.

² The Volcker Rule is the informal name for Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Federal officials at present are finalizing the rules, or regulations, to implement Section 619.

³ See, e.g., *Cost of the Crisis*, BETTER MARKETS (Fall 2012), available at: <http://www.bettermarkets.com/cost-crisis#.UMYFZdSUr14>

outsiders, the overwhelming majority of which have been Wall Street representatives.⁴ But these regulators must understand that the banking industry will thrive with a robust Volcker Rule.

II. The Rise of Casino Banking

The lure of astronomical profits from proprietary trading prompted a select group of large banks to deviate from sensible risk management practices. This sober account from the Group of 30, a non-profit international group consisting of private sector and academic leaders on financial issues,⁵ recalls how the industry succumbed to a gambling ethos:

Recent experience in the United States and elsewhere has demonstrated instances in which unanticipated and unsustainably large losses in proprietary trading, heavy exposure to structured credit products and credit default swaps, and sponsorship of hedge funds have placed at risk the viability of the entire enterprise ... These activities, and the “originate-to-distribute” model, which facilitated selling and reselling highly engineered packages of consolidated loans, are for the most part of relatively recent origin. In essence, these activities all step away from the general concept of relationship banking, resting on individual customer service, toward a more impersonal capital markets transaction-oriented financial system. What is at issue is the extent to which these approaches can sensibly be combined in a single institution, and particularly in those highly protected banking institutions at the core of the financial system.⁶

Concerns over the activities outlined above prompted Congress to institute the Volcker Rule—informally named after Group of 30 member and former Federal Reserve Chairman Paul Volcker—to prohibit federally insured banks from engaging in proprietary trading or owning hedge funds of more than *de minimis* size. Opponents and proponents alike commonly observe that this provision promises the greatest change in American banking since the enactment in 1933 of the Glass-Steagall Act, which separated of commercial and investment banking.

In principle, the Volcker Rule aims to protect banking’s core function of aggregating savings so that savings can be deployed in loans to consumers, homebuyers, and businesses. Federal deposit insurance protects the savers, which encourages them to accept lower returns (in this case, in the form of interest rates) than they would expect for higher-risk investments. Banks, in turn, are expected to pass on savings from their reduced cost of

⁴ Davis-Polk, *Dodd-Frank Progress Report* (November 2012), available at: http://www.davispolk.com/files/Publication/9a990de9-911b-4e6b-b183-08b071d8b008/Presentation/PublicationAttachment/8363256a-524d-4d65-8ebe-096127dab2a3/Nov2012_Dodd.Frank.Progress.Report.pdf.

⁵ See Group of 30 Web site, available at: <http://www.group30.org/about.shtml>.

⁶ *Financial Reform, a Framework for Financial Stability, Group of Thirty* (Jan. 15, 2009), available at: http://www.group30.org/images/PDF/Financial_Reform-A_Framework_for_Financial_Stability.pdf.

capital to their borrowers. The benefits that accrue from reduced costs of capital justify expectations that the banks abstain from high-risk activities.

The Independent Community Bankers of America (ICBA), consisting of more than 5,000 member banks,⁷ articulated this view in a comment letter it submitted to federal regulators on the proposed regulations to implement the Volcker Rule: “Banks are accorded access to federal deposit insurance and liquidity facilities because they serve a public purpose: facilitating economic growth by intermediating between savers and borrowers, *i.e.*, taking deposits and making loans, and by maintaining liquidity in the economy throughout the economic cycle. These activities constitute the fundamental business of banking.”⁸

By its nature, a proprietary trade is a bet—a gamble. For every winner, there is a loser. A bank’s gain from a proprietary trade results in a corresponding loss for the counterparty. No factories are financed, homes mortgaged, or cars purchased as a result of gambles won or lost by banks engaged in proprietary trading.

Gambling can generate profits for institutions. Last decade, traders and bank managers pocketed mind-boggling sums in exchange for presiding over successful betting strategies. But when the traders’ bets turned sour, wiping out the earlier gains and forcing their institutions to accept massive taxpayer-financed bailouts, the bankers retained the fortunes they had reaped in the previous years. Protecting the ability of bank executives and traders to command such bounties is a key reason that certain Wall Street leaders have intensely contested the Volcker Rule. The debate over the Volcker Rule has arguably been the subject of more lobbying expenditures, regulatory meetings, congressional meetings, formally commissioned studies, and media coverage than any other regulation called for in Dodd-Frank.

Public Citizen documented the scope of industry’s obsession of the Volcker Rule earlier this year.⁹ Wall Street interests contributed \$67 million to the campaigns of members of Congress who asked regulators to weaken the proposed regulations to implement the Volcker Rule. By contrast, members of Congress who pressed for a stronger regulations received a collective \$1.9 million from Wall Street donors. However, a crucial fact is: More than 99.9 percent of banks’ circumstances won’t change because of the Volcker Rule. This rule is important to prevent a fraction of 1 percent of banks from putting our financial system—and, ultimately, our economy—at risk.

⁷ ICBA Web site, *About Us*, available at: <http://www.icba.org/aboutICBA/index.cfm?ItemNumber=527>.

⁸ ICBA comment letter on the Volcker Rule (Feb. 13, 2012), available at: http://www.federalreserve.gov/SECRS/2012/March/20120305/R-1432/R-1432_021312_104966_451638070183_1.pdf.

⁹ NEGAH MOUZOON AND BARTLETT NAYLOR, PUBLIC CITIZEN, *Industry’s Messengers* (March 2012), available at: <http://www.citizen.org/documents/industrys-messengers-volcker-rule-report.pdf>.

There are 7,181 banks in the United States. Of these, six account for 88 percent of all proprietary trading affected by the Volcker Rule.¹⁰ Four banks account for 93 percent of total derivatives holdings, a major venue in proprietary trading.¹¹ “Proprietary trading in any real volume is confined to a very few large, sophisticated U.S. banks,” Volcker wrote in a letter to federal regulators.¹² The nation’s 6,888 credit unions are legally barred from using derivatives.¹³ In other words, of the 14,069 institutions that the average consumer would consider a “bank,” the Volcker Rule means business as usual for 14,063 of them.

It should be noted that banks do maintain investment accounts consisting of easily sellable securities, and will be able to continue doing so after the Volcker Rule takes effect. “Trading accounts,” which may include U.S. Treasuries, corporate stocks and other securities, help banks meet unexpected cash demands, such as an unusual surge in withdrawals. Managers of trading accounts typical invest in conservative securities and retain their investments for a longer time than do proprietary traders. Under the Volcker Rule, trading accounts may not be a playground for short-term speculation.

III. Three Case Studies: Safe at any Size

The banking industry is composed of firms of various sizes, ranging from banks with only a single store front, to mid-sized regional firms, to a handful of mega-banks. How will the Volcker Rule apply, based on bank size? Examined here are three case studies: A smaller bank, Generations Bank of Seneca Falls, N.Y.; a mid-size bank, M&T Bancorp, of Buffalo, N.Y.; and a mega-bank, Wells Fargo Bancorp, headquartered in San Francisco.

It’s a Wonderful Life: Generations Bank

In the heartland of America, largely served by community bankers, the type of activity targeted by the Volcker Rule is unknown.

One of the 7,181 American banks that will not be unaffected by the Volcker Rule is Generations Bank, of Seneca Falls, N.Y.

¹⁰ GOVERNMENT ACCOUNTABILITY OFFICE, *Proprietary Trading* (July 2011), available at: <http://www.gao.gov/assets/330/321006.pdf>.

¹¹ U.S. Comptroller of the Currency, *OCC’s Quarterly Report on Bank Trading and Derivatives Activities Second Quarter 2012*, available at: <http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq212.pdf>.

¹² Paul Volcker, letter to regulators (Feb. 13, 2012), available at: <http://www.sec.gov/comments/s7-41-11/s74111-182.pdf>.

¹³ GOVERNMENT ACCOUNTABILITY OFFICE, *Proprietary Trading*, at 64 (July 2011), available at: <http://www.gao.gov/assets/330/321006.pdf>. The credit union industry is lobbying to remove restrictions on derivative use. For example, here is a letter from the Credit Union National Association from April 3, 2012: <http://www.ncua.gov/Legal/CommentLetters/CL20120403DunnDerivatives.pdf>.

“It’s a Wonderful Life,” Frank Capra’s iconic Hollywood film about the travails of a small town banker, is set in mythical “Bedford Falls.” Seneca Falls claims to be Frank Capra’s inspiration. This real “Bedford Falls” features a museum dedicated to the film, and an annual “It’s a Wonderful Life” festival. The Clarence Hotel was named in honor of the angel Clarence who talks banker George Bailey off the bridge of despair by reviewing the virtues of traditional banking. This year, the actress who played the daughter of the beleaguered banker joined the December festival.¹⁴

Generations Bank, headquartered in Seneca Falls, founded in 1870, fits the description of George Bailey’s bank to a tee: Folks in the community deposit their savings (\$193 million) in one of the bank’s nine branches, and then the bank loans out this money in mortgages to home buyers, in loans to car buyers, and credit to small business (\$190 million).¹⁵

The bank has reported rising net income: \$476,000 in 2009, \$1.1 million in 2010, and \$1.3 million in 2011. Through nine months of 2012, the bank reported \$1.2 million in income.¹⁶

Generations Bank has transformed, at least in name, over the 14 decades since its founding in 1870 as Seneca Falls Savings Bank.¹⁷ Before the financial crash of 2008, the institution was called Seneca-Cayuga Bancorp. With the acquisition of other banks, the firm adopted Generations Bank as its umbrella name. CEO Menzo Case is the bank’s largest single shareholder.¹⁸

The Volcker Rule will result in no substantial change of operations for Generations Bank. none of the bank’s 85 employees are derivatives traders. None engage in market making or risky gambles. Generations Bank does hold some securities, in addition to its loans. In 2009, for example, the bank held \$1.7 million worth of securities, and earned a total of \$1,000 from trades involving them.¹⁹ Because of the minimal nature of its trading, Generations will not be subject to reporting requirements of the Volcker rule will require of larger banks.

¹⁴ Web site for Seneca Falls town festival. Available at: <http://www.therealbedfordfalls.com/>.

¹⁵ Generations Bank, Third quarter report, 2012. Available at: https://www.mygenbank.com/files/financial_filings/quarterly_reports/2012_3.pdf.

¹⁶ *Id.*

¹⁷ Generations Bank, Annual Report, 2009, available at: https://www.mygenbank.com/files/financial_filings/annual_reports/2009_annual_report.pdf.

¹⁸ Generations Bank, Annual Report, 2010, available at: https://www.mygenbank.com/files/financial_filings/annual_reports/2010_annual_report.pdf.

¹⁹ This was the last year the company reported its trading activity; it deregistered as a public company after that.

What Is the Ideal Size for a Bank?

How do banks perform based on size? While iconic, community banks lack the economies of scale enjoyed by larger banks. But the largest banks, others contend, may be unwieldy or difficult to manage. Is there a sweet spot in size? The field of industrial organization applies sophisticated metrics to examine the issue of the ideal size of a bank. This field of study figures into current issues about ideal bank size, evidenced by a December 4, 2012, speech by Federal Reserve Gov. Daniel Tarullo.²⁰

The simplest measure of efficiency is the ratio of expenses to revenue. How much does each dollar of revenue cost a bank to generate? A bank that generates \$1 in revenue with 45 cents in expenses is more efficient than the bank that generates \$2 in revenue with \$1 in expense. The former can generate a greater profit for its shareholders. The more efficient bank may be better for consumers, as it is better positioned to provide greater customer value in competition with its less efficient competitor.

As it happens, small banks dominate the list of “most efficient” banks. While rankings change with each quarterly report, *American Banker* routinely shows that banks with less than \$5 billion in assets command the lion’s share of “top 200” most efficient banks. In its most recent report, *American Banker* found that the top 10 most efficient banks all managed assets of less than \$3.3 billion, and most managed less than \$2 billion. U.S. Bancorp made this “top 200” list with an efficiency rating of 52 percent, placing it 89th on the list. U.S. Bancorp lists assets of \$340 billion. Two other banks with more than \$100 billion also made this efficiency list: BB&T Corp., with \$174 billion, ranked 173rd; and Fifth Third Bancorp, with \$116 billion, ranked 177th.

“No one can find such efficiency enhancements for banks with more than \$100 billion in total assets,” according to MIT economist Simon Johnson.²¹

²⁰ Speech by Gov. Daniel Tarullo at Brookings Institution, *Industry Structure and Systemic Risk Regulation* (Dec. 4, 2012), available at: <http://www.federalreserve.gov/newsevents/speech/tarullo20121204a.htm>.

²¹ Simon Johnson, *Why Are the Big Banks Suddenly Afraid*, THE NEW YORK TIMES (Aug. 30, 2012), available at: <http://economix.blogs.nytimes.com/2012/08/30/why-are-the-big-banks-suddenly-afraid/>. Identifying the sweet spot for efficiency and economies of scale has been compromised by vast changes in banking law. First, banks were allowed to branch across state lines only in the last three decades. Second, their powers were expanded, ultimately allowing the kinds of activity that the Volcker Rule will prohibit. Finally, major financial catastrophes cloud conclusions. Risky trading may have figured in the 2008 crash, but that led to problems at less culpable banks in the form of cascading housing prices and mortgage values.

“We have an [asset liability management] committee that reviews our position monthly, which includes consideration of whether we should purchase additional securities,” Case explained. “If securities are to be purchased, either myself or the CFO will make the purchase.”²² Generations devotes one employee to compliance.

“Our Company has a history of conservative risk management—we don’t ‘reach’ for yield by entering into areas that we do not understand or for which the risk is not understood,” Case wrote to shareholders.²³ “I have yet to find an NY community bank that is actively trading securities. It’s just not the way we operate,” he wrote in e-mail to Public Citizen.²⁴

Sweet Spot of Efficiency: M & T Bank

Will larger banks find their business undermined by the Volcker Rule? An examination of M&T Bank, the nation’s 31st largest with \$77 billion in assets,²⁵ shows that the Volcker Rule will cause no change to the bank’s operations. M&T Bank believes it will continue to thrive. Its efficiency ratio in the first quarter of 2011 ranked 83rd of the nation 6,900 bank holding companies on the *American Banker* list.²⁶

“Based on the proposed rules, M&T does not currently anticipate that the Volcker Rule will have a material effect on the operations of M&T and its subsidiaries,” the bank informed shareholders.²⁷

Founded in 1856 in western New York, the Buffalo-headquartered bank maintains 750 branches in eight states and the District of Columbia.

M&T employs 15,666 people, up from 13,869 in 2007 before the financial crash. M&T has grown by making acquisitions. Its largest acquisition, coincidentally, followed a proprietary trading fiasco at Allied Irish Bank’s Baltimore-based division.²⁸ Since the financial crash of 2008, M&T has purchased Provident Bank of Baltimore, the failed Bradford Bank (seized by

²² Menzo Case, CEO, Generations Bank, e-mail response to Public Citizen questions (Nov. 16, 2012). On file with author.

²³ Generations Bank, Annual Report, 2010, available at: https://www.mygenbank.com/files/financial_filings/annual_reports/2010_annual_report.pdf.

²⁴ Menzo Case, CEO, Generations Bank, e-mail response to Public Citizen questions (Nov. 16, 2012). On file with author.

²⁵ *Banks and Thrifts with the Most Assets*, AMERICAN BANKER (Second quarter 2012).

²⁶ *Most Efficient Banks*, AMERICAN BANKER (First quarter 2011).

²⁷ M&T Bank, Annual Report, 2011, available at: http://files.shareholder.com/downloads/MTB/2107851053x0x546897/5C592DA0-5A87-4F46-8AF6-8639E1B8963E/2011_Annual_Report.pdf.

²⁸ See Conor O’clery, PANIC AT THE BANK (2002).

the FDIC), Wilmington Trust, and Hudson City Bancorp. Berkshire Hathaway is its largest shareholder, owning 5.6 percent of its stock.²⁹

M&T has reported a profit in every quarter since 1970. Net income increased from \$380 million in 2009 to \$736 million in 2010, and \$859 million in 2011.³⁰

M&T reported \$27 million in trading account gains in 2011, in line with gains of \$17 million to \$30 million from 2007 to 2010.³¹ Its trading profits represented 3 percent of its net income in 2011.³²

M&T did report a “gain on bank investment securities” of \$150 million in 2011 that was not pursuant to its trading account. The bank explained that this stemmed from an agreement to boost its capital following its acquisition of Wilmington Trust. It booked the gain by selling slightly riskier securities, and then purchasing less risky securities. Capital, or the amount of investor funds in the bank, is measured against the relative risk of its assets. These assets include loans and securities. By holding less risky securities, its capital measure is considered stronger.³³

The fact that M&T derives only 0.6 percent of its total income from trading reflects a conscious decision by the bank’s leadership. CEO Robert Wilmers reported to shareholders: “Banks have traditionally played a clear, if limited, role in the economy: to gather savings and to finance industry and commerce. Trading and speculation were nowhere included—nor should they be.”³⁴

Of his larger peers that engage in proprietary trading, Wilmers expresses little sympathy. “The Wall Street banks continue to fight against regulation that would limit their capacity to trade for their own accounts—while enjoying the backing of deposit insurance—and thus seek to keep in place a system which puts taxpayers at high risk.”³⁵

Wells Fargo: Old School Banking

While the Volcker Rule essentially applies to only the largest banks with dedicated staff handling its trading account, mega-banks can remain large and profitable under the forthcoming restrictions on proprietary trading and hedge fund ownership. Wells Fargo proves this.

²⁹ M&T Bank, Annual Report, 2011, available at:

http://files.shareholder.com/downloads/MTB/2107851053x0x546897/5C592DA0-5A87-4F46-8AF6-8639E1B8963E/2011_Annual_Report.pdf.

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

Of the nation's 7,394 commercial banks, four institutions stand out in size: JP Morgan Chase, Bank of America, Citicorp, and Wells Fargo. Each of these banks holds roughly \$1 trillion in deposits, ranging from \$906 billion at Wells Fargo to \$1.1 trillion at JP Morgan.³⁶ Together, they account for nearly half of the nation's \$9 trillion in total deposits.³⁷ (The fifth largest depository is U.S. Bancorp, which holds \$233 billion in deposits, about a fifth of the next largest.³⁸) In the basic intermediation of savers and borrowers, these large four banks control about half of all deposits. How they deploy these dollars shapes the economy. Even a small diversion into proprietary trading of depositor savings is the equivalent to a wholesale decision by Generations, M&T, and hundreds of other like-sized banks to allocate all of their deposits to proprietary trading.

Government Report Says Proprietary Trading Is Not a Winner for Big Banks

Congress required the Government Accountability Office to study the role of proprietary trading at the largest banks. In July 2011, the GAO concluded that even at the six major banks, proprietary trading did not generate consistent profits. The researchers examined the 13 quarters from 2006 to 2010, before, during, and after the financial crash. While the firms collectively posted occasional winnings, they also suffered substantial losses. Proprietary trading resulted "in an overall loss from such activities over the 4.5 year period of about \$221 million," the government researchers concluded.³⁹

Citicorp and Bank of America received considerable taxpayer bailouts. Meanwhile, government leaders such as former FDIC chair Sheila Bair and even President Obama have called for the closure of one or both of these institutions.

Citigroup does not object to the Volcker Rule. For example, in Citigroup's relatively brief 10-page comment letter on the proposed rule to federal regulators, the firm states: "We stand firmly behind the Volcker Rule's core principles of re-focusing trading businesses on the needs of customers and markets, while reducing potential risk to financial institutions and our financial system."⁴⁰ No representatives of Citigroup or Bank of America have testified in any of the congressional hearings on the Volcker Rule in the 112th Congress. In

³⁶ Research by SNL Advisers, available at: <http://www.snl.com/InteractiveX/Article.aspx?cid=A-15031738-14889>.

³⁷ Federal Reserve statistics (Nov 7, 2012). Available at: <http://www.federalreserve.gov/releases/h8/current/>.

³⁸ Research by SNL Advisers, available at: <http://www.snl.com/InteractiveX/Article.aspx?cid=A-15031738-14889>.

³⁹ GOVERNMENT ACCOUNTABILITY OFFICE, PROPRIETARY TRADING (July 2011), available at: <http://www.gao.gov/assets/330/321006.pdf>.

⁴⁰ Letter from Brian Leach, chief risk officer, Citigroup (Feb. 13, 2012), available at: http://www.federalreserve.gov/SECRS/2012/March/20120307/R-1432/R-1432_021312_104979_542079506624_1.pdf.

fact, former Citi Chairman John Reed counts as one of the Volcker Rule's earliest and most outspoken supporters.⁴¹

JP Morgan's opposition to the Volcker Rule is well known. The firm's proprietary trading became infamous in the spring of 2012 when it revealed a \$5 billion to \$7 billion loss from self-described "egregious" trades in London.

And Wells Fargo?

The name Wells Fargo derives from the 1850s entrepreneurs who profited from the traffic generated by the California gold rush. The bank itself served as a side business to the freight enterprise. Today's Wells Fargo is more accurately understood as Norwest Bank, a Minnesota branch-bank network, which bought the more familiar San Francisco-based Wells Fargo in 1998.⁴² Norwest senior management has served in the top positions of Wells Fargo since the merger.

Of the largest four American banks, Wells Fargo's business is decidedly old school. Summarized a *New York Times* columnist, "It focuses on plain-vanilla lending like mortgages, credit cards and corporate loans, and ... emerged relatively unscathed from the financial crisis."⁴³ Wells Fargo boasts a high rating for its own debt.⁴⁴

Will the Volcker Rule undermine this San Francisco-based giant's prospects? Proprietary trading generated the firm \$2 million in profits in the third quarter of 2012, and \$16 million over the first nine months of the year.⁴⁵ The \$2 million in income represented 0.04 percent of the Wells' \$4.94 billion in net income.⁴⁶ Proprietary trading accounted for a \$9 million loss in the third quarter of 2011, and an \$18 million loss for the first nine months of 2011. Proprietary trading, concluded Wells Fargo CEO John Stumpf, is "almost zero for us."⁴⁷

⁴¹ Letter from John Reed to federal regulators (Feb. 13, 2012), available at: http://www.federalreserve.gov/SECRS/2012/March/20120301/R-1432/R-1432_021312_105359_329619421677_1.pdf.

⁴² Wells Fargo annual report, 2000, available at: <http://sec.gov/Archives/edgar/data/72971/0000912057-00-012168.txt>.

⁴³ Peter Eavis, *Banks Tread a Fine Line in Trading*, THE NEW YORK TIMES (May 13, 2012), available at: <http://dealbook.nytimes.com/2012/05/13/banks-tread-a-fine-line-in-trading/>

⁴⁴ Wells Fargo Web site: https://www.wellsfargo.com/invest_relations/debt/.

⁴⁵ Wells Fargo quarterly report, third quarter 2012, available at https://www.wellsfargo.com/downloads/pdf/invest_relations/3Q12_10Q.pdf.

⁴⁶ Wells Fargo quarterly report, third quarter 2012, available at https://www.wellsfargo.com/downloads/pdf/invest_relations/3Q12_10Q.pdf.

⁴⁷ *Wells Fargo's Stumpf on the Volcker Rule*, CNBC (Feb. 17, 2012), available at: <http://video.cnbc.com/gallery/?video=3000073921>.

The firm does engage in market-making, which the proposed Volcker Rule will allow. (Market making involves trading activities in which the bank aims to profit through commissions rather than through changing values of the underlying investments.) “We make active markets in more than 400 issues and are recognized as a top 10 trader in convertible bonds,” Wells Fargo says on its Web site.⁴⁸

Berkshire Hathaway—run by Warren Buffett, the nation’s second wealthiest person,⁴⁹ and Charles Munger—holds nearly 10 percent of Wells Fargo’s stock,⁵⁰ accounting for nearly 20 percent of the value of Berkshire Hathaway’s investment portfolio.⁵¹ On why Berkshire Hathaway and others might find Wells Fargo “so attractive,” *Forbes* observed: “Well, Wells Fargo is distinctive for what it doesn’t do: rely on proprietary trading.”⁵²

The one way the Volcker Rule could impact Wells Fargo is through the law’s ban on hedge fund ownership. Wells Fargo fears federal regulators might bar its venture capital and merchant banking subsidiaries under the Volcker Rule. The funds largely fall under the name of Norwest, such as Norwest Equity Partners, Norwest Venture Partners, etc. ⁵³ Wells Fargo lists 1,207 separate subsidiaries. ⁵⁴

Wells Fargo does not explicitly report the results of its venture and merchant capital subsidiaries. It does report various investment gains. In the latest quarter, Wells Fargo reported a gain of \$167 million from the sale of debt and equity securities. That represented 1.5 percent of its total \$10.5 billion in non-interest income, and 0.6 percent of its total interest and non-interest income of \$21.5 billion for the quarter. Income from these sales represented 3.3 percent of its net income.⁵⁵

Despite the apparent lack of significance of Volcker Rule-prohibited activity for Wells Fargo and CEO Stumpf’s dismissal of the importance of proprietary trading, Wells Fargo has joined the vigorous industry effort to contest robust implementation. The firm penned two

⁴⁸ This assertion appears in the promotional material of a Wells Fargo Web site, available at: <https://www.wellsfargo.com/securities/equity-sales>.

⁴⁹ See FORBES (Sept. 19, 2012), available at: <http://www.forbes.com/forbes-400/>.

⁵⁰ Wells Fargo, proxy statement 2012, <http://sec.gov/Archives/edgar/data/72971/000119312512117239/d285202ddef14a.htm>.

⁵¹ *Buffett How Has 19.4% of Portfolio in Wells Fargo: Why it's the Better Bank Stock*, FORBES (Nov. 25, 2012), <http://www.forbes.com/sites/ycharts/2012/11/25/buffett-how-has-19-4-of-portfolio-in-wells-fargo-why-its-the-better-bank-stock/>.

⁵² *Id.* Buffett discusses the Volcker Rule in this video: Buffett on Volcker rule: <http://www.valuwalk.com/2012/05/warren-buffett-talks-about-volcker-rule-video/>.

⁵³ Wells Fargo exhibit to annual report, 2012, available at: <http://sec.gov/Archives/edgar/data/72971/000119312512084528/d280360dex21.htm>.

⁵⁴ *Id.*

⁵⁵ Wells Fargo quarterly report, third quarter 2012, available at https://www.wellsfargo.com/downloads/pdf/invest_relations/3Q12_10Q.pdf.

letters to the federal agencies, and joined in endorsement of two others.⁵⁶ Instead of a rule, Wells Fargo asks for special treatment: “We believe that a better approach would be to allow each covered banking entity to work with its primary federal regulator to tailor more general rules applicable to each covered banking entity and its unique trading attributes.”⁵⁷

The Volcker Rule should portend minimal change for the company’s business. Further, Wells Fargo’s largest shareholder may be impatient with any attempts by management to violate the Volcker Rule. Berkshire Hathaway’s Munger commented, “Take the rapid trading by the computer geniuses [responsible for proprietary trading at banks]. Those people have all the social utility of a bunch of rats admitted to a grainery. I never would have allowed the rats to get in the grainery. I don’t want the brilliant young men of America being rats in somebody else’s grainery.”⁵⁸

IV. Conclusion: Closing the Casino

While large bank lobbyists and others who profit from bank proprietary trading vocally oppose the Volcker Rule, Washington representatives of the vast majority of American banks endorse this reform. The Independent Community Bankers of America boasts 5,000 members among the nation’s 7,181 banks.⁵⁹ While Wall Street lobbyists forecast grave harms from the Volcker Rule, here’s what the trade association for the lion’s share of the banking industry concludes: “ICBA generally supports the Volcker Rule, which is an important step toward protecting the business of banking from the speculation inherent in proprietary trading and sponsoring or investing in hedge funds.”⁶⁰ The trade association explains: “The recent financial crisis and the ensuing government bailout show what happens when banks depart from the fundamental business of banking.”⁶¹

If the Volcker Rule affects relatively few players on Wall Street, why the storm and fury? M&T Bank CEO Wilmers speculates that personal compensation figures at the center of this public controversy, and that compensation undermines public perception of the social utility of banking. “Public cynicism about the major banks has been further reinforced by the salaries of their top executives, in large part fueled not by lending but by trading. At a

⁵⁶ Compilation of all letters to Federal Reserve on Volcker Rule. Available at:

http://www.federalreserve.gov/apps/foia/ViewAllComments.aspx?doc_id=R-1432&doc_ver=1.

⁵⁷ Letter from Wells Fargo counsel James Strother (Feb. 13, 2012), available at:

http://www.federalreserve.gov/SECRS/2012/March/20120309/R-1432/R-1432_021312_104984_362706050221_1.pdf.

⁵⁸ Video interview of Charles Munger, available at: <http://www.webcompact.net/index.php/news/29149-charlie-munger-and-buffett-disagree-on-volcker-rule-video>.

⁵⁹ ICBA Web site, available at: <http://www.icba.org/aboutICBA/index.cfm?ItemNumber=529>.

⁶⁰ ICBA comment letter on the Volcker Rule (Feb. 13, 2012), available at:

http://www.federalreserve.gov/SECRS/2012/March/20120305/R-1432/R-1432_021312_104966_451638070183_1.pdf.

⁶¹ *Id.*

time when the American economy is stuck in the doldrums and so many are unemployed or under-employed, the average compensation for the chief executives of four of the six largest banks in 2010 was \$17.3 million—more than 262 times that of the average American worker. Thus, it is hardly surprising that the public would judge the banking industry harshly—and view Wall Street’s executives and their intentions with skepticism ... The Wall Street banks continue to fight against regulation that would limit their capacity to trade for their own accounts—while enjoying the backing of deposit insurance—and thus seek to keep in place a system which puts taxpayers at high risk.”⁶²

The thousands of bankers unaffected by the Volcker Rule may not travel frequently to Washington to defend it. Who petitions City Hall about a stop light on a street where one doesn’t drive? But as Washington’s rulemakers finalize this important regulation, they should be especially attuned to the silence of 7,000 banks.

⁶² M& T Bank, Annual Report, 2011, available at: http://files.shareholder.com/downloads/MTB/2107851053x0x546897/5C592DA0-5A87-4F46-8AF6-8639E1B8963E/2011_Annual_Report.pdf.