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Re: Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds (Federal Reserve Board Docket No. R-1432, RIN 7100 AD 82; SEC File Number S7-41-11; FDIC RIN 3064-AD85; OCC Docket ID OCC-2011-14; CFTC RIN 3038-AD05)

Dear Sirs and Madam:

Bond Dealers of America (BDA) is pleased to offer these comments on the above-referenced proposal (Volcker Proposal), which implements Section 619 (Section 619) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). As we describe in more detail below, we are very concerned that the Volcker Proposal if implemented will materially impair how bank-affiliated broker-dealers provide liquidity to the fixed-income market and will therefore cause the value of fixed-income securities to decline and become volatile and will increase the costs to issuers of fixed-income securities. We believe that there are ways to revise the Volcker Proposal to protect against the risks and other concerns giving rise to Section 619 without incurring the damage that the Volcker Proposal would incur if it is implemented as drafted.

Bond Dealers of America and its Members

The BDA is the only trade association exclusively focused on the U.S. fixed-income market and represents middle-market brokers and dealers who are headquartered in cities all over the country, doing business throughout the United States coast to coast. Our members are the "Main Street" firms, not the Wall Street firms. They help communities around the country to finance their schools, roads and bridges. They help businesses raise the funds they need to grow. They provide individuals and institutions with fixed-income investment opportunities in municipal, corporate and agency-backed securities. They also provide liquidity for the investors in those securities.

The Volcker Proposal affects many of our members who are broker-dealers affiliated with banks and who will, as a result, be subject to the restrictions on proprietary trading and investments under Section 619. But our members do not represent any systemic risk to the financial system and did not cause the financial crisis that led to the enactment of the Dodd-Frank Act. As we discuss below, the proposed Volcker rule will damage the role these broker-dealers play in the fixed-income markets without any significant corresponding systemic benefit.

Fixed-Income Market Background. The equity market and the market in Treasury obligations is not like market in other fixed income securities. Most bonds do not trade very frequently and they do not trade on exchanges. In the municipal securities market alone there are over 50,000 issuers most of which do not issue often and each of which is unique. There are over 1.5 million municipal CUSIPs outstanding, but on any given day there are only about 41,000 trades involving 15,000 unique municipal bonds.

An investor goes to his or her broker-dealer in search of a suitable investment. The broker searches what is available – including what is in the broker's own inventory – and proposes an investment. Or, on the other side, an investor seeks to liquidate an investment and, unless his or her broker can find an immediate buyer, the broker purchases the bonds for its own account. This role of the broker-dealer is crucial to the stability and viability of this market and the proprietary trading prohibitions of the Volcker Proposal would either prohibit or – what is nearly the same thing - do not clearly protect bank-affiliated broker-dealers from engaging in many of these important activities. Unless the activities are clearly protected, firms will reduce those activities to avoid being sanctioned at a later date when audited by regulatory agencies.

In such a market, broker-dealers play an important role by being familiar with the issuers and their credit, by selling bonds from their inventories to investors and by purchasing bonds from investors to hold in their inventory for later resale –at a profit, but a profit governed by the markup and markdown rules of the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB), under the authority of the Securities and Exchange Commission (SEC). These markup and markdown rules are an important point because they limit the potential gain of a registered broker-dealer in a particular position. They

thus also limit the risk a registered broker dealer is likely to take and consequently reduce the need to control that risk through the additional mechanism of the Volcker Rule. Stated another way, the benefit to the financial system of imposing the Volcker Rule on registered broker-dealers is significantly limited by the existence of the markup and markdown regime. The costs, on the other hand, to issuers and investors would be significant.

Comments on Volcker Proposal

General. In general, our comments reflect our serious concern that the Volcker Proposal, if implemented, would significantly reduce liquidity in the fixed-income market in general and the municipal securities market in particular. We believe that the bifurcation of the municipal securities market that the proposal would require does not add any meaningful systemic protection and will eliminate an important source of liquidity for a large portion of the municipal securities market. We believe that the Volcker Proposal's market-making and underwriting activities exceptions from the proprietary trading prohibitions are drawn from and therefore are currently only appropriate, at most, for the equity market, if there. They do not accommodate the different realities present in the fixed-income market. Further, we believe that the definition of covered fund is overbroad in its inclusion of tender option bond trusts.

Definition of Municipal Securities (Question 120). We have serious concerns with the Volcker Proposal's failure to exclude from the proprietary trading prohibitions[1] all state and local government securities, including those issued by agencies and authorities. This bifurcation simply does not make sense and will unnecessarily and severely damage the value of these municipal securities and increase costs to their issuers. Because the proposed rule does not exempt securities issued by agencies and instrumentalities of state and local governments, such as turnpike authorities and water and sewer districts, about 40 percent of the municipal market would still be covered by the Volcker rule. The roughly 40 percent of the municipal securities market that the Volcker Proposal would include in the proprietary trading prohibitions do not present any systemic or credit risk or other qualitative difference that would explain their disparate treatment from the other 60 percent of the municipal securities market. We simply do not believe that Congress could have intended such an arbitrary distinction.

The real problem with the bifurcation of the municipal securities market contained in the Volcker Proposal, however, is not its arbitrary character but the damage it would cause. As we discussed above, the municipal securities market depends on broker-dealers to provide liquidity that bridges gaps between seller and buyer. The proposed rule would remove a significant number of liquidity providers from the market, with the result that the existing value of the roughly 40% of the non-excluded municipal securities will decline and will become volatile. Investors (including retail investors) will be tangibly harmed. Further, without this liquidity, issuers of these municipal securities will see their costs increase.

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[1] See §__.6(a)(iii) of the Proposed Common Rules in and Footnote 165 of the Volcker Proposal.

We strongly recommend the Agencies to include the entire municipal securities market into the exclusion from the proprietary trading prohibitions.

Market-Making Exception (Question 85). We are concerned that the market-making exception from the proprietary trading prohibition will not allow broker-dealers to continue to engage in the kinds of legitimate market making activities that occur in the fixed-income market. Under the Volcker Proposal, the market-making exception only applies if the "trading desk or other organizational unit that conducts the purchase or sale holds itself out as being willing to buy and sell…the covered financial position for its own account on a regular or continuous basis." This is not how market making operates within the fixed-income market. In the fixed-income market, broker-dealers do not make markets by continuously or regularly supporting specific positions, as contemplated by the Volcker Proposal, but essentially support the market as a whole. A customer seeking to sell a position may call his or her broker and if the broker cannot find a buyer at that moment, the broker may purchase the position for its own account until the broker is able to sell that position. Thus, the market making aspect does not arise out of the broker-dealer's continuous or regular willingness to purchase a particular bond or even bonds of a particular issuer but rather as a steady presence in the fixed-income market to bridge buyers and sellers. Further, dealers also support this market by purchasing from other dealers to cooperate with each other to provide adequate liquidity to the market as a whole. If bank-affiliated broker-dealers are not permitted to engage in these legitimate market-making activities and these activities are treated as proprietary trading, then an essential source of liquidity will be eliminated from the fixed-income market and the existing value of these securities will decline and become volatile. Again, investors will be tangibly harmed in their existing, current fixed-income positions and issuers of these securities will also experience increases in the interest costs associated with these securities.

Underwriting Activities Exception (Question 67). We also believe that the underwriting activities exception[2] does not work properly for the kinds of underwriting activities in the fixed-income market. Under the Volcker Proposal, the underwriting activities exception is only effective if the "purchase or sale is effected solely in connection with a distribution of securities" and if the "underwriting activities…are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties." In the fixed-income market, underwriters frequently underwrite bonds knowing at the sale of the bonds that they may need to retain unsold allotments within their inventories. Since liquidity in the fixed-income market is not as deep as other markets, underwriters frequently cannot sell bonds when they go to market but they know that this is a function of timing and the presence of interested purchasers in the market at a particular time. Consequently, it is routine for underwriters to retain these unsold allotments until a sufficient amount of liquidity is available in the market to sell the bonds.

We believe that Congress intended to exempt all underwriting activities from the proprietary trading prohibitions.

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[2] §__.4(a) of the Volcker Proposal.

The fundamental conceptual difficulty and flaw in the Volcker Proposal in the case of the market making and underwriter exemptions is that the Proposal attempts something that is nearly impossible, which is to divine the intent of the market maker or underwriter when making a trade – did the dealer intend to facilitate market liquidity or did it engage in the trade with the intent of making a profit. The proposal also suffers from the fundamental conceptual flaw that, in a commercial situation, those are exclusive categories. Those flaws lead to an extraordinarily complex and unworkable proposal.

Tender Option Bond Trusts (Question 78). We also are concerned that the covered fund provisions of the Volcker Proposal will result in the inclusion of tender option bond trusts (TOB Trusts), which are important financing vehicles within the municipal securities market. Banks frequently sponsor TOB Trusts. Banks also frequently own residual and other ownership rights in TOB Trusts and provide credit and liquidity enhancement that supports securities issued by TOB Trusts. As now drafted, the Volcker Proposal would treat TOB Trusts as covered funds, the same as hedge funds and private equity funds. TOB Trusts should be excluded from the definition of a covered fund because they are safe and secure investments by banks. TOB Trusts usually hold municipal securities and only operate as a more efficient way for state and local governments to access the capital markets and for banks to participate in the issuance and financing of tax-exempt bonds.

We believe that any fund or trust the assets of which are entirely invested any of the obligations that are excluded from the proprietary trading prohibitions should also be excluded from the definition of covered fund. In short, if those assets are deemed not risky enough to prohibit banks from directly owning and engaging in short-term trading of the assets, then we do not think that the assets are risky enough to prohibit the indirect ownership of them. We note that this only works in the municipal bond market if the Agencies accept our recommendation to exclude all municipal securities from the proprietary trading prohibitions.

Limitations on Permitted Proprietary Trading Activities. We do not believe that the provisions in § ___.8(a) of the Volcker Proposal are appropriate as limitations to the provisions permitting trading in government obligations contained in § ___.6(a) of the Volcker Proposal. If these government obligations are considered safe investments for covered banking entities, we do not believe that covered banking entities should be required to make the subjective analysis of whether an investment in these government obligations constitutes either a high-risk asset or high-risk trading strategy. Further, to condition the permissibility of an investment by a covered banking entity in such a government obligation on the conflict of interest provisions contained in §___.8(a)(1) does not make sense to us since these securities are broadly traded and do not resemble at all the kinds of securities or transactions in which the types of conflicts of interest that the Agencies appear to be addressing have arisen.

Further, we believe that the Volcker Proposal's limit relating to conflicts interest contained in § ___.8(a)(1) is not appropriate. The purpose of the Volcker Rule is to protect the the U.S. banking system and regulating transactions that may conflict with the interests of customers of the covered banking entity is simply outside of the scope of the Agencies' task. This should be left to the great province of broker-dealer and derivative regulations. The final Volcker rule should focus only on the kinds of trading and investments that inappropriately subjects covered banking entities to enterprise-threatening risks.

Thank you for the opportunity to present our views on the Volcker Proposal.

Sincerely,

Mike Nicholas
Chief Executive Officer