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

RE: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds ("Volcker Rule"), (File No.: S7-41-11)

Dear Ms. Murphy:

I am writing to follow up regarding our meeting on July 11, 2012 with Amar Kuchinad and Thomas Eady regarding the implications of the Volcker Rule for fixed-income dealers. The Bond Dealers of America ("BDA") represents middle market and regional banks and securities dealers focused on the US fixed income markets. In response to our discussion, we have developed a proposed solution to the concerns raised regarding how to develop a balanced market maker exception that preserves liquidity while addressing proprietary trading. Suggested revisions to §__.4 of the Volcker Rule are attached. We would appreciate an opportunity to meet regarding this proposal.

In the July 11 meeting, we discussed the importance of the principal trading operations of bank-affiliated broker-dealers to the stability and efficiency of the capital markets and the need for the Agencies to fashion the Volcker Rule's proprietary trading prohibition such that it will not eliminate the ability of banks to engage in principal trading. In our discussion, we understood the SEC's main concern was to develop an approach that permitted principal trading operations by bank-affiliated broker-dealers that was narrowly tailored to ensure that those operations remained customer facing. That is, we understood your concern to be related to the practice of some banks to allow traders on a principal trading desk to maintain trading books that represent trading activity to and from other broker dealers for the purpose of generating profit on those trades (also known as "proprietary books") rather than to further the purpose of facilitating trading by the bank's clients and customers. We have thought about these concerns and have developed a potential solution.

Our suggestion is that the Agencies expand §__.4(b)(ii) (which is the market making exception to the Volcker Rule) to include purchases and sales of a "principal trading desk." Properly defining a "principal trading desk" starts with its purpose. A "principal trading desk" should be defined as having the purpose of facilitating trading among the bank's customers and clients. This, however, is the easy part. The difficult part is trying to determine a way to prove this in such a clear and objective fashion that banks feel comfortable that they are in compliance and regulators feel comfortable that they can clearly identify non-complying banks. To solve this difficulty, we think that sales representatives are the key. That is, the Agencies could use the percentage of transactions a trading desk effects through sales representatives to effectively determine when a trading desk clearly is and clearly is not a principal trading desk. Here are some of the reasons we think that this the right approach:

- Sales representatives trade with the customers and clients of the bank and trading with sales representatives thereby largely implies the involvement of the trading desk with customers and not broker-dealers;

- Sales representatives eliminate the incentive for banks to maintain "proprietary books" because trades involving sales representatives require the trading desk to pay a commission which is why broker-dealers maintained "proprietary books" in the first place; and

- Involvement of sales representatives is easily provable because the trade tickets need to record the involvement of the sales representative in order to properly credit the sales representative for sales commissions.

Based on this, we think that the Agencies could create a safe harbor under which a trading desk would be deemed to be a principal trading desk if it effects more than 50% of its transactions through sales representatives. Conversely, the Agencies could deem a trading desk to not be a principal trading desk if it effects less than 25% of its transactions through sales representatives. In our experience, a principal trading desk that is truly customer facing would not ordinarily effect a majority of its trades with broker-dealers and would rarely experience trading activity with broker-dealers exceeding 75% of the desk's total trading activity. That is, broker-dealers who experience trading activity exceeding 75% of the desk's total trading activity suggests to us that the broker-dealer is maintaining a "proprietary book." Conversely, we think it would be pretty hard for a broker-dealer to maintain a "proprietary book" if it effects a majority of its trading activity through sales representatives. To maintain an inventory that is suitable for facilitating trading with customers and to mitigate risks associated with holding securities too long or for which customer demand changes, a broker-dealer needs to engage in a substantial number of trades with other broker-dealers. But we think that these quantitative categories allow for these trades with other broker-dealers while helping to ensure that the trading desk is not developing a "proprietary book."

We have enclosed proposed revisions to §__.4 of the proposed Volcker Rule that would expand the market-making exception along these lines. We are enclosing these proposed revisions to help give concrete context to our thinking in this letter and these proposed revisions need more thinking and refinement. You also may think of better ways of crafting the exception to further the same aim. But we are sending them to you in the hope that they give a clearer sense of how the Agencies could craft a principal trading exception.

In these proposed revisions, we propose expanding §__.4(b)(ii) by adding purchases and sales of a "principal trading desk" as part of what would constitute market-making activities. This is how we propose defining a "principal trading desk":

- A “principal trading desk” would be a “trading desk or organizational unit of a covered banking entity that purchases and sells covered financial positions for the account of the covered banking entity for the purpose of facilitating the trading of equity or fixed income securities by clients and customers.” That is, to be a “principal trading desk,” the trading desk must exist for the purpose of facilitating customer trading.

- We propose a safe harbor that deems a trading desk to be a “principal trading desk” if more than 50% of its trading activity was effected through sales representatives. We think that this allows a principal trading desk that is legitimately customer facing to easily and objectively prove that fact.

- We propose the opposite of a safe harbor in that a trading desk would be deemed not to be a “principal trading desk” if less than 25% of its trading activity was effected through sales representatives. We think that it is hard for a principal trading desk to be legitimately customer facing if it has such little trading activity through sales representatives.

- In addition to defining a “principal trading desk,” our proposed principal trading exception would require the trading desk (except for hedging transactions) to make any covered financial position available for purchase to sales representatives through an electronic trading system if it is available to registered broker dealers for purchase through an electronic trading system. We think that this is very important because, to us, the essence of a “proprietary book” is that its sales and trading inventory are not available for purchase by sales representatives. By making these covered financial positions available to both registered broker-dealers and sales representatives alike, it renders difficult any effort to maintain a “proprietary book” that effectively navigates the quantitative categories above.

These proposed revisions also help to illustrate some of the issues we encountered in thinking these issues through:

- ***There is gray area here.*** While a principal trading operation with no “proprietary book” should ordinarily not experience trading activity with other broker-dealers that exceeds a majority of its trading activity, practices do vary and we recommend retaining the ability of a bank to establish that its principal trading desk is customer facing even if less than 50% but more than 25% of trades are through sales representatives. Our proposed revisions suggest using the 50% threshold as a safe harbor rather than the exception itself. Our proposed revisions fashion the principal trading exception itself as a trading desk or other organizational unit whose purpose is to facilitate trading for the customers and clients of the bank. We believe that this approach balances the certainty that the 50% threshold would provide banks who are able to satisfy it with the reality that some banks may not meet the 50% threshold but could use other evidence to prove the customer-facing nature of the principal trading operations.

- ***There need to be some exceptions.*** If the language only considers trades effected through sales representatives, this can distort the real picture and exceptions are needed. First, the trading activity thresholds we have proposed should not include trading activity that is intended to hedge risk in the bank's principal trading desk's inventory. Positions that hedge such an inventory are pretty easily identified (*e.g.*, short positions with long-dated inventory represent a clear hedging purpose). The ultimate purpose of the Volcker Rule is to reduce the risks to banks and these thresholds should not be a disincentive for banks to hedge risk. Second, the exception should allow for exceptional market conditions. Using clear percentage thresholds for transactions effected through sales representatives would need to be balanced with the reality that there are exceptional moments in the markets when even truly customer-facing principal trading operations have a substantially larger number of trades with other broker-dealers to mitigate rapidly evolving risks or rapidly changing customer demands.

- ***We need to close the loopholes.*** We tried to think through (and close) any loop holes that could be created by our proposed revisions. One such loophole we identified was that by using sales representatives to evidence customer facing trades, a bank could just use sales representatives in its trades with other broker-dealers. To close this possible loophole, we treated any trade with a broker-dealer for its account as though it were not effected through a sales representative even if it were.

We also want to note that we have some concerns with Appendix B to the proposed Volcker Rule. We think that Appendix B appears to have been crafted more with derivatives trading in mind than equity and fixed income trading operations. We believe Appendix B's discussion of revenue generation and risk management does not exactly match how principal trading operations are or even should be structured. Equity and fixed income principal trading operations do look to trading profit and loss to generate revenues for the trading desk and that does not mean that the trading desk does not exist to facilitate customer trading. Further, many of the measurements of risk exposure in Appendix B do not really make sense and are not used in equity and fixed income trading. Rather than confuse these concerns with the other concepts in this letter, we would like to just note these concerns now but would like to discuss them further with you if we can meet in person.

We appreciate the opportunity to submit these ideas to you and we hope they are helpful to you in crafting a market-making activity exception that protects the principal trading operations of banks. We hope that we have responded to your request for more market feedback as to what can be done to preserve principal trading but prevent the existence of "proprietary books" and other loopholes. We would appreciate an opportunity to discuss these concepts and our thinking behind them. Feel free to contact me at 202-204-7901 or my staff, Susan Collet, at 202-204-7902 with questions or to schedule a meeting.

Sincerely,

Michael Nicholas
Chief Executive Officer