FIXED INCOME Forum · The Credit Roundtable — In association with the Fixed Income Forum

February 13, 2012

The Honorable Timothy F. Geithner
Secretary
United States Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitutional Avenue, NW
Washington, DC 20551

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

Mr. Robert Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

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

Re: Notice of Proposed Rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (FRS Docket No. R-1432 & RIN 7100 AD 83; OCC Docket ID OCC-2011-14; FDIC RIN 3064-AD- 85; SEC File Number S7-41-11).

Dear Sirs and Madams:

The undersigned members of the Fixed Income Forum and/or Credit Roundtable,[1] respectfully submit the comments below to the Office of the Comptroller of the Currency, the Department of the Treasury, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission and the Securities and Exchange Commission (collectively, the "***Agencies***"), with respect to the proposed rules (the "***Proposed Rules***") to implement Section 619 (the "***Volcker Rule***") of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[1] The Fixed Income Forum and Credit Roundtable are groups of large institutional fixed income managers, including investment advisors, insurance companies, pension funds, and mutual fund firms, representing more than $6 trillion in fixed income assets under management.

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The undersigned recognize the important public policy purposes behind the Volcker Rule and appreciate the hard work the Agencies have undertaken in preparing the Proposed Rules. We are very concerned that the Proposed Rules, as currently drafted, could have potentially far reaching and unintended consequences that will reduce liquidity and increase trading costs in the U.S. fixed income markets, resulting in lower valuations for publicly traded fixed income securities. We are especially concerned about the effect these consequences would have on tens of millions of individual investors, and institutional clients such as pension funds, 401(k) plans and foundation and endowment funds. Additionally, we are concerned that the Proposed Rules will increase funding costs for companies that rely upon the public bond markets for financing, thus reducing the efficiency of our economy. Many of the expected negative impacts have already been quantified by other commenters, so we will not address that specific issue further in this letter.[2]

We acknowledge that in drafting the Proposed Rules, the Agencies sought to distinguish market making activities from proprietary trading. We believe the narrow and prescriptive approach to the market making exemption in the Proposed Rules will disincentivize covered banking entities from participating in market making activities and thus reduce liquidity in the U.S. fixed income markets.

Recommendations

We urge the Agencies to revise the Proposed Rules so that the final regulations focus on general guidelines rather than strict and rigid criteria. In considering revisions to the Proposed Rules as they relate to market making activities, the undersigned believe it is important for the Agencies to address three factors which could greatly inhibit market making. These factors are (i) the restrictive nature of the market making exemption, (ii) the application of the Proposed Rules at the trade level and (iii) the after-the-fact and complicated analysis with respect to compliance with the exemption. To address the above-listed factors, the undersigned support revising the Proposed Rules to adopt a portfolio approach coupled with a market making plan rather than a trade-by-trade approach.

"Portfolio" Approach

We believe the Proposed Rules should be revised to ensure that the **guidelines and criteria to determine a market making exemption are established on a portfolio basis**, as opposed to a "trade-by-trade" approach. The final regulations should focus the market making exemption criteria at the portfolio level rather than at the trade level to avoid missing the larger picture of a covered banking entity's actual risks. We believe that this type of oversight is achievable.

Development of Market Making "Plan"

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[2] We understand that you are already in receipt of several letters and studies which attempt to quantify, in financial terms, the impact of the Proposed Rules. We will not comment on the reasonableness of the methodologies used by other commenters to quantify the likely impact of the Proposed Rules, but we do believe the negative financial impact of the Proposed Rules will be very substantial.

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We support an approach that would **identify clear and measurable guidelines within which covered banking entities could safely pursue their market making activities**. This market making plan should identify the relevant metrics for a covered banking entity's market making and recognize that covered banking entities approach their businesses in different fashions with diverse product types and varying risk profiles.

As portfolio managers ourselves, we have each had to develop a forward looking investment process designed to assess the expected outcomes for individual trades and their overall portfolio impact. An effective investment process needs to recognize the fact that the outcome for investments is uncertain, and that some investments will not work out as expected. If the ultimate determination as to whether an activity is permissible is based on an after-the fact-analysis, we believe that liquidity will be dramatically reduced because covered banking entities will not enter into many transactions simply because investment results can be uncertain and the risk of non-compliance is too high. Instead, we believe the approach set forth above will maintain liquidity in the markets while accomplishing the goals of the Volcker Rule.

Hedging

The Proposed Rules rely on hedging as a way for market makers to offset the risk of short-term positions; however they require that the hedges be reasonably correlated to the targeted risk. The ability to hedge risk is a key element in managing a book of business and providing liquidity to customers. However, because the provisions of the Proposed Rules relating to hedging take a prescriptive approach, focus on a trade-by-trade application and take an after-the-fact approach to analysis, we believe that they will inhibit both market making and risk management. **We believe that any rules relating to hedging should not be backward looking but should instead take into account the reasonable expectations of the risks that are being hedged and permit hedging in connection with aggregate positions.**

Other important concerns

There are other examples of how the Proposed Rules, as currently drafted, will unintentionally reduce liquidity and increase costs. The Proposed Rules exempt "obligations of any State or political subdivision thereof" from the Volcker Rule; however they fail to include Treasury futures or municipal agency obligations. Treasury futures play a key role in market liquidity and price discovery for the Treasury cash market. If dealers are less willing to participate in the market, this will result in wider spreads, reduced Treasury liquidity, and higher borrowing costs for the Federal government. Since Treasury futures mirror the characteristics of U.S. government debt and repurchase contracts, exempting Treasury futures is consistent with the Proposed Rules. With respect to municipal bonds, municipal agencies are often the primary sources of financing for vital government projects such as healthcare facilities, airports and infrastructure projects. **Treasury futures and municipal agency obligations should also be exempted from the Volcker Rule.**

Furthermore, in order to qualify for the market making exemption, a covered banking entity must evidence, among other things, that there is a two-sided market on a regular or

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continuous basis. Two-sided markets do not exist for all instruments, particularly those in more illiquid markets. The undersigned support a market making exemption based on the covered banking entity holding itself out as being willing to buy and sell on a regular and continuous basis to the extent two-sided markets are not available in a given instrument.

Implications of Rules as Proposed

To the extent that market makers are no longer willing to commit capital to market making activities as a result of the difficulty of complying with the Proposed Rules, we anticipate liquidity would be permanently and dramatically lowered. Alternatively, market makers may decide to limit the size of their positions or abstain from market making in certain asset classes in order to comply with the Proposed Rules. If the Proposed Rules result in market makers moving toward an "agent" model, a customer's ability to trade would be delayed until an offsetting trade could be identified. This would expose customers to increased market and price volatility. Further, investment portfolios would need to be managed differently in that type of environment, with higher cash levels. For example, mutual funds generally have the legal requirement to fund a shareholder's redemption request the following business day. In a market environment of reduced liquidity, the mutual fund will need to hold more cash or very short-term instruments with lower yields that will reduce investor returns. The impact of this reduced demand for bonds will raise the cost of funding to issuers as well.

Implementation

We appreciate the Agencies extending the comment period deadline, and we urge the Agencies to be considerate with respect to the implementation process for the Proposed Rules. As discussed above, the risk of the Proposed Rules to liquidity in the markets and overall impact on the U.S. economy we think requires the Agencies to **be deliberate about how the Proposed Rules should be implemented, which we hope will minimize market disruption and strains on liquidity**.

The undersigned appreciate your time in reviewing our comments and proposals. We know that the effort undertaken by the Agencies with respect to the Proposed Rules has required a great deal of work, and we are pleased to have the opportunity to participate in the rule making process through this comment letter. We hope that our views and recommendations assist in an effective implementation of the Volcker Rule and would welcome the opportunity to meet with the respective staffs to discuss our concerns in more detail. We are more than happy to answer any questions regarding this letter or provide any further information that would assist you in finalizing the Proposed Rules.

Respectfully submitted,

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Nationwide Mutual Insurance Company
Nuveen Asset Management
Prudential Fixed Income
Sun Life Financial, Inc.
TD Asset Management
Torchmark Corporation
Unum Group
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