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April 13, 2012

VIA EMAIL

Mr. David Stawick
Secretary
Commodities and Futures Trading
Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Rules for Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds

Dear Sir:

Business Roundtable appreciates the opportunity to comment on proposed regulations (NPRM) recently issued by the Commodities and Futures Trading Commission to implement the Volcker Rule provisions set forth at section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Pub. L. No. 111-203, 124 Stat. 1376, 1620 (2010); *see* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds, 77 Fed. Reg. 8332 (Feb. 14, 2012). Business Roundtable previously submitted a comment letter in response to the proposed rule[1] issued jointly by the prudential banking regulators and the Securities and Exchange Commission (collectively, "the agencies"). Because the CFTC's proposed rule substantially overlaps with that prior joint release, and in fact "adopt[s] the entire text of the proposed common rules section from [that proposal]," 77 Fed. Reg. at 8332, we are submitting below for the Commission's consideration the previous comments we made in response to the joint proposed rule.

[1] Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (proposed Nov. 7, 2011).

As a threshold matter, this rulemaking would have a broad impact on our nation's financial markets and companies in all sectors of the economy that rely on well-functioning markets. Therefore, it is critical that the agencies carefully examine the economic consequences of their actions and adopt sensible regulations.

Business Roundtable is an association of chief executive officers of leading U.S. companies. Its member companies generate more than $6 trillion in annual revenues and employ 14 million people. These companies comprise nearly a third of the total value of the U.S. stock market and pay $163 billion in dividends to shareholders each year. They also represent nearly half of all private U.S. research and development spending—more than $150 billion annually—and generate an estimated $420 billion annually in sales for small and medium-sized businesses. Business Roundtable members are focused on business expansion and job growth, and with the economic climate remaining unsettled, it is more important than ever that the agencies adopt regulations that facilitate these efforts.

We believe that the proposed regulations would undermine liquidity in the markets by curtailing necessary and beneficial activities such as market making and underwriting. The statute purposefully excluded market making and underwriting from the scope of the Volcker Rule requirements, but the NPRM fails to give full effect to the intent of Congress. The reduced liquidity that will result from these restrictions will increase borrowing and capital costs for businesses, thereby preventing companies from expanding operations, hiring additional employees, and introducing new products and services. Indeed, a recent study by Oliver Wyman concludes that the proposed regulations may increase the cost of borrowing for companies by $12 to $43 billion dollars each year. In addition, companies may experience an additional $7 to $11 billion in increased transaction costs each year. For their part, investors may lose as much as $1000 per household, amounting to a total loss of between $91 and $304 billion. At a time when the global economy remains in a precarious position, these restrictive measures promise to handcuff U.S. companies from serving as economic engines towards a brighter future.

We offer the following comments to suggest areas where the proposed regulations could be modified to better align with the statute and to help sustain vibrant financial markets. Given the substantial costs that the proposed rule would impose, it is critical that the agencies weigh the concerns of the business community carefully and act thoughtfully in adopting the final rule.

I. The NPRM Will Negatively Affect Market Liquidity.

The Dodd-Frank Act exempts "market-making related" and underwriting activities from the Volcker Rule because of the centrality of those activities to sound capital markets. *See* Dodd-Frank Act, § 619(d)(1)(B), 124 Stat. at 1624. That exemption was designed to prevent the Volcker Rule from negatively affecting liquidity in the U.S. securities markets.

Senator Jeff Merkley, a principal author of the Volcker Rule provisions in the Dodd-Frank Act, explained, for example, that the exemption of "market-making-related" activities, as opposed to "market-making" activities, was purposeful. 156 Cong. Rec. S5896 (statement of Sen. Jeff Merkley). The broader exemption reflected Congress's intent to exempt additional activities to meet "client liquidity needs." *Id.*

This legislative determination was well-advised, because these activities are critical to liquid capital markets and the activities of commercial businesses. A well-functioning system of market-makers reduces the costs that market participants face when they trade in the markets. Similarly, a well-functioning system of underwriters reduces the costs that companies face when they seek to raise capital in the markets. That makes it less costly for companies to obtain financing for business expansion, hiring, and developing new products and services.

The NPRM confirms these fundamental market principles. For example, the agencies recognize "the important liquidity and intermediation services that market makers provide to their customers and to the capital markets at large." 76 Fed. Reg. at 68,869. And, when discussing different types of market-making activities, the NPRM aptly summarizes that "[p]ermitting legitimate market making in its different forms should promote market liquidity and efficiency." *Id.* at 68,925-26; *see id.* at 68,941.

However, despite recognizing the importance of market-making and underwriting-related activities, the NPRM places several harmful restrictions on these activities. The following are examples of provisions in the proposed rule that conflict with the intent of Congress to insulate true market-making activities from market-inhibiting restrictions:

- Market-making activity may include taking positions in anticipation of customer demand but only "so long as any anticipatory buying or selling activity is reasonable and related to clear, demonstrable trading interest of clients, customers, or counterparties." 76 Fed. Reg. at 68,871.

- Section _.4(b)(2) of the proposed rule specifies that for the market-making exemption to apply, "[t]he trading desk or other organizational unit that conducts the purchase or sale [must] hold[] itself out as being willing to buy and sell . . . for its account on a regular or continuous basis."

- Market-makers may "typically only engage in transactions with non-customers to the extent that these transactions directly facilitate or support customer transactions." 76 Fed. Reg. 68,961.

- The NPRM impermissibly establishes a "rebuttable presumption" that a position taken for 60 days or less is a prohibited transaction. *See* _. 3(b)(2)(ii), 76 Fed. Reg. at 68,945.

These various limitations undermine the ability of market-makers to perform their roles and to provide enhanced liquidity to the markets. Notably, the NPRM does not explain how

these restrictions comport with congressional intent, much less examine the attendant effects on financial markets from limiting market-making in ways not supported by a factual record or the realities of how financial markets operate efficiently.

The NPRM is written as if all market-making and underwriting occurs in markets similar to those for common equities on the New York Stock Exchange, in which market-makers and underwriters serve only as passive intermediaries. But market-making for corporate bonds—even the corporate bonds of the most credit-worthy corporations—is more fragmented and differently situated. Market-makers and underwriters in these markets must be active. They must act to discover prices, they must anticipate customer demands, and they must trade with other market-makers and underwriters to both ensure and smooth out flow in the markets.

With respect to these activities, market-makers and underwriters behave similarly to other inventory-driven businesses. Take, for example, companies that sell seasonal apparel. In preparation for the summer, businesses would reasonably take into account the demand for apparel that previously sold well and stock up accordingly. In addition, businesses may test the markets in order to ascertain the extent of customer demand for certain souvenirs, perhaps by allowing customers to place pre-orders. And after the release of the new summer lines, businesses may trade amongst themselves in the event that certain apparel sells better in certain stores or certain parts of the country. If these various forms of legitimate business activities were forbidden, businesses selling seasonal apparel would face significant risks. The same applies to financial markets.

Yet the NPRM would forbid just this sort of activity. For example, seasonal apparel-selling businesses would be hard-pressed to meet the requirement that their anticipatory market-making activity is related to "demonstrable client interest," because, until summer approached, there likely would be little such interest. Also in light of that requirement, businesses would be unable to test customer demand for pricing purposes until they knew that customer demand existed, which is unhelpful. In addition, the NPRM's restriction of inter-dealer trading would prevent businesses from redirecting inventory to meet customer demand in different geographic regions. And the NPRM's 60-day presumption would discourage businesses from preparing for the summer season more than two months before they predicted that customer demand would swell. Market-making—whether for seasonal apparel or financial securities—would be hampered under these restrictions.

Market-makers in the financial markets must have the latitude to perform activities to create and sustain markets. By limiting *bona fide* market-making and underwriting activities, the proposed regulations will reduce market liquidity for financial securities, including corporate bond instruments, making it more difficult and costly for companies to finance their operations. These significant effects are discussed in greater detail below

II. The NPRM Will Impose Significant Costs On Commercial Companies.

While the agencies have worked hard to propose a way to implement the Dodd-Frank Act's Volcker Rule provisions, they have failed to grapple with the costs that will result from the NPRM. They provide no analysis of the costs of the proposed rules to market-makers or underwriters, to U.S. companies seeking to raise capital, to investors in the markets, or to the American economy. In addition, the agencies fail to consider the costs that will result from extending the regulatory requirements to non-financial companies that are deemed "affiliates" of banks due to their ownership or control interests in banking entities (or through investments in companies with such ownership or control interests). Companies will either have to forego these beneficial arrangements that enhance the soundness and stability of the banking institution through the support provided by the commercial parent company, or companies will have to significantly limit their other business activities in order to comply with the broad Volcker Rule restrictions. Either way, significant harm will ensue. The agencies fail to analyze these effects and have abdicated their responsibility even though they acknowledge the proposed rules will "likely have a negative impact on market efficiency and liquidity and, as a related matter, capital formation." 76 Fed. Reg. at 68,941.

This failure is particularly troubling because President Obama has recently reaffirmed that executive agencies should carefully weigh the costs and benefits of regulatory actions. *See* Executive Order 13,563—Improving Regulation and Regulatory Review, 76 Fed. Reg. 3,821 (Jan. 28, 2011) (citing Executive Order 12,866—Regulatory Planning and Review, 58 Fed. Reg. 51,735, 51,738 (Sept. 30, 1993)); Executive Order 13,579—Regulation and Independent Regulatory Agencies, 76 Fed. Reg. 41,857 (July 11, 2011). Numerous other statutes, including the Regulatory Flexibility Act, 5 U.S.C. § 601 *et seq*., the Unfunded Mandates Reform Act, 2 U.S.C. § 1501 *et seq.*, the SEC's organic statutes, 15 U.S.C. § 78c(f) (Exchange Act); 15 U.S.C. § 80a-2(c) (Investment Company Act), and the Administrative Procedure Act, impose similar requirements of weighing costs against benefits that must be followed in this rulemaking. However, the NPRM fails to undertake a robust economic analysis even though the effects of the proposed regulations will likely be severe for businesses and employers.

As noted above, a recent study by Oliver Wyman has confirmed that the proposed regulations through their negative effects on market liquidity will impose dramatic costs on both investors and companies. It is thus imperative that the agencies explore less burdensome regulatory alternatives and take appropriate measures to ensure that market-making and underwriting activities remain vibrant. *See Jicarilla Apache Nation v. U.S. Dep't of Interior*, 613 F.3d 1112, 1114-15 (D.C. Cir. 2010) ("Because we are persuaded [the agency] failed to consider an important aspect of the problem . . . we reverse in part and remand."); *see also Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (vacating a SEC regulation for failing to consider statutorily-required factors of efficiency, competition, and capital formation in part because the SEC "did nothing to estimate and quantify the costs it expected companies to incur" under that regulation).

III. The Proposed Regulations Will Harm The American Economy.

The stakes regarding the proposed administrative rules could not be higher. Capital markets depend on market-making and underwriting in order to function. U.S. companies, in turn, rely on capital markets to raise funds to finance growth. The American economy relies on U.S. companies to create jobs, develop new products and services, and improve the standard of living. The proposed regulations threaten to disrupt this framework and slow job and economic growth.

Indeed, the United States is currently a leading global financial center. Its markets, for example, accounted for nearly one third of global equity capital and nearly one half of the debt capital raised worldwide in 2009. That preeminent status aids U.S. companies and the American economy. Ross Levine & Sara Zervos, *Stock Markets, Banks, and Economic Growth*, 88 *Am. Econ. Rev.* 537 (1998). And that status is due in part to the superior liquidity of the U.S. markets across all asset classes. *Id.* The regulations, however, would place the U.S. economic engine at risk.

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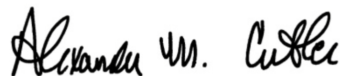
The proposed regulations will harm U.S. companies and ultimately the American economy. These rules are particularly problematic from the perspective of commercial companies, which drive job creation and rely heavily on capital markets. We respectfully request that the agencies re-propose this rule, remedy the flaws in the current rulemaking, and implement the Volcker Rule in a way that makes the economy safer without wounding it in the process.

Sincerely,



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