BETTER MARKETS

TRANSPARENCY · ACCOUNTABILITY · OVERSIGHT

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February 13th, 2012

Robert Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN 3065-AD85

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
File Number S7-41-11

Jennifer J. Johnson
Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551
Docket No. 1432
RIN 7100 AD 82

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0014

Re: Prohibition on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds

Dear Ladies and Gentlemen:

Better Markets, Inc.[1] appreciates the opportunity to provide comments to the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency (collectively "the Agencies") in response to the request for public comment in connection with Notice of Proposed Rulemaking ("Proposed Rule")published on October 11th, 2011, in connection with the "Volcker Rule" required under §619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

The Volcker Rule is narrow in application and limited in scope: it only applies to a few banks that are so big that their failure would threaten the entire financial system and the country's economy – as they did in the financial crisis of 2008. Thus, the Rule only applies to those banks that the federal government would spend any amount of money to prevent them from failing so that the country would not have to suffer a Second Great Depression, which almost happened as a consequence of the financial collapse of 2008.

The Volcker Rule's prohibition is also narrowly targeted at a particularly pernicious, dangerous and, indeed, lethal type of bank behavior: proprietary trading where banks place

[1] Better Markets is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular in the rulemaking process associated with the implementation of the Dodd-Frank Act.

huge bets with borrowed money that promise enormous upside, but risk even greater downside. This type of conduct, a key reason for huge losses in the 2008 financial crisis, is the equivalent of Russian roulette for any other firm or business in America where bad bets mean bankruptcy and, often, losing everything. The only place in American that doesn't happen is Wall Street: the biggest banks know that, if their bets lose and the roulette bullet hits them, they don't die or go bankrupt. Rather, the taxpayers will pick up the bill for their losses and prevent their failure, as demonstrated in the 2008 crisis.

And, that bill can be gigantic. Any unbiased analysis shows that the costs of the last financial crisis to the United States alone have been in the trillions of dollars, with many continuing to this day as the worst recession since the Great Depression ravages the country. Depending on when it happens and what form it takes, the next financial crisis will likely cost at least as much, if not significantly more.

Those massive and debilitating costs are what financial reform generally and the Volcker Rule in particular are intended and designed to eliminate or reduce. The American people should never again have to pay trillions of dollars for another Wall Street bailout due to its trading and investment activities.

Notwithstanding one of the most comprehensive disinformation campaigns in modern history, implementing the Volcker Rule is not complex or difficult. The keys are:

1. breaking links between proprietary trading and banker bonuses,
2. backing up the law with swift, certain, and significant penalties for traders, supervisors and executives,
3. eliminating unstable funding methods used by bank broker dealers, and
4. requiring hedging congruence.

If the link between proprietary trading and banker bonuses is removed, then the incentive to proprietary trading will be gone. This can be readily accomplished by requiring that all compensation for the permitted activity of market making be limited to the historic and well known methods of fees and commissions. This can then be easily policed after the fact by analyzing the bonus pool – after all, that is the entire purpose for proprietary trading: getting the biggest bonuses possible. Nothing is tracked more carefully on Wall Street than the bonus pool, which is a roadmap to where every penny was made or lost. Conveniently, this can be cross-referenced by the many individuals and desks that assiduously track this.

Because proprietary trading is banned and illegal, the firm cannot be allowed to profit from it either. A real market maker's trading book is fully hedged and, therefore, does not generate profits in excess of fees and commissions (other than in rare and extraordinary market conditions, when gains are as probable as losses, and either should be consistent industry wide). If such profits are somehow generated anyway, then increased prudential standards must be applied to bring the bank back into compliance with the law.

Some who attack the Volcker Rule say that is not possible to distinguish between proprietary trading and market making for customers. This is a very dubious claim given the oft heard claim that the smartest people on the planet work on Wall Street (and get paid unprecedentedly high compensation for being so smart). If they can't distinguish between proprietary trading for their own pocket and trading for their customers, then a very thorough investigation of their businesses is required and quickly. That is what happened at

MF Global. Wall Street cannot really be saying that their trading books are like MF Global's. However, that is the logic of the principal argument being made against the Volcker Rule.

Importantly, limiting all trading compensation to fees and commissions will not be enough to end illegal proprietary trading. There is simply too much money at stake, especially bonus money, to expect people to follow the law unless there are very significant penalties for violating the law and a reasonable expectation that they will be caught. Those penalties have to be as significant as the potential gains if they are to be effective. If not, the cost of violating the law will become a cost of doing business and the illegal profits from proprietary trading will continue to flow, albeit diminished for the rare or occasional paltry fine. Even worse, the destabilizing risks that the Volcker Rule is intended to reduce or eliminate will remain, threatening our financial system, our taxpayers, our treasury and our economy. That is why very substantial penalties must be spelled out in the rule or it will be rewarding illegal conduct and inviting systemic risk.

As discussed further below, the risks created by the high leverage, liquidity-maturity mismatch funding model used by broker dealers must be changed and the permitted activity of risk mitigating hedging has to be tightened. Underpinning and reinforcing all the reforms in the Rule is the elimination of conflicts of interest between the banks and their customers and counterparties, which were and are shockingly rampant.

The Volcker Rule is a reasonable response to a foreseeable and severe threat that materialized in the last crisis and contributed to systemic failure, which precipitated massive bailouts. Avoiding those trillions of dollars in costs (not to mention the equally high human costs arising from unemployment, foreclosure, etc.) or, put another way, gaining the benefits of avoiding such a crisis, are why it is so important to implement the Volcker Rule as intended. Imagine what would have happened if, in 2007-2008, the biggest banks didn't have any proprietary positions or inventory. Simply put, they would not likely have failed and multi-trillion bailouts would not likely have been necessary. That was, after all, what happened when the tech stock market bubble popped in 2001.

If the Volcker Rule is implemented as proposed here, that scenario will not have to be imagined. It will be the reality. The biggest banks will either not fail or, if they do, they will be able to do so without systemic implications, just as MF Global did recently.

Dear Ladies and Gentlemen:

We endorse these comments made by Better Markets, Inc.) and also the 30+ pages of reasoning which accompanied their original testimony. This matter is of vital importance to the future financial health of our nation. We appreciate your careful attention, hopefully to strengthen the regulation of our financial system.

Del and Erma Coppinger