

Banking Group To Withdraw Suits Over Volcker Rule

By Kurt Orzek

Law360, Los Angeles (February 12, 2014, 9:42 PM EST) -- The American Bankers Association and four banks told a Washington, D.C., federal court Wednesday that they will voluntarily withdraw litigation seeking to block the so-called Volcker Rule from applying to certain “trust-preferred” collateralized debt obligations, after federal regulators changed the provisions-at-issue.

The ABA notified the court that it and other plaintiffs — including CB&T Bancshares Inc., Citizens Bank & Trust Co., MBT Financial Corp. and Monroe Bank & Trust Co. — would voluntarily dismiss without prejudice all claims asserted in its complaint over the Dodd-Frank Act's ban on proprietary trading by banks. They also told the D.C. Circuit in a stipulation that the parties had agreed that their petition for review was voluntarily dismissed.

The filings came roughly two weeks after the Federal Deposit Insurance Co., the Securities and Exchange Commission, the Federal Reserve Board, the Department of the Treasury and the Commodities Futures Trading Commission each put their stamp on an interim final rule that will allow banks to hold on to the CDOs.

ABA President and CEO Frank Keating said in a Wednesday statement that the interim final rule has allowed banks to avoid taking hundreds of millions of dollars in unnecessary write-downs and helped to minimize the cost and compliance burden for the affected entities.

“We believe the best opportunity to pursue successful resolution of these issues is to constructively engage with the regulators without the chilling impediment of pending litigation, particularly in light of their recent public statements expressing a desire to address the Volcker Rule’s unintended consequences,” he said.

Trust-preferred securities are issued as preferred stock through a company-created trust in exchange for debt issued to the trust, with proceeds going back to the originating company. Although able to be issued by any company, they have typically been issued by bank holding companies, as regulations treat the securities as bank capital rather than debt and offer other tax and accounting advantages, according to the ABA.

The securities, often packaged into CDOs known as TruPS-backed CDOs, were not exempted from the Volcker Rule — which bans bank holding companies and their subsidiaries from short-term proprietary trading of any security, derivative or other financial products intended to only benefit the company, among other measures — when the rule was finalized Dec. 10.

This decision prompted the ABA to express its “dismay” in a December statement, saying that including TruPS-backed CDOs within the Volcker Rule would cost small community banks millions of dollars from having to divest their holdings in the securities, despite being told by regulators that the rule — designed to protect against systemic risk — would not affect them.

The unlawful decision will cause “substantial, immediate and irreparable” harm to about 275 community banks by requiring them to divest their holdings in the CDOs — used to generate steady, long-term income — by 2015, resulting in an immediate \$600 million hit to their balance sheets in addition to ongoing effects, the suits argued.

Following the regulators’ announcement that they would review the status of TruPS-backed CDOs under the Volcker Rule, ABA’s Keating issued a statement calling the ruling a “promising, if incomplete, development.”

In late December, federal financial regulators said they would consider exempting certain CDOs from the so-called Volcker Rule.

In January, federal agencies greenlighted the rule, saying that banks can hold on to their interest in those funds as long as they meet certain requirements, including that the bank acquired the interest in the TruPS before Dec. 10, when the final rules were issued to implement Section 619 of the Dodd-Frank Act.

The interim rule set at ease some concerns raised by bankers, sentiments that Keating echoed Wednesday.

“We were particularly encouraged by Federal Reserve Governor [Daniel] Tarullo’s recent comments that [CDOs] are ‘at the top of the list’ of issues to be addressed by the inter-agency working group charged with implementing the Volcker Rule,” he said. “We look forward to sitting down with regulators to work out a solution to this issue.”

The plaintiffs are represented by Anthony Herman, Christian J. Pistilli, Henry Liu, Andrew Soukup, David M. Zions and Matthew J. Berns of Covington & Burling LLP.

The district court case is American Bankers Association et al. v. Federal Deposit Insurance Corp. et al., case number 1:13-cv-02050, in the U.S. District Court for the District of Columbia.

The case is American Bankers Association et al. v. Board of Governors of the Federal Reserve System et al., case number 13-1310, in the U.S. Court of Appeals for the District of Columbia Circuit.

--Additional reporting by Evan Weinberger, Daniel Wilson, Sindhu Sundar and Kat Greene. Editing by Philip Shea.