CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

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September 6, 2012

The Honorable Spencer Bachus
Chairman
Committee on Financial Services
Washington, DC 20515

The Honorable Barney Frank
Ranking Member
Committee on Financial Services
Washington, DC 20515

Dear Chairman Bachus and Ranking Member Frank:

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses and organizations of every size, sector, and region, believes that effective regulation would help facilitate capital formation for America's businesses. The Chamber appreciates the opportunity to respond to the House Financial Services Committee's request for alternatives to Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), more commonly known as the Volcker Rule.

I. Discussion

On January 21, 2010, President Barack Obama proposed a ban on proprietary trading and named it after former Federal Reserve Chairman Paul Volcker, its chief architect. The Obama Administration requested other nations to follow suit, but was universally rejected by the international community. The House of Representatives had passed their version of what would become Dodd-Frank prior to the roll-out of the Volcker rule, but specifically did not include a proprietary trading ban in its bill. However, a tougher version of the Volcker Rule was eventually made a part of the Dodd-Frank Act through the passage of the Merkley-Levin Amendment in the Senate.

The Volcker Rule is to be administered by five different regulatory agencies – the Board of Governors of the Federal Reserve ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"),the Office of the Comptroller of the Currency ("OCC"), the Securities and Exchange Commission ("SEC"), and the Commodities and Futures Trading Commission ("CFTC") (also collectively known as the "Regulators"). On November 7, 2011, the Federal Reserve, FDIC, OCC, and SEC published in the *Federal Register* a 298 page proposed joint rulemaking that posed over 1,000 questions. The CFTC followed suit with its piece of the rule on January 11, 2012.

While the Volcker Rule is directed at financial institutions, its impacts will be felt by Main Street businesses.

As part of standard business practices, corporate treasurers use the debt and equity markets on a daily basis to ensure they have the cash needed to pay bills, to raise capital needed to expand and create jobs, and to mitigate day-to-day financial risk surrounding business

operations. In order to do this, American businesses rely on the market-making capacity and underwriting expertise of our financial services industry. Any interference in this interconnected financing system would harm capital formation, disrupt the ability of treasurers to do their jobs, and hamper the capability of businesses to expand and create jobs.

In passing the Volcker Rule, Congress sought to minimize impacts upon the ability of non-financial businesses to raise capital by including exemptions for market making and underwriting activities. However, the regulators acknowledged the difficulty in determining the difference between proprietary trading, market making and underwriting. Under questioning by the House Financial Services Committee on January 18, 2012, after the Volcker Rule implementing regulations had been proposed, the regulators acknowledged that proprietary trading was not a cause of the financial crisis. Equally significant, these regulators were forced to admit that they could not provide a comprehensive definition of what normal market making and underwriting practices were.[1]

On July 20, 2012, the Chamber released a report, ***The Economic Consequences of the Volcker Rule***, which examines the numerous unintended, yet harmful, effects of the Volcker Rule, particularly on Main Street businesses. This report, authored by Washington University Finance Professor Anjan Thakor, finds that the Volcker Rule will raise the cost of capital. While it is unknown exactly what the increase will be until the text of a final Volcker Rule is released, one thing is absolutely certain – increased cost of capital will hinder our economic recovery. For instance, a 100 basis point increase in the cost of capital for many non-financial businesses is possible. Such an increase may lead to losses of between 550,000 and one million jobs.[2] Among the other findings of the report were:

1. The Volcker Rule will have a negative effect on market making and liquidity provisions for many securities;

2. The Volcker Rule will reduce the network benefits of market making for financial institutions and businesses;

3. The Volcker Rule is likely to lead to higher costs of capital for businesses and potentially lower capital investments, with a possible greater focus on riskier or more short-term oriented investments; and

4. The Volcker Rule will make risk management for financial institutions less efficient and harm the ability of businesses to raise capital.

Because of these adverse impacts of the Volcker Rule upon Main Street businesses and the communities they support we believe that it is important for Congress to consider legislative vehicles to prevent the negative consequences of the Volcker Rule.

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[1] *Examining the Impact of the Volcker Rule on Markets, Businesses, Investors, and Job Creation: Joint Hearing Before the Subcomms. on Capital Markets and Government Sponsored Enterprises and Financial Institutions and Consumer Credit*, 112 Cong. (Jan. 18, 2012), *available at* http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=274322.

[2] See the Chamber's December 15, 2011 letter to the Regulators that included a survey of a limited sample size of corporate borrowers. This survey found that at a minimum the Volcker Rule would increase capital costs for larger borrowers by 25-50 basis points and less frequent borrowers would face even greater increases in borrowing costs of between 50 and 100 basis points. Therefore, extrapolating the Thakor Report estimates, the job losses caused by the Volcker Rule, could at a minimum, be between 137,500 and 1,100,000.

II. Legislative Alternatives

A. Repeal and Replace the Volcker Rule With Higher Capital Standards for Proprietary Trading

During the Dodd-Frank Act debate, the Chamber applauded the intent of the Volcker Rule to stabilize the financial sector, but opposed the rule itself because it would be too restrictive for a growing economy and the prohibition of certain activities would place the U.S. capital markets and companies at a competitive disadvantage. As an alternative, the Chamber suggested the use of heightened capital requirements and liquidity standards to achieve the intent of the Volcker Rule.

In passing the Dodd-Frank Act, Congress imposed both the Volcker Rule ***and*** heightened capital requirements, while international regulators also contemplate additional capital requirements through Basel III.

As discussed earlier, the Volcker Rule will hamper capital formation for Main Street businesses. In addition, regulators are faced with perhaps insurmountable issues in how to define market making and underwriting and to exempt appropriate activities. Furthermore, actual implementation poses its own set of issues as each regulator has different historic practices of regulating the markets, products, and industries they oversee, which can lead to unclear rules of the road. For instance, some may prefer a trade-by-trade subjective analysis, while others may prefer a more objective principle based approach. This will create ambiguities that will force market participants to act at their own risk creating circumstances that could force capital off-shore. These implementation issues will raise the cost of capital and slow down our capital markets. Furthermore, innovation will be stifled as the Volcker Rule will seek to police dynamic markets through a static regulatory structure.

Only a small number of firms engaged in proprietary trading. Proprietary trading was not a widespread practice within the financial sector. However, the adverse impacts of the Volcker Rule, as currently constructed, would impact all market participants and put in place a system that allows competiting regulators to have enormous discretion to second-guess the day to day decisions businesses make about their use of various lawful mechanisms to raise capital.

Accordingly, we would respectfully request that Congress repeal the Volcker Rule and allow the regulators to use existing powers under the Dodd-Frank Act to impose higher capital requirements and liquidity standards upon covered financial institutions that engage in proprietary trading if needed. These powers should be used carefully and with precision: any additional capital charges should be assessed only with respect to the true proprietary trading, and only to backstop the particular risks associated with a firm's proprietary trading desk.

Under this suggested alternative, if financial institutions choose to engage in proprietary trading, they may be subject to higher capital requirements commensurate with risk profile of these trading activities. This would permit regulators to ensure that these institutions do not engage in unreasonable risk taking with their own funds. Similarly, the regulators could adjust capital requirements and liquidity standards, up or down as conditions warrant.

Under this system, the capital formation activities of Main Street businesses will be held harmless, while the regulators could address potential issues related to proprietary trading in a nimble and flexible manner.

B. Suspend Enforcement of the Volcker Rule Pending International Adoption and Reconciliation with Existing Trade Agreements

As discussed earlier, the Volcker Rule was originally meant to include all of the major global capital market participants. However, this international call to action was swiftly and universally rebuffed by other nations.[3] Accordingly, the United States has unilaterally placed itself at a disadvantage in an increasingly competitive global capital marketplace.

To prevent this potential harm to the American economy and to provide for a level international playing field, the enforcement of the Volcker Rule should, at a minimum, be suspended pending certification by the Treasury Secretary that other international competitors have adopted similar statutory schemes and that they are abiding by similar restrictions.

The following language could be included at the conclusion of Section 619:

> Provided that, the requirements of subsection (a) and (c), and any regulations promulgated under subsection (b) (2) or any regulatory actions to enforce or implement any subsection of Section 619 shall not come into effect until the Secretary of the Treasury publicly (i) identifies the nations that are home to the headquarters of financial institutions that compete significantly with the U.S. financial institutions that would be subject to the regulations enacted pursuant to this section (including, without limitation, the United Kingdom, France, Germany, Switzerland, Japan, Brazil , China, Canada and Mexico) and (ii) certifies that such nations have applied to such competing financial institutions, including their subsidiaries and affiliates wherever located, restrictions equivalent to those set forth in subsections (a)-(g) and in the Bank Holding Company Act of 1956, Section 13(b). Such certification shall be made on the record after an opportunity for a hearing in accordance with the procedures prescribed in 5 U.S.C. § 554 and shall be reviewable in the United States Court of Appeals for the District of Columbia Circuit under 5 U.S.C. § 706.

This language would limit global disparities and eliminate any competitive disadvantage under which United States companies would face if the Volcker Rule, as proposed, were implemented.

Similarly, the Volcker Rule may violate certain existing treaties such as the North American Free Trade Agreement ("NAFTA"). NAFTA was designed to eliminate trade and investment barriers between the United States, Canada, and Mexico. However, the Volcker Rule imposes significant regulatory oversight that could inhibit the purchase of securities and debt instruments in ways that Canada and Mexico do not impose. The certification language would allow for all three nations to have similar treatment of investments as envisioned under NAFTA.

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[3] See **E.U. Ministers to Resist Obama's Proposal for Banking Overhaul**, *Bloomberg News*, February 16, 2010.

C. Create a Legislative Vehicle to Address Specific Issues

The Chamber believes that the first two legislative options provide the clearest and most effective means of achieving the intent of the Volcker Rule without harming the efficiency and competitiveness of the U.S. capital markets. If those options are not adopted, then we believe the following more targeted proposals can help alleviate some of the negative effects of the Volcker Rule while still achieving the original intent of the Volcker Rule.

i. Eliminate Compliance Programs for Companies that Never Engaged in Proprietary Trading

The Volcker Rule forces financial institutions and non-financial companies that own financial institutions, to create Volcker Rule compliance programs even if those financial institutions never engaged in proprietary trading or fund investing. This will needlessly increase costs and burdens for those companies without conferring any benefits. These institutions and companies will also have to undergo increased regulatory scrutiny that will adversely impact their operations and their ability to raise capital. This is particularly true of insurance companies that were specifically exempted from the Volcker Rule, but are brought back within the ambit of the rule if they own a depository institution. Non-financial companies affiliated with financial institutions should not be covered by the Volcker Rule as they do not engage in the relevant activities or present the same types of risk. Financial companies that do not engage in the specified prohibited activities similarly should be relieved of the associated compliance burdens.

ii. Exempt Illiquid Issuances

Many equity and debt instruments trade in illiquid markets with activity not occurring for days or weeks at a time. Congress recently attempted to grapple with this issue in relation to emerging growth companies during the passage of the JOBS Act. By forcing these illiquid markets to undergo Volcker Rule scrutiny, the interest in these issuances will evaporate further. Accordingly, to promote efficiency and liquidity, the Volcker Rule should include a definition of illiquid markets and instruments so these thinly traded issues and markets are deemed to be non-proprietary trading *per se* and therefore exempt from the regulatory strictures of the Volcker Rule. The Existing protections for market making are insufficient to accomplish this end. That is because the Volcker Rule does not distinguish between highly liquid markets sch as those for common equities and illiquid markets such as those for many other equity and debt instruments, and the regulators have not indicated a willingness to recognize this distinction. As a result, all markets are treated with a one-size-fits-all approach, even though different markets vary widely with respect to liquidity.

iii. Exempt Joint Ventures

Joint ventures[4] are a means for companies and entities to band together to develop new business lines or assets. This is an important vehicle for companies to remain competitive, particularly overseas. Under the Dodd-Frank Act, if an entity involved in a joint venture is

[4] A "joint venture" is a business organization formed by multiple entities. It may be an operating company, that is, a company that generates or sells goods and services, but it may also be a vehicle for investments. *E.g.*, 156 Cong. Rec. S5905 (July 15, 2010) (statements of Sens. Barbara Boxer and Chris Dodd) ("[T]he intent of the rule is not to harm venture capital investment.").

required to have a Volcker Rule compliance program then the joint venture itself also will be required to have Volcker Rule compliance program. This is an illogical overextension of the Volcker Rule. Subjecting joint ventures to Volcker Rule compliance programs will increase regulatory complexity for joint ventures and place American companies at a competitive disadvantage as compared to their foreign counterparts.

iv. Exempt State and Municipal Debt Issuances

While the sale of United States Treasury Securities is exempt from the Volcker Rule Proposal, certain State and Municipal bonds are not exempt because of differences of definitions between the Dodd-Frank Act and the Securities Exchange Act. Accordingly, because certain State and Municipal bonds are not exempt, the costs for issuing these instruments will be higher, or may delay the issuance of such debt.[5] These State and Municipal bonds are used for important services including critical capital and infrastructure projects that sustain local communities and are utilized by all Americans. Further, these projects are important businesses opportunities for companies and employ thousands of workers. Many of these projects—bridge and road construction or repair, or school construction—have widespread indirect benefits for businesses and the overall economy besides those that may have a direct role in building that infrastructure.

Raising the costs of, or delaying the issuance of debt for State and Municipal debt will reduce the number of infrastructure projects, harming businesses and endangering jobs. The Municipal Securities Rulemaking Board (MSRB)—the entity established by Congress to regulate the municipal securities market—filed comments[6] and the bipartisan U.S. Conference of Mayors passed a resolution[7] objecting to this aspect of the Volcker Rule. They agree that the net effect of the Volcker Rule as proposed will be a significant increase in the cost of capital and a corresponding reduction in the overall amount of funds available to construct and maintain schools, roads, bridges, water systems and other basic infrastructure essential to the quality of life in every American community.

Amending the Dodd-Frank Act to adopt the definition of municipal securities used in the Securities Exchange Act will facilitate these critical projects and save the jobs associated with them by ensuring all municipal bonds are exempt from the Volcker Rule.

v. Study of Market Making and Underwriting Impacts

As stated earlier, the Chamber believes that the Volcker Rule should be repealed. Instead, firms that wish to engage in proprietary trading could be subject to increased capital requirements and liquidity standards. However, if the Volcker Rule is finalized giving life to the current legislative mandate, then Congress should require a Government Accountability Office study on the potential market making and underwriting impacts of the operational implementation of the rule before the rule is finalized or becomes effective. As envisioned, this study would allow for one year's worth of data to be analyzed to better understand the adverse impacts upon the ability of Main Street businesses to raise capital. Such a study would allow

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[5] See **MSRB Urges Regulators to Exempt Munis from Volcker Rule**, *The Bond Buyer*, January 31, 2012.
[6] *Id.*
[7] Adopted Resolution of the 80th Annual Conference of Mayors, June 13-16, 2012 at http://usmayors.org/resolutions/80th_Conference/metro02.asp .

regulators and legislators to better understand the negative market implications of the Volcker Rule and develop appropriate responses to correct them.

vi. Require Cost-Benefit Analysis

In addition, the Chamber believes that any regulations promulgated to implement or enforce the Volcker Rule should be subject to cost-benefit analysis. Congress has often required the SEC and other agencies to consider the effect of their regulations on, among other things, "efficiency, competition, and capital formation."[8] And President Obama has ordered executive agencies and exhorted independent agencies to conduct cost-benefit analyses.[9] To the extent these requirements are not already applicable to the Volcker Rule, it is desirable to require the agencies to conduct such analysis, reviewable by courts, in order to ensure that the costs of Volcker Rule regulatory activity do not outweigh the benefits.

III. Conclusion

Thank you once again for this opportunity to provide the House Financial Services Committee with ideas to legislatively address the pressing issues that have arisen because of the possible implementation of the Volcker Rule. We applaud your interest in this important issue and your commitment to preventing harm to the economy that Congress surely did not intend when it enacted the Dodd-Frank Act.

In its current form the Volcker Rule may have significant adverse impacts upon the ability of Main Street businesses to raise capital directly, harming their ability to grow and create jobs. The ideas presented here allow the intent of the Volcker Rule—to stabilize the financial sector—without the unnecessary adverse impacts.

We look forward to working with you to promote financial regulatory reform needed for the U.S. economy to grow and compete in a 21st century global market.

Sincerely,

R. Bruce Josten

cc: Members of the House Committee on Financial Services

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[8] *E.g.*, 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c).

[9] Executive Order 13,563—Improving Regulation and Regulatory Review, 76 Fed. Reg. 3821 (Jan. 28, 2011); Executive Order 13,579—Regulation and Independent Regulatory Agencies, 76 Fed. Reg. 41857 (July 11, 2011).