

July 5, 2011

VIA ELECTRONIC MAIL

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**Re: Release No 34-64352; File No. S7-15-11
Removal of Certain References to Credit Ratings under the
Securities Exchange Act of 1934**

Dear Ms. Murphy:

The Bond Dealers of America (“BDA”) is pleased to offer comments on the Securities Exchange Commission (the “Commission”) Release No. 34-64352: Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934 (the “Exchange Act”) (the “Release”). The BDA is the Washington, DC based trade association representing securities dealers and banks focused primarily on the U.S. fixed income markets.

The Dodd Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) provides that the Commission, after removing any reference to or requirement of reliance on credit ratings, is to substitute in such regulations such standard of credit-worthiness as the Commission deems to be appropriate.¹ While the BDA supports promoting independent investment and credit risk analysis by all market participants and recognizes the concern regarding the appropriate role of credit ratings in these analyses, the BDA is particularly concerned with the proposed amendments to Exchange Act Rule 15c3-1 (the “Net Capital Rule”) which prescribes the minimum regulatory capital requirements for broker-dealers. In its current form, the Net Capital Rule uses credit ratings to determine prescribed percentages of the market value of securities owned by the broker-dealer (“haircuts”) that the broker-dealer then uses to discount the value of certain securities held by such broker-dealer when calculating its actual net capital.² The discount is intended to provide a margin of safety against losses that might be incurred as a result of market fluctuation in the prices of these proprietary positions. In place of the Net Capital Rule references to credit ratings, the Commission in the Release is proposing that a broker-dealer take a 15% haircut on its proprietary positions in commercial paper, nonconvertible debt and preferred stock unless such broker-dealer has a written policies and procedures in place for determining whether the investment has only a minimal amount of credit risk.³ A broker-dealer would only be able to apply the lesser haircuts requirement of the current

¹ See Pub. L. No. 111-203 § 939A(b).

² Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, Securities Exchange Commission Release No. 34-64352 (April 27, 2011) 76 FR 26552 (May 6, 2011).

³ Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, Securities Exchange Commission Release No. 34-64352 (April 27, 2011) 76 FR 26552 (May 6, 2011).

Net Capital Rule if an investment has a “minimum amount of credit risk” under its written policy and procedures for determining creditworthiness.⁴

Under that alternative, a firm would have to establish procedures for determining the credit risk and apply those procedures to its holdings, and thereby determine the amount of its net capital. The BDA opposes the alternative proposed in the release on several grounds. It is subjective and contains an inherent conflict of interest. It is complicated and would disproportionately burden smaller firms, favoring larger “too big to fail” firms. It would reduce liquidity and increase volatility.

The BDA urges the Commission to establish an objective system of haircuts based on how a given security trades relative to an established benchmark, such as Treasury obligations or some other accepted market standard. We believe that establishing particular “haircuts” associated with specific ranges of such trading would be a simpler, more objective way of achieving the goal.

The BDA believes that there is an inherent conflict of interest involved in allowing broker-dealers to establish, maintain and enforce their own written policies and procedures for evaluating the credit risk of the securities they hold and ultimately determining how much capital they must hold against those securities. Even with the list of factors set forth in the Release to be used as guidance in assessing credit risk and the review in regulatory examinations by both the Commission and self-regulatory organizations, the proposed amendments in the Release do not sufficiently address the concern that there is tremendous incentive for broker-dealers to overestimate the creditworthiness of the securities since it will reduce the amount of capital they are required to maintain and ultimately reduce their costs.

BDA is also concerned that replacing objective rating-based standards with new subjective standards that rely on the discretion of an interested decision-maker will have undesired results. While some broker-dealers may have the required resources available in-house to develop and enforce the procedures required to be established by the provisions of the Release, many broker-dealers will need to retain consultants to assist them and the cost to comply may be prohibitively high for the smaller or middle-market broker-dealers. Smaller broker-dealers need to be able trade, and potentially hold, debt securities from a large universe of issuers, both municipal and corporate, and do not have research departments or the internal resources available to assess creditworthiness on the many thousands of CUSIPs that that would need to be individually assessed.

What the SEC proposes is, essentially, that broker-dealers replicate the efforts of the credit rating agencies. Setting aside that doing so would effectively perpetuate – and multiply - the problems perceived in credit ratings, there are relatively few firms – and only the largest ones - that would have the resources to establish such a system.

Additionally, there will be an unintended negative effect on issuers of these securities. Broker-dealers provide a substantial source of capital for issuers of commercial paper, nonconvertible debt and preferred stock and changes such as those proposed could result in increased compliance costs and difficulties in applying the proposed criteria that could have a negative impact on the

⁴ Removal of Certain References to Credit Ratings under the Securities Exchange Act of 1934, Securities Exchange Commission Release No. 34-64352 (April 27, 2011) 76 FR 26552 (May 6, 2011).

market for these securities. Another consideration is that smaller deals that have very little trading activity will require proportionately greater efforts to monitor. This will be prohibitively expensive for those issues and will reduce the market for those issues and liquidity for the investors in those issues. Larger broker-dealers are also unlikely to follow the smaller companies or industries in which there are not sufficient opportunities for them to re-coup their investment, effectively further limiting access to the capital markets.

Finally, the Commission's proposed changes will necessitate increased oversight by Commission staff to enforce the use of internal processes in capital charge calculations. Without use of objective criteria, certain securities held by different broker-dealers could (and most likely would) be treated differently when calculating net capital. For example, one firm may determine a security qualifies for a 9% haircut, while another might determine the haircut for the same security is 15%. The subjectivity and inherent conflicts of interest would make financial statements less reliable and transparent, thwarting the very principles that spurred this regulatory reform. With internal processes likely to be different at each broker-dealer, examiners would also find it more difficult to complete their reviews of net capital and requiring additional scrutiny by the Commission for large and small broker-dealers alike.

BDA believes that there needs to be an objective standard applied to the determination of the haircuts taken for specific classes of securities. One of the benefits of using third-party credit ratings to determine the haircuts under the current regulatory scheme is that there was a relatively objective standard in use among the broker-dealers which reduced subjectivity and ensured adequate capital levels and some level of safety for broker-dealers holding those securities in their capital positions. Similarly, BDA believes that the use of credit spreads and/or inclusion of an index should be the objective standard used to determine the creditworthiness of these securities. Analyzing the difference between a particular security's yield and how it compares to the yield for Treasury securities (or some established market index) and setting a schedule by which the amount of the haircut would be determined by the amount of such difference would provide an objective standard that would reflect the creditworthiness of a particular security as determined by the market as a whole. To obtain a lower haircut, the securities should trade closer to the indexes to which they are being measured. BDA believes eliminating the use of credit ratings and allowing broker-dealers to establish and enforce their own policies to determine creditworthiness without the use of an objective standard will only create additional concerns and fears about the adequacy of counterparty capital and liquidity, especially in times of market stress. We therefore urge the Commission to consider and examine the use of an objective standard, such as credit spreads, in Rule 15c3-1, rather than allowing broker-dealers to rely on their own subjective credit risk determinations in order to achieve the Commission's regulatory objectives.

Thank you for this opportunity to present our views on the Release. Please do not hesitate to call if you have any questions.

Sincerely,



Mike Nicholas
Chief Executive Officer