February 13, 2012

By electronic submission

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, D.C. 20551

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 2-3
Washington, D.C. 20219

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E
Washington, D.C. 20549-1090

Re: Prohibitions and Restrictions on Proprietary Trading, etc. (RIN number 3038–AD05)

Dear Committee Members:

This letter provides commentary on behalf of Western Asset Management Company regarding Volcker Rule proposed rulemaking. Our firm, Western Asset, manages over $440 billion in fixed income assets and invests on behalf of public and private pension plans, endowments and foundations and retail mutual funds. Western Asset's daily operations and the goals of our clients rely heavily on Wall Street's ability to make markets. We felt it imperative to pass along our viewpoints on the proposed rules.

Western Asset commends the regulators and acknowledges that the Congressional hearing on January 18th did an excellent job of highlighting the difficult task that regulators and legislators face in translating the statute into functional rulemaking. Western Asset believes, however, there are still many hurdles to overcome with respect to the Volcker Rule. Western Asset agrees with the feedback and commentary already put forth by market participants regarding the need for better clarity of definitions within the Volcker Rule as part of an overall goal of maintaining liquidity in our markets. We,

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too, are in favor of strengthening the regulation of reckless activities and better control over proprietary trading conducted within banking entities. In an effort to be additive to the multitude of excellent comments already provided, Western Asset believes the following areas require further attention before proceeding with the Volcker Rule. We have outlined these views below.

Resolution surrounding the 300 questions put forth by Regulators and Clarify Certain Definitions with the Volcker Rule. Market participants initially approached Volcker Rule documents and the accompanied 300 questions with great trepidation. Since then, the market has come to realize that regulators have made a worthy first-attempt to "get it right." Regulators can give the market more certainty by demonstrating their willingness to "refine" their initial attempt at rulemaking. In light of the cumbersome nature of the rules and questions presented by the initial proposal and the potentially severe consequences of getting the rule wrong, we urge the regulators to consider a re-proposal of the rule for further review and discussion prior to final adoption.

Furthermore, it now appears that many large foreign governments, who are also sizable players in the securities markets, have, for good reason, loudly voiced concerns around the "permitted securities" and "extra-territoriality" issues. No study or analysis can concretely measure the potential for unintended consequences in these areas. It appears that regulators have chosen the "bright lines" approach with respect to the Permitted Securities issue. Bright lines exclude securities such as foreign government bonds and contain vague definitions of municipal securities. Banks also have a need to better clarify definitions that affect their daily market making activities and compliance regimes. Some of these definitions include verbiage such as "reasonably expected near term demands of clients," "trading unit", and the frequency of Metric monitoring. The market has already witnessed a sizable backlash from small transaction-based retailers at the expense of large-box retailers with regard to recent debit card legislation. Both market participants and Regulators should attempt to avoid a similar situation with Volcker rules.

Consistency of Market Making and the Assumption that New Firms will Easily Fill the Void. Some leading regulators have made several overtures and expressed sentiment toward the need for vibrant secondary fixed income markets. However, these regulators seem to also rely heavily on the notion that new market makers will come into the market and fill any void caused by the chilling effect of the Volcker Rule. Western Asset is not confident about this far reaching assumption. Even if this assumption were true, near-to-intermediate term market liquidity could be severely affected. Most of the small firms that have come into the market have only really approached on an "agency" basis. These firms do not actively take positions on their balance sheets. There is great value to the markets in having the large banks provide a <u>continuous</u> flow of "principal" market making activity. Of course, we would not recommend subsidizing banks or fostering artificial competition, but regulators need to ensure that principal-based market makers are consistently in the business. In the electric utility sector, customers don't think about the continuous flow of electricity in their daily lives. Electricity customers pay for the ability to have flick-of-a-switch availability even though they sometimes don't exercise the option to use it late at night while they are sleeping. The counter-cyclical nature of the market making business calls for market makers to be there when nobody else wants to bid or offer securities. The continuous flow of principal market making and good liquidity provide the oxygen for markets to operate on an optimal basis. A lack of oxygen could have real implications on our $15 trillion U.S economy.

Vigilant Surveillance Will Be Critical Going Forward: Surveillance will be the key to monitoring future imbalances within the financial markets. The Volcker Rule proposes 17 metrics to be calculated by the banks on an on-going basis. Regulators have demonstrated that their intention was to have the banks build compliance regimes "on-top-of' existing regimes opposed to reinventing the wheel. There has been great rhetoric surrounding the famous 17 metrics. All of the large banks <u>already</u> calculate some form of the proposed 17 metrics. Western believes this was a good "first-attempt" at creating a common language between regulators and banks. Flexibility by regulators surrounding the proposed Metrics will be paramount in "getting it right." Realization that the Metrics may be pro-cyclical in nature and could potentially send false signals will be part of the flexibility in interpreting the data. Very much like the market regularly evaluates Fed balance sheet and Treasury auction data, market participants, like Western Asset, should also be able to view some form of the bank Metric data on a regular basis.

Financial regulators should take a page from the NFL's playbook. The regulating body in the NFL came to realize that their on-field officials were not able to correctly catch every penalty. Too many missed calls might compromise the integrity of the game. Over time, NFL regulators armed its surveillance officers (the on-field referees and line judges) with better technology through the use of new camera angles and Instant Replay. The NFL even gave the coaches of each team a red flag to throw when they felt a referee made a mistake during the game. Loud booing from the fans has become a mechanism that helps prompt the coach to contemplate throwing that red flag during live play. The fans, too, have become incorporated into the surveillance process of the game. In the exact same way, bank regulators need help and should empower market participants the ability to throw a red flag if they see a "missed call" in the financial markets. Finally, there are many stories about how NFL referees are a very select group of individuals who have been tested many times at many different levels of the game. Small groups of referees study the game together, travel together, and work together on a daily basis. These referees also engage in extensive postgame analysis in an attempt to evaluate how they can do even better next time. The referees are well paid and each small group seems to compete against other small groups of referees. Ultimately, there is an elaborate scheme in place determining who is nominated to referee the Superbowl at season's end.

In contrast to the NFL, five different regulating bodies have been charged with writing and implementing the Volcker Rule. A next step might incorporate narrowing the body of regulators that focus on the Volcker component and begin structuring the small teams of on-field referees that will ultimately compete to monitor on-field banking activities. Once again, this should be clearly defined for the market prior to the July implementation. Over time, market participants (the fans) will come to learn about the "special forces units" within the Fed or chosen regulatory body that focuses solely on Volcker compliance and on-going bank regulation. Their lead will guide the market and provide a high standard of integrity.

Finally, Western Asset has attempted to independently evaluate the proposed Volcker rulemaking. Western appreciates the extensive effort placed on effective implementation by regulators. Clear refinement of the rough edges, preservation of consistent principal-based market making and stringent surveillance will be the keys for successful Volcker Rule implementation.

Thank you and best regards. Please contact our firm if you have any questions (626.844.9687).

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