Federal regulators released on Tuesday a draft of the long-anticipated Volcker rule, a regulation that will limit large banks’ bets with their own money. Some experts, however, said the proposal doesn't go far enough to curb the risk-taking practices that helped bring the financial system to the brink of collapse three years ago.

The Volcker rule, named after former Federal Reserve chairman Paul Volcker, was meant to ban proprietary trading at large federally insured banks -- that is, to prevent banks with the government's backing from making risky bets that could force taxpayers to bail them out. Some financial law experts said that the government's proposal for the Volcker rule has too many loopholes, is too vague and relies too much on banks' own self-reporting and self-regulation, which could allow for manipulation.

For example, the proposal includes a number of exemptions for banks to make bets with their own money, including market-making, or facilitating trading of a certain security, and hedging risks "on a portfolio basis." Some experts said that although the complicated 298-page proposal will force banks to spend a significant amount of money and time making sure that they are complying, the Volcker rule includes enough loopholes to allow banks to continue a certain amount of proprietary trading under a different name.

"Unless they’re actually embedded in banks, they may have a great deal of trouble determining whether permissible or banned activities are going on," said Andrew Tuch, a law professor at the University of Sydney and a fellow at Harvard Law School.

Tuch said that the Dodd-Frank Act's provisions for the Volcker rule unsuccessfully tried to accomplish two aims at once: promoting financial stability and reducing conflicts of interest. The Volcker rule's effectiveness now will depend on banks' own internal compliance, he said.

Proprietary trading has been a hugely lucrative business for Wall Street. Large banks reported at the end of 2009 that trading accounted for 77 percent of their net operating revenues. The Volcker rule would cost Goldman Sachs $3.7 billion in annual revenue, according to one estimate earlier this year. In response, banks have been lobbying heavily to water down the Volcker rule and other regulations in the Dodd-Frank Act.

The main problem revolves around the proposal's "disturbingly vague" definitions of key terms, allowing banks to find ways around the Volcker rule, said Duke Law School professor Kimberly D. Krawiec. For example, a bank could claim that it is putting its own money at risk as a hedge or "in the name of serving customers," she said.

Since the definitions are so vague, some experts said, the ultimate effectiveness of the Volcker rule will depend on its enforcement. Frank B. Cross, University of Texas at Austin law and
business professor, said that a "pattern of enforcement" will emerge from how banks will try to get around the rule and which rule-breaking the government will track down.

Cross said that the Volcker rule ultimately will reduce, but not eliminate, proprietary trading. He said the proposal has "too many loopholes," including an exemption for currency trading, which he called "probably the single biggest area where people have had catastrophic loses, out of all possible investments."

If a currency bet goes bad and a bank is in danger of failing, taxpayers could be on the hook to bail that bank out, Cross said.

Lawrence Baxter, professor at Duke Law School, said that the Volcker rule gives banks too much leeway to self-regulate and self-report. He said that the government needs to investigate what is happening inside banks, rather than approve of the complex compliance system that they are ordering banks to create. If the government fails to do that, he said, the Volcker rule could amount to "just a checklist to see did you meet the record-keeping requirements," instead of meaningful supervision by regulators.

"They essentially are passing the buck back to the companies," Baxter said. "With all these complex compliance requirements, regulators themselves may create unintentionally an illusion of supervision that’s not really there."

The banking industry said that the complexity of the Volcker rule will result in a waste of resources as banks scramble to comply with the law. Frank Keating, president of the American Bankers Association, wrote in a statement that the many employees who will be tasked with implementing the rule "will be transferred to a role that provides no customer service, generates zero revenue and does nothing for the economy."

Former U.S. Sen. Ted Kaufman (D-Del.), a visiting professor at Duke Law School, said that the proposal's exemption for market-making activities is "the loophole," and that the only solution is to reinstate the Glass-Steagall Act of 1933, which separated investment banking and commercial banking completely.

"I don't think they're ever going to be able to come up with a rule that the banks can't get around," Kaufman said.