

1 of 1 DOCUMENT

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REP. SPENCER BACHUS HOLDS A HEARING ON EXAMINING THE IMPACT  
OF THE VOLCKER RULE ON MARKETS, BUSINESSES, INVESTORS AND  
JOB CREATION, PART II

December 13, 2012 Thursday

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**TYPE:** COMMITTEE HEARING

**LOCATION:** WASHINGTON, D.C.

**COMMITTEE:** HOUSE COMMITTEE ON FINANCIAL SERVICES

**SPEAKER:** REP. SPENCER BACHUS, CHAIRMAN

**WITNESSES:**

REP. SPENCER BACHUS, R-ALA. CHAIRMAN

REP. FRANK D. LUCAS, R-OKLA.

REP. JEB HENSARLING, R-TEXAS

REP. SHELLEY MOORE CAPITO, R-W.VA.

WITNESSES: JAMES BARTH, LOWDER EMINENT SCHOLAR IN FINANCE, AUBURN UNIVERSITY AND SENIOR FINANCE FELLOW, MILKEN INSTITUTE

WILLIAM R. HAMBRECHT, FOUNDER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, W.R. HAMBRECHT & CO.

DENNIS M. **KELLEHER**, PRESIDENT AND CHIEF EXECUTIVE OFFICER, BETTER MARKETS

JEFF PLUNKETT, GENERAL COUNSEL AND EXECUTIVE VICE PRESIDENT, NATIXIS GLOBAL ASSET MANAGEMENT, ON BEHALF OF THE ASSOCIATION OF INSTITUTIONAL INVESTORS

THOMAS QUAADMAN, VICE PRESIDENT, CENTER OF CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

PAUL SCHOTT STEVENS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE INVESTMENT COMPANY INSTITUTE

REP. FRANCISCO 'QUICO' CANSECO, R-TEXAS

REP. NAN HAYWORTH, R-N.Y.

REP. DAVID SCHWEIKERT, R-ARIZ.

REP. MAXINE WATERS, D-CALIF.

REP. JOE BACA, D-CALIF.

REP. STEVE PEARCE, R-N.M.

REP. BLAINE LUETKEMEYER, R-MO.

REP. STEPHEN F. LYNCH, D-MASS.

REP. STEVE STIVERS, R-OHIO

REP. AL GREEN, D-TEXAS

REP. BILL HUIZENGA, R-MICH.  
REP. CAROLYN B. MALONEY, D-N.Y.  
REP. JOHN CARNEY, D-DEL.

**TEXT:**

**BACHUS:** Good morning. We started this hearing at 9:00 instead of 10:00, because we didn't want votes again to interrupt what we consider a very important hearing.

The hearing will come to order.

As previously agreed with the ranking member, there will be 10 minutes on each side for the purposes of making opening statements. And without objections, all members written statements will be made a part of the record, as well as the witnesses. Your entire statement will be made part of the record. Without objection, I'll recognize myself -- I guess without objection, all written statements will be made a part of the record.

I recognize myself for 5 minutes for purposes of an opening statement. This morning the committee holds its second hearing to focus exclusively on the Volcker Rule, and specifically its impact on the markets, investors and job creation. The Massachusetts Educational Finance Authority has warned regulators in its comment letter of February 13th that the Volcker Rule would increase funding costs for the authority's bonds, which, quote, "... would be passed along to consumers, funding higher education expenses through their loan programs."

In a February 14th comment letter to regulators, the Financial Executives International, which represents corporate treasurers of both public and private companies, wrote, "... that the Volcker Rule as proposed could adversely affect the ability of American businesses to grow, create jobs and contribute to a healthy economic recover."

Putnam Investments also cautioned regulators in their comment letter that the consequences of the Volcker Rule, and I quote, "... may range from reduced liquidity in U.S. capital markets, and harming their global competitiveness through raising the cost of capital to U.S. corporations, lowering returns to investors, and curbing the American economy's capacity to grow."

The Volcker Rule is designed to prevent proprietary trading by banks, but no one, not even Paul Volcker himself, argues that proprietary trading was the cause of the financial crisis. The erosion of lending standards in the Federal government's poorly conceived efforts to subsidize lending caused the financial crisis, not proprietary trading. Therefore, the Volcker Rule sticks out as an oddly considered afterthought, a solution in search of a problem.

Even if one attempted to argue that proprietary trading played a role in causing the financial crisis, and even if banning proprietary trading would make the financial system safer -- propositions, by the way, that are simply not supported by the evidence -- the prospect that regulators have been unable to agree on a single version of the Volcker Rule is extremely troubling.

Competing versions of the Volcker Rule will make it all the more difficult for market participants to know what their obligations are and how to comply with them, particularly if they find themselves subject to conflicting obligations enforced by different regulators. The Volcker Rule, or even worse, rules, will not make the financial system any safer.

But as I said, it will impose significant costs on consumers, workers, savers, students, taxpayers and businesses. It will stifle the growth of businesses that operate far from Wall Street, and it will hamper the ability of asset managers, pension funds and insurance companies to grow the value of their portfolio for millions of individual investors or retirees.

The Volcker Rule is a self-inflicted wound that should be repealed. Unfortunately, the 112th Congress

did not do that. Hopefully, the 113th should. I thank all the witnesses for being here today to offer their perspectives, and I look forward to a discussion we will have on this important topic.

At this time, I recognize the ranking member for his opening statement.

**FRANK:** Thank you, Mr. Chairman. I'll yield myself such time as I consume, because I'll want to consult with my colleagues about their time.

I will say that this is a very important subject, but not all of the members are at this point in the spirit of full participation in the legislative process. That means no disrespect to those who have honored us by coming here to this hearing.

I want to talk about the Volcker Rule in the context of the broader question of bank regulation. I understand my colleagues on the Republican side, this is part of their general approach that very little needs to be done after the financial crisis of 2008 and 2009.

And I'm particularly struck by what seems to be a great inconsistency. Many of the Republicans, while the critics of our legislation, have complained that we didn't do anything about the too big to fail doctrine, quite the contrary to the written language, and some have said, well, maybe the banks are too big. The argument is, you know, as long as they are as big as they are, probably too big to fail is inevitable.

Well, one of the things that has been proposed and I believe will go into effect to reduce the size of the banks is the Volcker Rule. And it does it, I believe, in a thoughtful way. It reduces them, not by some arbitrary order by the government to sell things off, not to create a fire sale of financial assets, which I think would be the result of some of the demands if they simply reduce. It does it in a functional way.

Now, I do want to address the notion that this will put us in a competitive disadvantage. To some extent, my friends in the financial institutions have taken as their model the 14-year-old child of divorced parents who think they can play mommy against daddy and get a great deal more freedom in their lives. When I hear the Americans talk about how restrictive the Volcker Rule will be, it sounds like what the British are telling the British authorities about ring fencing. In fact, there was a good deal of coordination and I doubt very much that we are going to be far in advance, for instance, of the British and even of the E.U. with regard to this kind of separation. It is simply an effort to play one off against another.

It is a functional way to reduce. And I want to address this, because it is a question I want to ask some of my friends when they say, well, we have not dealt with too big to fail appropriately. The Volcker Rule is, in context, is one of the ways to do this. And I was particularly moved to say that by an article in Political yesterday, which is in many ways as close to 100 percent inaccurate as it is possible linguistically to get. And I believe I have complied with the rules of the House in stating that.

For example, it begins -- and this is not one my colleagues -- the author says, "The government's decision to bail out AIG in 2009," -- wrong by a year, and a critical year. In 2009 Barack Obama was president. In 2008, when AIG was bailed out, it was bailed out by the unilateral decision by the Federal Reserve, with the full concurrence of the Bush administration. It was under Section 13-3 of the Federal Reserve Act. Mr. Bernanke and Mr. Paulson -- and I mean no criticism of them. I think they behaved very well during this.

As a matter of fact, many of us on the Democratic side were more supportive of the crisis efforts of President Bush and his aides than my Republican colleagues. And it was an example of full bipartisanship, I have to say, a month before the 2008 election, the Bush administration got complete cooperation from the Democrats here in dealing with the crisis.

But Bernanke and Mr. Paulson and informed us that they had decided to advance, Mr. Bernanke did under his statutory authority, \$85 billion to AIG. It had nothing to do with TARP, it had nothing to do obviously with subsequent legislation. It was a decision made by the Federal Reserve.

And then I note some of my Republican colleagues were saying, well, this is an example of a problem

with too big to fail and the legislature's failure to address it. As a matter of fact, the authority under which Mr. Bernanke unilaterally gave -- lent, we got the money back -- \$85 billion to AIG has been rescinded. The statutory authority, Section 13-3, was repealed.

So in fact, the bailout of AIG, that process, was made illegal by the Act. Exactly the contrary of suggestions that somehow the Act embodies it. The Act goes further, and it says that if a financial institution gets in trouble, it can be resolved and there may even be a payment of some of the debts if that's felt necessary. That, by the way, suggested to us by Mr. Paulson, in particular, but only as part of dissolving the institution.

Now, we have this extraordinary proposition from some that says if a bank gets into trouble, a very large institution, -- and my colleagues while they say we haven't done enough about some of this too big to fail -- oppose almost everything we've proposed that would reduce their size and make them less of a problem. The Volcker Rule is, I believe, an operational sensible way to reduce the size by removing some of the functions in a way that I think is less disruptive than any other alternative. A required sale, et cetera.

But we're told is that if a large financial institution gets in trouble somehow in some parallel universe a secretary of the Treasury would feel political pressure to give federal money to bail them out and keep the institution alive, despite the fact that that would be a violation of federal law, and despite the fact that politically it would be exactly the opposite. All the pressure would go the other way.

Now, obviously there were still problems with the law and the institutions, although I note in an article which I saw from -- well, I'll get the article and put it in the record -- that the investment community is starting to price down what they give the large financial institutions. It's from BreakingViews, and I would ask to put it into the record. "Too big to fail looks on its way to being licked." Talking about the market finally trying to price into fact that the law clearly states that no large institution can receive assistance, except as part of its death sentence.

The final point I would make is about the complexity of our rule. There was an article of complaint in February about the handling of some bonds. I believe it will be resolved. But the final point is this. When the Volcker Rule was first proposed, many in the financial community asked to take into account this, that and the other.

There's been an effort to try to accommodate this, and now that's being used the people who have listened to some of these comments, by saying, well, you make it too complicated. I believe it is important that it get done this year. I believe it will be. And I think you will see a Volcker Rule that will be adopted uniformly that will be reasonable, that will not put Americans at a competitive disadvantage.

And I'll make a prediction. One of the things that frustrates me is that people are able to make all kinds of criticisms of all sorts of things, secure in the knowledge that 2 and 3 and 4 years later, when the criticisms have proven them to be unfounded, no one will remember what they said. So I hope that the media here will not just chronicle what is said, but will put it somewhere where you can retrieve it and in a couple of years from now see how unfounded all these dire predictions have been.

And I -- you can just add how much time I consumed, Mr. Chairman.

**BACHUS:** Thank you.

Before recognizing the new chairman of the full committee, I wanted to say that Chairman Frank and I have not always agreed on the issues before the committee, or even before Congress. But I believe at all times we've strived to conduct business in a civil manner, and to be civil towards one another. And I compliment on that. We try to disagree without being disagreeable. And while we've not always succeeded in that, it's not been from a lack of trying.

I've very much enjoyed my association with both the chairman when he was chairman, and as ranking member. And this is the ranking member's last meeting, or last hearing, as a member of this committee unless we schedule another meeting.

**FRANK:** You were getting people's hopes up, Mr. Chairman, when you said that.

**BACHUS:** But Chairman Frank has served with distinction for three decades and I know all my colleagues join me in wishing Congressman Barney Frank all the best as he moves forward onto other challenges.

At this time, I'd like to give you a round of applause.

(APPLAUSE)

**FRANK:** Thank you, Mr. Chairman.

I appreciate that, and I join in your sentiments that we have worked together without legitimate profound differences becoming personal. I'd like to take a second to say that one of the things that bothers me in this, you never hear the word "partisan" used in a good sense. Partisanship is essential to democracy. You don't have self-governance by large numbers of people without political parties. Otherwise, you descend into a kind of purely thing.

The problem with partisanship is not that it exists, because there are legitimate differences that should be debated, the problem is when the differences that are legitimately recognized at a partisan alignment become so personally embittering that cooperation is impeded elsewhere.

And I thank you, Mr. Chairman, because that has never happened under your chairmanship. And I'm very pleased that we've been able to do it. As you said, we've tried to agree without being disagreeable. That hasn't always come naturally to me, but I've worked hard it and I think that in the end that's been the result. So I thank you for that consideration, and I look forward to being out there and watching you guys in the future.

**BACHUS:** Thank you.

And this committee has, with the good work of both the minority and the majority, no matter which party was in what position, has produced some very good legislation. A lot of the legislation has passed by over 400 votes, some of which has been adopted into law and worked very well. We have two bills over in the Senate now, the FHA bill and the Flood Insurance bill. Both passed by over 400. And I understand that the Senate may pass one of our bills today. But I saw an awful lot of members on both sides. I think this committee sort of stood out as being able to work in a bipartisan way through some very difficult challenges.

At this time I'd like to recognize the new chairman of the committee come January, Mr. Jeb Hensarling, for 3 and-a-half minutes or whatever you want.

**HENSARLING:** Thank you, Mr. Chairman. I like the "whatever you want" part of that.

With the indulgence of our guests and our witnesses, Mr. Chairman, I wish to add my voice into this moment of respect and admiration. I suppose selfishly one day I will be an ex-chairman and I hope somebody chooses to say something nice about me, and note my passing.

So today, even though Mr. Chairman we may, given the progress of the talks on the so-called fiscal cliff, may be hanging our stockings with the next to the chimney with care next to our colleagues who are celebrating the new year. I sense this is the last hearing of this committee in the 112th. And as the incoming chairman of the committee, I would be remiss if I did not note that this will be the last hearing for two chairman who have loomed in this committee's history. One, leaving not only the committee and Congress, but the other stepping down as chairman.

First, to Ranking Member then Chairman Frank, you have left a mark on this committee quite like he has. Few have brought into this room and into its proceedings an intellect as keen or a wit as clever. I will personally miss our spirited debates, not quite enough to ask him to reconsider to stay.

But when I think in terms how it is often challenging to say kind things about one in the opposing party, I

believe passionately in the ideas that I bring into this committee room. And I have my greatest respect and admiration for those who also bring passion and sincerity to their cause in their debate. And certainly Chairman Frank has done that.

And as a member of the other party who has opposed him vigorously for years, Mr. Chairman, he always conducted the proceedings in this room with fairness and his word was always good. And so, I know although we will say goodbye to him today in the Financial Services Committee, I sense that his presence will loom large someday soon perhaps over my right shoulder or left shoulder. I'm sure some competent staffer will one day tell me how these port cherts (ph) work, and I guess I perhaps look forward to the day where I see more of him and have to debate him less.

Chairman Bachus, you are the epitome of a gentleman. You have brought into your style of leadership great kindness, humility and integrity. Particularly those on our side of the aisle are fond of quoting President Reagan, who said, "There is no limit to what a man can do or where he can go if he doesn't mind who gets the credit."

You have also embodied what President Reagan said. You have empowered members. You have led by example. And you have taught us all, as my 9-year-old son who takes karate lessons back in Dallas, Texas, as part of an oath he recites he talks about character. And he has defined to me, his old man, that character is doing the right thing when no one else is watching.

And Spencer Bachus, our chairman, has character, because he has always done the right thing. Mr. Chairman, we will continue to benefit, fortunately, from your wisdom, your counsel, and your leadership as you soon will take your status as Chairman Emeritus in this committee. So again, I look forward to the day where I have one portrait over one shoulder, the other portrait over the other shoulder, but know somewhere down the way you are also there to provide the counsel and wisdom and leadership and character that you always have.

And with that, Mr. Chairman, even though the topic at hand is terribly important, I will allow other members to address it in their opening statements.

And I yield back.

**BACHUS:** Thank you.

Ms. Capito?

**CAPITO:** Thank you, Mr. Chairman.

I'd like to thank you for convening this morning's hearing, and this will be the last time, as we've heard, that my good friend Spencer Bachus will be chairing this committee, and I also want to thank him.

And I want to thank the ranking member for his leadership, not just in this committee, but in our nation. And he's taken me down a few pegs every now and then, so I've enjoyed that, sort of.

And anyway, I'm going to talk about the subject at hand. The majority of the focus on the implementation of the Volcker Rule has been on the effect it will have on Wall Street's ability to conduct trading activities. Less attention has been paid to the effect that the Volcker Rule could have on Main Street financial institutions and the businesses they serve.

Earlier this year the Financial Institution and Consumer Credit Subcommittee held a field hearing in Mr. Renacci's area of Cleveland, Ohio. One of our witnesses at our hearing was a representative from Key Bank, a regional bank based in Cleveland. Key Bank raised significant concerns about the effect compliance with the Volcker Rule will have on their ability to meet their clients' liquidity needs.

Specifically, their institution is concerned that market-making activities in less liquid securities that are demanded by their clients could be construed as proprietary trades. Regional banks like Key Bank are

servicing small and mid-sized businesses across the nation. If they cannot rely on their local and regional financial institutions to provide liquidity they will not be able to help our economy grow.

We've also heard concerns from our regional banks about the substantial costs, both monetary and man hours -- or I'll say woman hours -- involved just to prove that their market-making activities are not proprietary. These institutions are not the ones engaging in the activities the proponents of the Volcker Rule are seeking to address.

The regulatory agencies must ensure that the final rule addresses these concerns so small businesses and regional financial institutions are not adversely affected.

And I yield back. Thank you.

**BACHUS:** Thank you.

At this time, Mr. Frank?

**FRANK:** Thank you, Mr. Chairman.

I talked longer than normal because people weren't here, and then I offered time to my colleagues, who have really very graciously refused it and have yielded it back to me and I don't want to take up to much of the time. But I did want to address a couple more things on the Volcker Rule.

I understand the difficulty, but I do want to say in defense of the regulators that they are to some extent damned if they do, and damned if they don't. If they were to go ahead with a proposal generated among themselves, put out there for comment, and then adopted substantially unchanged, they'd be legitimately criticized for not listening to the people who had good input.

When, as they now did, they listen to a very large number of comments and seek to deal with them and move the rule, then people complain that it's taking too long, et cetera. I think the amount of time we are talking about is too long, given the importance of this and of doing it right. I also believe that the fears that have been expressed -- and I understand these, but I think they are without basis -- that some institution, because of the complexity of this when it's finally done, might inadvertently find itself in trouble.

I do not believe we will ever have in this country financial regulators so bloodthirsty that they would fall on an innocent mistake excessively. In fact, I think it is hard to look at the record of enforcement from both parties over all the time and find any hanging judges in their midst. Clearly, there will be a recognition that this is experimental to some extent, that it is new, and I am sure I will certainly be critical if it isn't the case that there will be the kind of forbearance, and that in fact what the regulators will appropriately do as we go forward with this is to say in some cases, no, that's not what you should have done. And there will be no penalty for it, obviously exempting cases of egregious and willful abuse. There'll be no penalty, but do it differently in the future.

And I say again, I would reiterate there is a complaint, including from some on the Republican side, many on the Democratic side in the commentary community, that the banks are just too big. Well, I challenge people. The Volcker Rule was one way to diminish their size, and it diminishes it by a logical and functional way and its one that is being dealt with by other countries.

If you reject the Volcker Rule, if there is to be no restriction of this sort, and you still believe the banks are too big, I read this stuff very diligently up until now. Come January I'm going to forget an awful lot. My theme song, taken from the old antiwar days is ain't going to study derivatives no more.

But up until now I have read this and I have not found any alternative serious, thoughtful way to reduce the size of the large banks. And I believe it is inconsistent logically and bad policy to complain that these large financial institutions are too large, to oppose the Volcker Rule and to propose no alternative means of reducing their size.

Now, Mr. Chairman, you and to all the members of this committee, I am very appreciative for the great and generous tolerance of me and all of my facets that we've had. And I am very proud to have served here. And I mean, I just want to close it by -- you're not (inaudible) for another 30 seconds.

In addition to the members, can I say of the staff on both sides, I don't think the American people understand what a great bargain they get in the people who are talented and dedicated and creative, and who work for us at a lot less money with harder hours and not the best working conditions than they could get anywhere else.

We've alternated. We've been in the majority and the minority. Majority, you get pretty good quarters. All of our staffs have been in the minority. Not so hot. So I do want to close as I acknowledge the generosity of my colleagues to express what I know everybody agrees with, the enormous debt, not just the members owe our combined staffs, but what the American people owe them.

Thank you, Mr. Chairman.

**BACHUS:** Thank you.

And let me say, just take 15 seconds. Last night we had our Republican staff Christmas party I've had every year. We had 86 staffers and former staffers. Several of them said -- that were no longer staffers -- said I would love to still be on The Hill, but I couldn't turn down an offer. And in almost every case it was for twice as much money. And some of them said I had children and going to college I just had to do it. But what a talented group we have here on both sides and they work very well together. And I know that that will continue, or I pray that it will.

At this time we...

**FRANK:** Mr. Chairman, can we give a round of applause for the staff?

**BACHUS:** Yes.

(APPLAUSE)

All right. Well deserved.

At this time we'll introduce the panelists. The first panelist is Professor Jim Barth, who is the Lowder Eminent Scholar in Finance, Auburn University, and is senior financial fellow at the Milken Institute. Some of you may not be familiar with Auburn. Auburn, you could consider it either the Yale of the South, the Stanford of the East, I guess. But I went there, so that's why I made that remark. But a very fine school.

And Jim, it's great to have a friend testifying this morning.

Mr. William Hambrecht is the founder, chairman, and chief executive officer of WR Hambrecht & Company. We welcome your attendance.

Mr. Dennis **Kelleher**, who is the president and CEO of Better Markets. Welcome you back to the committee.

Mr. Jeff Plunkett, general counsel and executive vice president of Natixis Global Asset Management, on behalf of the Association of Institutional Investors.

Mr. Thomas Quaadman, vice president, Center of Capital Market Competitiveness, U.S. Chamber of Commerce.

Mr. Paul Stevens, president and CEO of the Investment Company Institute. Welcome you gentlemen.

Welcome you gentlemen.



At this time, Professor Barth you can proceed with a 5 minute -- approximately 5 minute -- opening statement.

**BARTH:** Thank you.

Chairman Bachus, Ranking Member Frank, and members of the committee, thank you for the opportunity to testify today on the Volcker Rule. My opinions are based on my experience as an academic studying financial institutions and markets, and as an official at bank regulatory...

**BACHUS:** Just pull the mic a little closer.

**BARTH:** Is this better?

**BACHUS:** Yes. Thank you.

**BARTH:** My opinions are based on my experience as an academic studying financial institutions and markets, and as an official at bank regulatory agencies. I am now on the faculty at Auburn University and previously was on the faculty at George Washington University. In addition, I have served as director of the Office of Policy and Economic Research of the Federal Home Loan Bank Board, and chief economist of the Office of Thrift Supervision.

I've also held positions as visiting scholar at the Congressional Budget Office, the Federal Reserve Bank of Atlanta, the Office of the Comptroller of the Currency, and the World Bank. In my scholarly research and government service I have studied the performance of hundreds of financial institutions, including the causes of distress of many that failed.

I believe the Volcker Rule is based on an incorrect premise, will be extremely difficult to implement, and worse, will produce far more harmful economic effects. There is no evidence to support the belief that proprietary trading was the cause of the recent or any other financial crisis. In fact, all the evidence points to the contrary.

The most recent crisis was triggered by poor lending and underwriting practices in the real estate sector, and excessive leverage by and insufficient liquidity at banking entities, not by proprietary trading by banks. The implementation of Volcker Rule will require regulators to distinguish between prohibitive proprietary trading and permissible activities, such as market-making, hedging and underwriting.

Because these permissible activities sometimes appear similar to proprietary trading, it may be virtually impossible for regulators to draw a bright line between the prohibits and permissible activities that are not arbitrary. To the extent that regulators err on the side of restricting beneficial trading activities, or that the regulation deters banks from engaging in some permissible activities, the result will be banks providing less liquidity in the market.

This in turn will increase the bid-ask spread on securities, issuers will pay higher interest rates to raise capital, and investors will pay more to purchase securities and receive less when selling them. All these developments harm markets, businesses, investors and job creation.

As banks are denied the opportunity to engage in profitable trading activities, they may be driven to engage in ever more risky activities in an attempt to provide investors with an acceptable return. The Volcker Rule may therefore lead to riskier, not less risky, banks. The rule may also place U.S. banks at a competitive disadvantage to banks in other countries.

In addition, if proprietary trading is simply carried on at non-banks, the question then becomes is the forced migration of proprietary trading from banks to non-banks more likely to increase or decrease financial stability? To address this issue, I recently conducted a preliminary examination of 22 years of individual trading losses of at least \$1 billion each. These trading losses were in no way limited to banks or financial services firms. Rather, they occurred at a range of firms, including banks, investment banks, hedge funds and manufacturing firms. Even a local government authority was involved.

Specifically, for the period 1990 to 2012, the banks' losses were 5 percent over their equity and posed relatively little risk to solvency. Investment banks had losses equal to 34 percent of equity. Manufacturing and petrochemical firms, firms that are typically are endusers of derivatives and other financial processes had losses of 48 percent of equity. Finally, the most risky are hedge funds which experienced losses equal to 140 percent of equity.

These illustrative results suggest that trading appears to be less risky when carried out at banks than at non-banks. The important point of this exercise, however, is that one should not focus on trading losses per se, but on potential trading losses relative to equity capital, which reflects a firm's ability to absorb losses. Excessively leveraged firms are clearly less able to absorb trading losses, or any losses, for that matter.

Moreover, some large trading losses did occur during the financial crisis, but mortgages based poor lending and underwriting quality were largely to blame, rather than the trading itself. The focus of regulation should therefore be in ensuring that banking entities have sufficient capital commensurate with risk, not on separating some invasive banking activities from commercial banking.

In conclusion, I see very little if any upside to the Volcker Rule, but substantial costs to markets, businesses and investors. That the rule is well-intentioned and banks may survive it is not the issue. The issue is whether the benefits exceed the costs. There is no evidence that this is the case and my reading of the evidence is to the contrary. It is therefore difficult to justify such a major organizational change.

Thank you very much.

**BACHUS:** Mr. Hambrecht?

**HAMBRECHT:** Thank you.

**BACHUS:** And one thing, we'll -- if everybody will turn on the mic on? But also, and this is a problem almost every witness has, pull it a lot closer than you think it should be. And would somebody on the staff...

**HAMBRECHT:** The light went out.

**BACHUS:** ... I don't know who is...

**HAMBRECHT:** OK. OK, thank you very much.

Thank you, Mr. Chairman.

I was a member of the Investor's Working Group, an independent task force sponsored by the CFA Institute, and the Council of Institutional Investors that was chaired by two former SEC chairmen, Arthur Levitt and William Donaldson. The report concluded, if I may read the quote, " ... proprietary trading creates potentially hazardous exposures and conflicts of interest, especially to institutions that operate with explicit or implicit government guarantees."

We came to that conclusion after a lot of debate and a lot of looking at what actually happened. And we thought our charter was, first of all, to try and figure out why the six largest banks were suddenly in trouble? How did that happen in an environment that, where for almost 70 years from the Glass-Steagall Act, there had been no crisis of that magnitude, nor had it fallen on the banks. There were a lot trading losses. There were a lot of -- we went through all kinds of different kind of market cycles, but why did this happen?

And there was a difference of opinion within the committee and I'm just giving you my opinion now, because I was designated to be the spokesman for this particular issue. And in my mind, the basic issue, as it is in almost every major breakdown in the marketplace, is one of the leverage. If you look at the market for mortgage paper, yes, you can say, gee, this was a terrible market.

If you look at the Shiller-Case Index, the real estate market went up about 20 percent in 2004. It climbed back down to about even. And then, in the 2008-2009 marketplace, declined 20 percent. So it was a major

move, but the kind of moves in markets that we've had countless times. And the thing that really created the crisis, in our opinion, was excessive leverage.

Well, where did this excessive leverage come from? And the question we kept asking the CFOs and the people who ran these companies was, "Hey, what banker in his right mind would lend you 97 cents on the dollar against an opaque piece of paper that's hard to understand, that's traded in a market dominated by the guys who create the paper"?

You know, who would do that? And frankly, the answer was no one would do that. And huge leverage, the \$700 billion trading position at Lehman Brothers, was basically financed with customer deposits in the form of free credit balances, most of them from short sales of hedge funds, and also from a repo market that basically you borrow in the evening and you pay it off before the market opens up. So there wasn't any real liquidity.

So we focused on, number one, how do you create a market that will truly reflect price discovery, to not be dominated by a few people, and propping up prices that don't hold up? And then secondly, how do you regulate the lending to these trading accounts when there's no lending discipline, when they make the decision as to how much money that could come, because the customer base doesn't know about it?

So we arrived at basically a conclusion that there had to be regulation. That it had to focus on functionality, as former Chairman Barney Frank said. But also, it also should focus on the leverage factor. And how do you control that leverage? So we came out with a recommendation that it be included in whatever regulatory framework that would evolve out of this crisis, but that it focus, as the Glass- Steagall Act did, on leverage and control of leverage. So that, when we do hit these inevitable market declines and excesses, the Fed and other people can control the amount of leverage that's inherent in the business.

My statement, I could go through it in great detail, I will say there's some detail on the mechanics of how it works, because we found that very few people really understood where the money came from. Investor banks' balance sheets are remarkably opaque. It's very difficult to understand where the money comes from. So I apologize for the technicalities in the paper, but they're based on a career of over 50 years in raising capital and dealing with traders and dealing with trading departments.

And I find there are certain characteristics of trading departments and traders that seem to reoccur in every kind of market. And the committee has of course focused, as many of us did on how do you separate or how do you determine what is a proprietary trade and what is a trade that's really providing liquidity to a customer and adding value in the aftermarket?

I can walk into a trading department and take a look at the compensation scale. And I can say, "OK, those are the prop traders and those are the agency traders." You can just take a look at the pattern of trading and you can smell it. I mean, basically people who operate as specialists with specialist responsibilities, will be there to participate in the market, normally counter against the market, to provide some liquidity to avoid some of the excesses.

The prop traders will almost always go with the trend, because they're on a profit and loss basis. When they see a raft of selling orders coming in, they want to get ahead of those orders and be short. They don't want to sit there and buy them.

So that's your essential problem. And I have no idea how you can go short forever, but you sure can give them unlimited money.

**BACHUS:** Thank you.

Mr. **Kelleher?**

**KELLEHER:** Good morning, Chairman Bachus, Ranking Member Frank, and members of the committee. Thank you for your invitation to Better Markets to testify today.

I'm the president and CEO of Better Markets. It's a non-profit, non-partisan organization that promotes the public interest in the domestic and global financial markets. It advocates for transparency, oversight and accountability with the goal of a stronger, safer financial system that is less prone to crisis and failure, and thereby eliminating or minimizing the need for taxpayer-funded bailouts. I've detailed my background and what Better Markets in my written testimony. It's also available on our website, [bettermarkets.com](http://bettermarkets.com), and I won't repeat that here.

For those who say that high risk, speculative proprietary trading by the handful of too big to fail banks is not a problem, I say look at JPMorgan Chase and the so-called London Whale trade that so far has cost the bank more than \$6 billion, and might cost it as much as \$9 billion. That doesn't include the more than \$20 billion in shareholder market capitalization losses, which are never mentioned.

Those billions in losses resulted from a huge speculative proprietary trade using federally insured depositors' money, which was done to generate profits for JPMorgan. JPMorgan bet around \$100 billion of federally insured depositors' money. And remember, JPMorgan and its CEO admitted -- including right here before this committee -- he admitted that the risk taken by the traders when they were betting their depositors money, they were done without anyone in senior executive, financial, legal, compliance risk or others, even knowing what the risks of the trade were. That admission shows that these gigantic banks are not only too big to fail, but they're too big to manage.

For those who say that the JPMorgan London Whale prop trade had nothing to do with the financial crisis, I say, 1), it doesn't matter, because the issue is eliminating or reducing high risk speculative trading that could prove lethal to taxpayer-backed banks and require taxpayer bailouts. And 2), there are plenty of examples of prop trading in connection with the financial crisis, with Citi Group being the poster child and having to write off almost \$40 billion just due to the CDO positions on its trading book.

Because time's short, I won't go into details here, but they're detailed in my written testimony and in the four comment letters Better Markets has filed in connection with the regulators' consideration of the Volcker Rule. It's important to remember that the Volcker Rule is narrow in application and limited in scope. It prohibits the handful of biggest too big to fail banks from making huge, high risk, speculative bets usually but not always with the bank's own or borrowed money. This type of trading is in stark contrast to banks investing and trading their customers' money on their customers' behalf. Proprietary trading by the biggest banks is nothing more than gambling.

Now, big banks gambling like this would be fine if it only threatened the betting bank, and if only the bank suffered the consequences of its betting. But that is not the case with high risk propriety trading by the biggest too big to fail banks. Those gigantic banks are backed by taxpayers. Their failure threatens our financial system and the entire economy, and as a result the banks get the upside of the gambling and taxpayers get the downside, as evidenced by the last crisis.

And the downside can be enormous. Better Markets did a recent study showing that the crisis will cost the U.S. more than \$12.8 trillion, and that's a conservative number. Now, banning proprietary trading isn't the solution, but it is an important part of a solution, along with capital liquidity, leverage standards, resolution authority, and much more.

Finally, implementing the Volcker Rule in our view is not complex or difficult if you follow two keys. Key number one, focus -- Bill just alluded to -- focus on compensation to break the link between proprietary trading and banker bonuses. We've detailed in our writing, in our testimony, and in our comment letters. If you deconstruct and disaggregate the bonus pool, then you'll know right where the proprietary trading is, both before and after. That's easy for them to follow, easy for regulators to follow, and easy to police.

Secondly, and most importantly, the law has to be backed up with swift, certain, and significant penalties for traders, supervisors, and yes, finally, executives. If those two keys are followed, implementing the Volcker Rule can be done and it can be done without interfering with the permitted activities of market-making, risk mitigating hedging, and the other permissible activities without prop trading.

As a result, if you do it that way, as a result the ban on prop trading will not harm customers' credit or job creators. Indeed, removing the threat posed by these biggest too big to fail banking giants to our financial system and our economy is likely to unleash a renaissance in our financial industry as transparency, competition and fairness create numerous opportunities for current and new market participants.

And in closing, I'd just like to say, as a native of Massachusetts and who's had the privilege of watching the career of Chairman Frank for it seems like more than 30 years, but I guess it's just 30 years, that I wanted to thank him for his public service. The people of Massachusetts and the people of the country I think owe him a great debt. And Chairman Bachus, I'd like to second everything that's been said about you as a gracious, smart, tremendous contributor to the mission over the years in any capacity here, and your courtesy has been most appreciated.

Thank you.

**BACHUS:** Thank you, Mr. **Kelleher**.

And Mr. Plunkett, who is Natixis; right?

**PLUNKETT:** Yes, sir.

**BACHUS:** Oh, I got it right this time, Natixis.

**PLUNKETT:** Chairman Bachus, Ranking Member Frank, and members of the Financial Services Committee, thank you for inviting me to participate in today's hearing.

My name is Jeff Plunkett. I'm general counsel and executive vice president of Natixis Global Asset Management. Today, I'm testifying on behalf of the Association of Institutional Investors, an association that includes some of the oldest, largest, and most trusted investment managers in the United States. Collectively, the association's members manage pension funds, 401K funds, mutual funds, and personal investments on behalf of more than 100 million American workers, and retirees.

The association supports the Volcker Rule's core objective of eliminating risky behavior at banks. However, the current proposed rule is burdensome, and goes beyond congressional intent. This could have far-reaching, negative consequences for investors. Asset managers and their clients rely on banks to execute trades. The regulators proposed rule will discourage banks from engaging in these transactions due to compliance costs, and uncertainty regarding what is permitted under the rule. In part, this uncertainty comes from the rule's complex, after-the-fact tests for determining what is proprietary trading, which do not reflect the realities of financial markets.

The regulators are doing their best to implement the statute as written, however, unless changes are made there will be significant disruptions to the market. The association also includes bank-owned asset managers. We believe the covered fund restrictions could be focused in a manner that addresses systemic risk without creating a competitive disadvantage that would lead to fewer choices for investors, and less innovation in the marketplace. In order to address these concerns, the association has offered the committee specific technical corrections.

While our written testimony discusses these suggestions in more detail, today I'd like to touch on several of our main concerns. First, with regard to proprietary trading, we support clarification that regulators should focus on trading activities that do not have any connection to customer facilitation. This change would be consistent with former Federal Reserve Chairman Paul Volcker's statements that proprietary trading should be easy to recognize. Second, with regard to the market-making exemption, Congress must provide clarification to regulators on the definition of, near term.

Near term means different things in different markets. For certain, in liquid markets the near term may be much longer than in other markets. The market-making exemption should apply to market making activities in illiquid markets, or markets that have only episodic liquidity. Third, in the covered fund restrictions, Congress should revise and narrow the definition of hedge fund, and private equity fund to exclude all

registered investment companies, and specifically identify the factors that must exist in other pooled vehicles, before the regulators may designate them as, similar funds.

Foreign funds that are not actively marketed to U.S. investors should be excluded from the definition, as should non-U.S. regulated funds, which are subject to supervisory regulation in their foreign jurisdictions. Finally, Congress should amend the naming prohibition in the Volcker Rule, to allow hedge funds and private equity funds to continue to identify themselves as the manager of the fund, so long as the fund does not use the word bank, or the same name as an insured depository institution in the name of the fund. This restriction, along with the rules existing disclaimers and anti-bailout provisions, should ensure that the entities are viewed separately in the marketplace.

Mr. Chairman, a technical corrections bill would provide regulators with a clear statement of congressional intent, and would go a long way to mitigate the potential unintended consequences that will harm millions of Americans who are saving for their retirement. The changes that we lay out in our written testimony, would ensure that we can continue to serve their needs, while still meeting the needs of the Volcker Rule. We commend the committee for considering taking such actions to address industry concerns, particularly prior to further rulemaking from the financial regulators.

Thank you for your time today, and I look forward to answering your questions.

**BACHUS:** Thank you. Mr. Quaadman?

**QUAADMAN:** Thank you Chairman Bachus, and first let me thank you Chairman Bachus and Ranking Member Frank for your work on this committee, and for your service. We've enjoyed working with both of you. And Mr. Hensarling and Ms. Waters as you embark on your leadership on the committee, we look forward to working with you as well. The Chamber agrees with the intent of the Volcker Rule, and that is to stabilize the financial system, as well as to protect against federally insured deposits.

We believe, however, that capital and liquidity requirements are a better pro-growth means of achieving that goal. Congress was right to include a market-making and underwriting exemption to the Volcker Rule. Market making and underwriting are important, critical tools for non-financial businesses to raise capital. However, regulators are constructing a system to engage in a trade by trade analysis, to discern the intent of a trade and to determine if it is complying with the Volcker Rule.

This will raise costs of capitals -- cost of capital formation for all businesses, and in fact will shut some businesses out of capital markets all together. The Volcker Rule must also be viewed in conjunction with other major financial regulatory initiatives, many of which actually converge on the desk of the corporate treasurers. Derivatives rules directly impact the ability of a corporate treasurer to mitigate risks, lock prices -- lock in prices, as well as insure access of raw materials for the corporation. Money market funds which are currently being discussed, affect the ability of a corporate treasurer to sell commercial paper, as well as to employ effective cash management techniques.

The Volcker Rule impacts the ability of a treasurer to enter capital markets, as well as raise his costs, while Basel-III impacts the ability of a corporate treasurer to obtain bank loans, as well as to have commercial lines of credit. So as one example that a mid size corporate treasurer told me, is that when they go out and sell their commercial paper, their entire costs for that sale are 46 basis points. Because they believe that the Volcker Rule will prevent them from entering the commercial paper market, they then have to tap their commercial lines of credit which are prime plus 1 percent, or about 425 basis points, for a 10-fold increase in their capital costs.

However, you have to remember that commercial lines of credit under Basel-III have a negative risk weight to them to there's a disincentive for banks to actually provide commercial lines of credit. Therefore the only alternative that is open to that corporate treasurer, is to increase their cash reserves. Corporate cash reserves in the United States are currently \$2 trillion, or about 14 percent of GDP which is a historic high number here in the United States. If because of the Volcker Rule we have to morph to a higher European level of -- of cash reserves, that would be \$3 trillion, or 21 percent of GDP.

That means that corporate treasurers will have to idle \$1 trillion in cash that could otherwise be used for more productive economic means. So because of those impacts as well as the complexity of the Volcker Rule, we believe that the regulators need to propose a role to allow all stakeholders the opportunity to view the final rule, give regulators informed comments, and avoid adverse or unforeseen consequences before they occur. We also believe that the Bachus- Hensarling initiative to propose an extension of the conformance period, will also allow regulators the time to get it right.

In -- at the request of the committee, we provided a letter in September on Volcker Rule alternatives. We believe there are certain legislative alternatives, as well as means of fixing the rule itself. First off as I said before, if the Volcker Rule were to be repealed, the higher capital and liquidity requirements in Dodd-Frank will actually allow regulators to deal with financial institutions who -- who should desire to engage in proprietary trading, if they choose to do so.

When President Obama first proposed the Volcker Rule in 2010, the rule was envisioned to be an international rule, and that all major financial players around the globe would follow that. However, other players have decided not to go down that route. We believe the legislation introduced by Congressman Peter King, which would -- which would save the enforcement of the Volcker Rule until there is international -- coordination compliance with a similar Volcker Rule policy, is an important means of protecting American competitiveness.

Finally, we've also listed a number of different specific fixes that we think are important to the Volcker Rule if it is to go forward. Namely that if financial institutions, and by financial institutions I also mean non-financial institutions that may own a bank, or a financing arm, that if they do not engage in proprietary trading, they should not have to construct a costly, intrusive compliance program, that illiquid issuances in both debt and equity, which Congress also recognized as a problem in passing the JOBS Act, should be exempt.

That there should be a clear exemption for joint ventures to protect American competitiveness abroad. There should be an exemption for state and municipal debt issuances, which are a key means of financing for infrastructure projects, and finally 11 months ago, Governor Tarullo sat in this seat and said that regulators did not understand what normal market making and underwriting practices are. We believe there should be a further study of those market making, and underwriting practices, so that regulators understand how non- financial businesses access the capital markets, and to ensure that those businesses are not adversely impacted.

Thank you and I'm happy to take any questions you may have.

**BACHUS:** Thank you Mr. Quaadman, and Mr. Stevens?

**STEVENS:** Thank you Mr. Chairman. For ICI, let me add our own salute to you, and to former Chairman Barney Frank for your leadership of the committee during a period of extraordinary challenges. America's mutual fund investors owe you both a great debt of gratitude. Mr. Hensarling, Ms. Waters, we look forward to working with you and all of the members of the committee in the 113th Congress. I -- I appear today on behalf of the Investment Company Institute. We're the National Association of Mutual Funds, Exchange Traded Funds, Closed End Funds and other registered investment companies.

Our members, as you know, manage almost \$14 trillion on behalf of 90 million American investors. Mr. Chairman by right, our membership should have few, if any concerns about the Volcker Rule. Congress enacted section 619 of the Dodd-Frank Act to restrict banks from engaging in proprietary trading, and from sponsoring or investing in hedge funds, or private equity funds. The Volcker Rule was not directed at the institute's members, that is at registered investment companies.

And yet, unfortunately the ways in which the five regulatory agencies proposed to implement the Volcker Rule would expand the reach of section 619, beyond what Congress intended. This raises a number of serious concerns for our registered funds, for our members. Chief among the concerns is the fact that the proposed implementing rule could treat many registered funds, as hedge funds, a result that contradicts the

plain language of the statute that Congress passed.

The statute restricts bank's relationships with hedge funds, private equity funds and quote "similar funds, as defined by the regulators." The statute defines hedge funds and private equity funds by reference to the fact that these investment vehicles are not registered under the Investment Company Act of 1940, nor regulated under that act. Clearly registered funds, which are organized and operated under that act's strict requirement, are not remotely similar to the funds Congress intended to cover in the Volcker Rule. Yet, the definition of covered funds offered by the agencies would sweep in many registered funds under the rule.

The same definition would also sweep in all non-U.S. retail funds, even though these non-U.S. retail funds are comprehensively regulated in their home jurisdictions, just as mutual funds are here in the U.S. and therefore, are not the type of funds that Congress meant to reach. In addition, some U.S. registered funds and non-U.S. retail funds could be traded under certain circumstances as banking entities, which would anomalously subject them to all the prohibitions and restrictions of the Volcker Rule itself.

Implementing the Volcker Rule in this way will impede the organization, sponsorship, and very normal activities of U.S. registered funds, and of non-U.S. retail funds alike, and investors will suffer as a result. Now, in detailed written submissions and numerous meetings, ICI and its international affiliate ICI Global have urged the agencies to provide explicit exclusions from the Volcker Rule for U.S. registered funds, and non-U.S. retail funds, as well as clarification that these funds are not quote, "banking entities."

Registered funds must also look at the Volcker Rule and its implementation from our perspective as investors in the capital markets. We do not believe that the proprietary trading restrictions as currently proposed will achieve their apparently narrow intended goal of addressing risky and speculative trading by banks. Instead, they are likely to have broader adverse impacts on the financial markets in the United States and abroad. And in the process will penalize registered funds and other investors who participate in these markets.

The proposed trading restrictions would -- could decrease liquidity, especially for those markets that rely mostly on banking entities to act as market makers, such as the fixed income and derivative markets, and the less liquid portions of the equities markets. A reduction of liquidity could ultimately lead to higher costs for funded shareholders, and for other investors. Similarly, the proprietary trading restrictions call into question whether banking entities could for example continue to serve as authorized participants, and market makers for exchange traded funds.

Banks play a critical role in ETF trading to help maintain efficient pricing, and to protect ETF investors. We recommend that the rule be clarified to spell out that banking entities can continue to support the efficient functioning of the ETF market. Now in this -- this and many areas of our concern, we believe the agencies implementing the Volcker Rule have it within their power to avoid all of these harmful consequences for funds and their investors. Given the number, and seriousness of issues that need to be addressed, however, we have recommended and we continue to urge that the agencies issue a revised proposal for public comment before adopting any final rules.

Further, we are deeply concerned about recent press reports that raise the possibility that the agency will -- agencies will adopt final Volcker Rule regulations that substantially differ one from another. This would be a true disaster, and it would fly in the face of Congress' express direction that the agencies coordinate their rulemakings. We urge that the committee do all that it can to ensure the consistency of any final rules issued by the agencies. Finally, if the serious adverse consequences for registered funds are not addressed through the regulatory process, ICI has suggested potential legislative changes to address several of our concerns.

We stand ready to work with the committee and interested members in this regard. Mr. Chairman, thank you for the opportunity to present our views. I would welcome any of your questions.

**BACHUS:** Thank you. At this time we have questioning by the members. I'd like to recognize Mr. Brad Miller who is retiring. Mr. Miller really was a leader in this Congress in highlighting subprime lending



practices in the early 2000's, and I commend him for that. His -- some of his predictions unfortunately came true. At this time, would you like a minute?

B. MILLER: Thank you Mr. Chairman I have appreciated the chance to serve on this committee for a decade, and have appreciated the relationships -- the relationships that I've had with other members, with our staff with the folks that sit back there. Some of you anyway, and the folks that sit over there as well. Mr. Chairman I would like to join in the kind of general spirit of this meeting and say nice things about you, but the last time I did that, it didn't work out well.

Three or four years ago, someone who sits over there stopped me in the hallway and said they were writing an article about you, and asked me to comment, and I said nice things. And then a day or two later the -- the article came out and the lead was that some Republicans did not trust Spencer Bachus because he got along too well with Democrats. And the second paragraph quoted me, saying how well I got along with you.

(LAUGHTER)

And, Mr. Chairman the next several meetings after that, you seemed to go out of your way to pick a fight with me about something or another to...

(LAUGHTER)

...show that we really didn't get along. And I wanted you to know that since that time whenever anybody has asked me publicly what I think of you, I have said, I don't like that sonofabitch.

(LAUGHTER)

And -- and Mr. Chairman I want you to know that I have done that as a personal favor to you.

**BACHUS:** Thank you.

(LAUGHTER)

Mr. Miller, it helped me in my primary.

(LAUGHTER)

Thank you. At this time I'd like to recognize Mr. Quico Canseco for two minutes, for the purpose of questioning?

**CANSECO:** Well I too want to thank you Mr. Chairman for your leadership on this committee. It has been a privilege serving on Financial Services, albeit a short two years. It has been quite an honor to serve on this committee and regrettably I won't be here the next Congress. And thank you for the opportunity to ask some questions here. Professor Barth, is there even a practical way to distinguish between prohibited proprietary trading, and market making?

**BARTH:** In answer I would say that it's going to be extremely difficult. And my concern is that the attempt to do so may actually eliminate beneficial trading activities by banking entities. The other part of my answer would be then, to the extent that banks are concerned about whether or not they are indeed engaging in proprietary trading, it may deter them from beneficial trading activities. I think it's extremely difficult to judge the intent of banking entities when it comes to proprietary trading.

And as we all know, there's the time factor over which one is going to try to determine whether or not the bank is engaged in proprietary trading or speculative trading activities, and other legitimate and permissible trading activities. That's my biggest concern.

**CANSECO:** So, even if regulators were to somehow make this distinction, which is unlikely as you say, in

your opinion, would a final regulation make the financial system any safer?

**BARTH:** No. I don't think there's any evidence whatsoever, despite what some people claim, that proprietary trading has, or will cause those sort of problems. As I pointed out in my testimony, it turns out it was basically poor underwriting and lending practices relating to real estate -- the real estate sector that really triggered the crisis, and is the major concern. And one should not talk about losses per se.

Whether or not JPMorgan Chase incurred a loss of \$6 billion, or \$9 billion is not the issue. The issue is really whether or not there's sufficient owner contributed equity capital on the part of that bank to cover that loss. One can talk, as I did in my testimony about losses, but it's losses relative to equity capital which is the issue. Not just big numbers to throw out, and say they're big losses. Is there sufficient equity at financial institutions to cover those losses? And that indeed has been the case, as I point out I think in a little more detail in my testimony.

**BACHUS:** Thank you. At this time, Ms. Hayworth is recognized, the gentlelady from New York, for two minutes.

**HAYWORTH:** Well thank you Mr. Chairman. And I echo the lavish and well-deserved praise that you have received this morning. And I -- I know that you're going to continue to illuminate our -- our proceedings as you retire to emeritus status. And with that, Professor Barth, I can't agree with you more about the root causes of this -- the crisis that precipitated the passage of Dodd-Frank, and this attempt to create barriers that are obviously very -- very difficult to -- to define.

And I was reading -- Mr. Hambrecht I was reading your -- your testimony, and you refer of course, to one of the -- the -- one of the primary problems being unlimited leverage and essentially taxpayer backed, low-cost financing. So you know we -- we're looking at -- and you speak of exerting market discipline. Eventually market discipline did come to bear in a -- a fairly catastrophic way as we know in 2008. Because you can't repeal the laws of gravity, so to speak. You can't repeal the laws of economic physics.

What would the most elegant solution to this problem be? Given what you've said, Professor Barth, what you've said Mr. Hambrecht. Should we be exerting energy? Because there is a cost of capital here, there is a cost of effort. Should we be exerting all of this energy on trying to create these barriers? Or should we go back to the root cause and devote our energies to withdrawing the federal government from activities that create market risk to begin with in unnatural ways?

**HAMBRECHT:** Well, there are a lot of solutions I'm sure that might work. I -- I still think that the key to it will be the recognition of what functionality those trades are in. And I -- I -- I maintain you can have a reasonable basis of judgment as to, what is a proprietary trading account, and what is a market making? To me the -- the -- the best solution would be to go back to the original margin requirements and approach that Glass-Steagall took. And basically what they said is, margin is allowed on exchange base trading where you have specialists who have obligations to make of an orderly market.

And you have the right to say how much you can borrow against that piece of paper. So to me, the Glass-Steagall pattern of transparent open markets and margin requirements that are basically in force on a real time basis, so that you're sold out before you can get your other parts of your balance sheet in trouble...

**BACHUS:** Thank you.

**HAMBRECHT:** ...I think that would be the most elegant solution.

**HAYWORTH:** Thank you Mr. Chairman.

**BACHUS:** Mr. Schweikert, two minutes?

**SCHWEIKERT:** Thank you Mr. Chairman, and first Mr. Chairman thank you for your kindness. And also to Scott Garrett as my subcommittee chairman, thank you for tolerating me. You -- you've treated me -- look the greatest joy I've had my two years here in Congress has been this committee, and I'm going to miss this.

Quick question, and not to try to repeat other ones that have come through, and is it Mr. Quaadman, you sort of touched on this. I have a great concern interest in liquidity of fixed income markets. Particularly municipal, quasi-municipal debt.

A lot of the bigger institutions often as good community players, you know will be the one to step in either when we've done a defeasance, or other things and play a -- will that type of concentration start to play in the margins of the Volcker Rule?

**QUAADMAN:** That -- that's a very good question. There is -- there is -- in the legislation there are certain disincentives actually for state municipal debt so that there are -- it will be more difficult for state municipalities to go into the capital markets and raise bonds in certain instances because they're going to be subject to the Volcker Rule. That will entail larger costs, and in fact may actually shut them out of certain markets.

The Conference of Mayors actually passed a resolution on this several months ago highlighting those concerns, and asking that this be fixed. So we believe that this is something that Congress should go back to in order to address. And this particularly impacts education projects, transportation projects. University of Massachusetts system would be affected by \$150 million in debt.

**SCHWEIKERT:** Thank you Mr. Quaadman. And this is one, Mr. Chairman and for everyone on the committee both right and left, this may be one of those areas where we can all agree that we may have to do a fix, just because it affects a lot of our communities, our sewer districts, our states, our communities and I think it's something that we can fix bipartisan. Thank you Mr. Chairman.

**BACHUS:** At this time, Ms. Waters is recognized for six minutes?

**WATERS:** Thank you -- thank you very much Mr. Chairman. Since this is a moment where we have an opportunity to share our thoughts and our feelings about you and Mr. Frank, I just want to tell you that I have appreciated so much working with you. And even though we have worked together on this committee, work outside of this committee where we have worked on Fed (ph) relief, was extremely important. We were successful in helping to alleviate some of the pain and poverty in some of those countries that we spent time on. And I want to thank you so very much for that. And I won't say very much more because I don't want anybody to get the idea that we're really friends.

(LAUGHTER)

You've been in enough trouble without that. Barney Frank, let me just say that having worked with you has been an extraordinary experience. And having served on the Dodd-Frank Conference Committee was a highlight of -- of your work, and my work on this committee. Most everyone here has said how much were going to miss you, and that's really an understatement because this institution has been able to solve some great problems with your leadership, and we've all learned so very much from you, and we expect that you will be by the telephone, and we may call you even in the middle of a committee hearing, or a mark up when we need you and you don't have to answer that now, because you may tell me where to go. Thank you very much.

(LAUGHTER)

**WATERS:** All right, let us get to Volcker. Mr. **Kelleher**, you gave such passionate and strong testimony just a few minutes ago about Volcker, and I'm very appreciative for that, and -- and I've been leaning in that direction. But I've also heard today some criticisms that seem to be based in some facts, or documentation. And I'd like you to take time to address some of what I've heard, particularly from Mr. Stevens. I welcome all of the members who have testified in opposition to you thoughts. Would you please share that with us?

**KELLEHER:** Thank you. I think one of the things that's most surprising is the collective amnesia that's run rampant on Wall Street since the Volcker Rule has come in. There was a time, and Chairman Frank can appreciate how amnesia comes and goes, it's not just in this building. But, you know if you go back to '07 or '06 there didn't seem to be a massive problem with distinguishing between proprietary trading, and market

making, or risk mitigating hedging. People knew what it was.

I mean these after all are supposed to be the smartest people in the world, making the most money in the world. The best of the best, the brightest of the brightest. And since the Volcker Rule there's been this massive problem, what is proprietary trading, what is it not? And frankly it's more of a problem in Washington. I talk to traders and bankers all the time. I had a breakfast the other morning with a very senior executive banker. These people laugh at the concept that they can't tell the difference between proprietary trading, and market making or hedging.

Frankly, if they couldn't, that means they couldn't segregate customer funds. It means that they couldn't comply with many laws, rules and regulations on compliance, and risk, and capital. Do you think it's true that the executives at any one of these big banks has no idea at their trading desk that the trader or the desk doesn't have capital risk and compliance requirements? No, they've all got their risk limits, their capital -- they can't be putting the bank's money at risk by putting the bank itself at risk without everybody knowing exactly what it is moment by moment.

And as it gets rolled up, they also know it on an aggregate level. Not just at the desk level, but at the division level and department level by T&L and otherwise. So I think that many of the complaints that we hear are really attacking financial reform and attacking...

(CROSSTALK)

**WATERS:** What would you say about the competition argument that is being presented here also?

**KELLEHER:** Well I think that the -- there's a -- there's something to be said in terms of transition period of any new rules, and how they disproportionately affect market players across countries. But that means that we need greater international harmonization, not that we need to lower the bar. There should be a race to the top, not a race to the bottom. Cross-border -- the cross-border rules are going to be very important in that. But it was eluded to earlier, every country is trying to struggle with -- trying to limit this high risk speculative trading by their banks. In the U.S., it's Volcker. In the U.K. it's Vickers. In the E.U. it's the Lincoln -- the Lincoln (ph) report.

So, I think the problem with competitive concerns are more of a transition period than an ultimate. And the sooner we get to final rule and harmonization, the better off we all are.

**WATERS:** Well, it was suggested in the King legislation that was brought up, that we should delay implementation of the Volcker Rule until there is harmonization. What do you say about that?

**KELLEHER:** Well, I say that the schizophrenia of the complaints are just -- I almost get whiplash, right? I mean originally it's like, our problem is lack of certainty, lack of certainty, we need clarity. And now that they're going to get certainty and clarity, oh we don't like that, so we need you to delay it so we can have a longer period of uncertainty and lack of clarity. Let's get certainty and clarity and let the regulators do their job.

They're really on the cusp of putting in a very substantial architecture in the derivative space and in the -- in the Volcker Rule in other areas. Let them get the job done. Let's see how it works. It works together, or it doesn't. Then let's revisit it with the actual knowledge, rather than self-serving statements by market participants that are really no more than guessing. But let's protect the American people. It's four years, and three months almost to the day since the Lehman failure. Our job is to protect the American people from another financial collapse and a potential second Great Depression brought on by a financial collapse.

Let's get the rules in place, get the clarity. And where it needs to be fixed, let's wait to see how it works, or doesn't work and fix it then.

**WATERS:** Just lastly, I've been told that Ms. Schapiro has entered into some negotiations, some talks with the other regulators, and that she's bringing something to the table that's going to help wrap this all up very soon. Do you know anything about that?

**KELLEHER:** I only know what I read. And of course if I read it, it must be true because it was in the papers, right?

(LAUGHTER)

But I do think that if they focus on -- clearly on compensation -- if you eliminate the compensation incentive for prop trading, which can be easily policed, and easily followed both in the banks, and by regulators and then you back it up with swift and clear sanctions, they can get the Volcker Rule in place quickly with very little market disruption, and very little regulator intrusion into the business of the banks.

**BACHUS:** Thank you.

**WATERS:** Thank you very much. Of course what Ms. Waters is referring to, is the article in yesterday's Wall Street Journal and -- about those conversations. Mr. Hensarling for five minutes? And let me say this, Mr. Leutkemeyer and Mr. -- Mr. Pearce and Mr. Leutkemeyer were the only other members here, who were here at the start. So we have Mr. Pearce and Mr. Leutkemeyer on our side.

**HENSARLING:** Thank you Mr. Chairman. Kind of the stock and trade often in these committee hearings is to try to separate purported benefits of rules from their actual benefits, and certainly weigh them against their actual cost, and to essentially determine whether the cure may not prove to be worse than the illness. I think we have all taken note of Chairman Volcker's statements that: Number one, proprietary trading in commercial banks was not central to the crisis, and that he has expressed concern with the rule bearing his name, quote "I don't like it, but there it is. I'd write a much simpler bill."

So I don't quite think he's put his offspring up for adoption, but he doesn't seem to be well pleased with it. Mr. **Kelleher** in your written testimony you say the Volcker Rule quote, "Is narrow in application, and limited in scope." And you further testify, quote "It only applies to a few banks.", and yet as the vice chairman of this committee I have noted not a few, not hundreds, but literally thousands -- thousands of negative comments that have either arrived to this committee, or to the regulators from entities that supposedly are not negatively impacted.

One of them being TIAA-CREF which I believe to be one of the largest pension funds in the nation, taking care of numerous teachers. In their letter to regulators, quote "Depriving the insurance companies that invest on behalf of those pensioners, the returns available through investments and covered funds impairs the ability of those pensioners to maintain their retirement security." I've got a cousin who spent her entire life teaching in a small town in central Texas who is retired. I note that the Federal Reserve hasn't done her and other pensioners any favor as of recent, including their actions yesterday.

And so when I think about her, and her husband, also somebody who spent their entire life in teaching, getting by on pretty much a fixed income, I'm wondering at the end of the day, I hear much language here about the big banks, but to what extent are we thinking about the little teachers? I also think about one other comment we received from the Public Utility Commission of Texas, in my home state quote, "The Texas PUC is concerned that the wholesale and retail power markets within the electricity -- Electric and Reliability Council of Texas are likely to be materially, and adversely affected from the approach taken by the agencies. The limitations will result in higher and more volatile electric prices to end user customers."

These are two comments that literally are representative of thousands of comments that we have received. And so with the onset of winter, I know that perhaps Massachusetts is maybe colder than Texas, but I think about a lot of low income people in the fifth congressional district of Texas. They struggle in this economy to pay these utility bills, and now I'm hearing from, not a big Wall Street bank, but a government entity in my home state, saying that the current iteration of the Volcker Rule is going to make winter more challenging for them.

And so, you know I -- I guess, Mr. **Kelleher**, how thousands got it wrong, and you got it right. So I'll give you a moment to explain.

**KELLEHER:** Well I -- I think there's a couple of things. First of all, we obviously are not looking forward to,

or advocating policies that we think are going to disrupt the markets. Well functioning, deep liquid markets are the basis of our economy. We need them to work, and we need them to work for everybody from the teacher in Texas, to the banker on Wall Street to anybody else on Main Street. So what we need to do is design a system that serves all those interests, and not primarily a narrow sector of that.

There is no cost that -- this is a slight overstatement, but there is no cost I can think of associated with the Dodd-Frank Act that comes anywhere near close to the cost imposed on the American people and the economic wreckage from the last financial crisis, or the next one. And that's what we have to be focused on. That's the cost that's already inflicted and...

**BACHUS:** I see we're out of time here, and...

**KELLEHER:** ...secondly most of those...

(CROSSTALK)

... ignore entry...

(CROSSTALK)

**HENSARLING:** ...the nexus between the two so I appreciate -- I see my time is -- is over. I yield back.

**BACHUS:** Mr. Baca?

**BACA:** Thank you very much Mr. Chairman. First of all, I'd like to thank you and it was an honor serving here in the Financial Service Committee. I'd like to ask thank Chairman Frank as well, thank you very much. And then of course I look forward to continuing to stay active in some of these issues that are important to a lot of us, and it's been an honor, not only for me to serve here, but those that are currently serving right now because these issues that are impacting us on financial service, impact the market and where we're going to be in terms of the future and not -- not to mention housing, and other areas too as well.

But let me ask this question of the panel, and this is any one of the panelists can answer. Are there any particular transactions or positions to which applications of proposed definitions, a training -- training account that is unclear?

**STEVENS:** Congressman if I might, one specific point that's covered in my testimony has to do with the ambiguity of the application proprietary trading restrictions to the activities that banking entities engage in, a authorized participants and market makers, to support exchange traded funds. Those are an extraordinarily popular and growing part of the registered fund industry in the United States, and it's not clear under the rules whether that would, or would not be regarded as proprietary trading.

I will say that in response to Mr. **Kelleher's** comment...

**BACA:** Does it need to be made clearer?

**STEVENS:** It does, and we have urged that it be made clear. You -- you must understand the way that the rule, as proposed works, there is a presumption that any trading activity that the bank engages in is proprietary trading. Unless it's proved otherwise. In other words, you're guilty unless proven innocent. And getting that wrong, has very serious compliance implications. But Mr. **Kelleher's** colorful comments are not grounded in actually the rule proposal.

Our comments are not amnesiac. Ours are grounded in exactly what the agencies have put forward. And unless it's clarified, it will for example potentially impact this market, which millions of ordinary Americans participate in.

**BACA:** So the -- the innocent are guilty before proven?

**STEVENS:** The -- the rule as -- as written, as proposed, presumes that everything a bank engages in is proprietary trading.

**BACA:** OK, thank you. And this is another question for the whole panel, do you think the proposed rule approach to implementing the hedging extension is effective? If not, what alternative approach do you think would be more effective?

**HAMBRECHT:** Well, let me try. You know first of all I want to second Mr. **Kelleher's** statement that people know what is a prop trade, and what is an agency trade. Historically it used to be divided by whether you acted as principal, or whether you acted as agent. If you acted as agent, clearly that was not a prop trade. You had no economic interest in the trade. The minute you become a principal trader, you have an economic interest in that -- in the success of the trade. You don't get a commission, it's based on the success of the trade.

So I think anybody can define that very clearly. I think the problems become much more complex when you go into derivative markets, or you go into other markets where the definition of the risk is hard to understand, and the definition of the impact on counterparties is hard to understand. And -- and I think the only way you can really do that, is have the trades transparent. And have much more standardization of derivative trading, hopefully on exchanges.

**BARTH:** May I add that the issue is not whether or not bankers can distinguish between proprietary trade and principal trading activities, can regulators make that distinction and determine the intent of -- of the bankers? I think that's an important point that hasn't been made. And so we're not talking about bankers trying to distinguish between proprietary trading, and permissible trading activities, regulators. And does anyone have sufficient confidence that regulators would make the right distinction?

**KELLEHER:** It's not so much intent, it's economic interest, which is tracked to the penny at these banks. So your intent is almost -- people say you need a lawyer and a psychologist on your shoulders. It's not true. Look and see how the trader is running his book, and look at the book on the desk. They track to the penny whether or not it's the bank's money, or a customer's money and where the -- which side they're on, and how it changes minute to minute.

Once they take a position, they monitor it very closely. That's because their money is at risk. They know -- it's not an issue of intent, it's an issue of clearly identifiable, contemporaneous economic interest.

**BACA:** And if it isn't done, than it could impact the consumer, and I think that's the question that was asked earlier in terms of some of the residents in the area, is that correct?

**HAYWORTH:** The gentleman's time has expired. And I'd like to ask unanimous consent to enter into the record, statements from the American Council of Life Insurers, the Bond Dealers of America, BBVA Compass, and the Institute of International Bankers. Without objection, so ordered. And now five minutes to the gentleman from New Mexico, Mr. Pearce?

**PEARCE:** Thank you Madam Chair. I would like to associate myself with the comments that Mr. Schweikert made about the need for financing for local projects and small states. It's a very key thing and I think this question pertains to that. Mr. **Kelleher**, I was interested in your comments that -- that the regulators job is to protect the American people. And if you have watched any of my recent questioning in here you will find that I have a fascination with MF Global.

Do you have an opinion about the regulators, and their protection of the American people in the application of that -- those final hours of MF Global?

**KELLEHER:** I think -- I only know what's in the public record, and so far I think that the answer has to be that the public record isn't really complete enough yet to form an opinion.

**PEARCE:** Well let me -- let me -- I'll leave a little bit of it for you. As they were sitting there, both CFTC and SEC sitting in the room, were counting down the last hours before this billion -- billions of dollar corporation

fails, they'd been taking the funds from segregated accounts to float the deal. The regulators decide at the urging of the SEC at 5:30 in the morning to declare it a securities firm, not a futures trading firm, not a commodities market, 30,000 commodity accounts, and 318 security accounts.

I think the two guys who were responsible for the decision -- this is my thoughts they've never exactly confirmed it, and didn't confirm it yesterday when they were in hearing, but they were in the room making the recommendations. And their recommendation was to declare it a securities firm, not a futures, not a commodities firm. 318 to 30,000 they decided for the 318. The bankruptcy proceedings then favored the investors, not the 30,000. So I guess my question is when you assure us all that the Volcker Rule is going to be -- that it's going to protect the American people, we had the guys here yesterday who -- who made those decisions to not protect the American people, but to protect the 1 percent.

Now if my assertions are correct, and neither one of the gentleman yesterday who were apparently in the room, or on the telephone with the people in the room, would contend with it. Do you have an opinion now about the regulators doing their jobs?

**KELLEHER:** Well, I don't think there's any question that regulators, like legislators, and like everybody else are not perfect, and they're going to make mistakes. And one of the reasons we advocate clear rules, particularly in Volcker focusing on compensation, is because discretion and judgment is largely taken out of it. And it would be a rule that would be both easy to comply with, and easy to police. We try and find...

(CROSSTALK)

**KELLEHER:** ...ambiguity out of the rules...

(CROSSTALK)

**PEARCE:** ...my time back because I really did want an answer. Because you are very articulate, and you're very opinionated. You're willing to use the word, amnesia, schizophrenic with regard to businesses, but you're unwilling to describe activities on the part of regulators as maybe preferential?

(CROSSTALK)

**KELLEHER:** Don't get me wrong...

(CROSSTALK)

**PEARCE:** I've tried to give you a chance to respond, and -- and I didn't find that clarity in the response. So if you don't mind, I would make my observations. As you describe the perfect world of regulators, I worry that the protection of our consumers is not going to be any closer under the Volcker Rule, than it is under the CFTC, the SEC, the RMC, the ABC, nothing. I think that people are always going to find their way out.

Just looking yesterday at the HSBC. We sent Martha Stewart to jail for 4,000 shares of stock, whatever happened there? 4,000 shares. But billions of dollars over multiple years, for the HSBC laundering money in a -- or our judicial department didn't seem to find a reason. So I don't think -- I mean I -- I know there are mistakes made by businesses, but I'm not sure in your perfect world of regulations and regulators, to where we regulate the very last common denominator will end up choking off investments to small towns in New Mexico. I'm just not sure your process is going to get us any closer to what we're doing now.

Thank you, I yield back.

**HAYWORTH:** Thank you Mr. Pearce. The chair now recognizes Mr. Miller of North Carolina for five minutes?

B. MILLER: Thank you Madam Chair. Before I begin, I'd like to introduce some directives (ph), moving (ph) directives (ph), or reports from public citizens that finds it's -- that 99.9 percent of banks would not be affected by the Volcker Rule. Mr. **Kelleher?**



**FRANK:** Madam Chair, is that going to be in the record? Because I just need to have it ordered.

(CROSSTALK)

**HAYWORTH:** Without objection, so ordered.

B. MILLER: Thank you. Mr. **Kelleher**, the Volcker Rule is one of the provisions in Dodd-Frank designed to make banks simpler, less likely to fail and -- and if they do fail, they fail without such catastrophic consequences for the financial system, and for the broader economy. But just in the last couple of weeks William Dudley has spoken on the -- the first versions of living wills, and said we've got a long way to go before we have a financial system that will not -- that -- a major bank can fail, the kind of banks that would be subject to the Volcker Rule could fail without catastrophic consequences to the financial system.

And even more strikingly -- and -- and that it was the beginning of an interesting process, that we would get there eventually. Even more strikingly, HSBC just in the last couple of days, has entered into a settlement for \$1.9 billion in fines for money -- for laundering \$800 million in drug money, in addition to having laundered money for the Iranian regime, and the repugnant genocidal regime in Sudan.

And the stated reason, what they said right out loud in front of God and everybody, that they weren't going to bring criminal charges was because the disruptive effect it would have on the global financial system. I think Chairman Frank is correct when he said earlier that -- that Dodd-Frank has made many of the extraordinary interventions of four years ago no longer within the law, but is it -- is it -- do you think that the biggest bank -- biggest banks can fail without significant consequences for the financial system, or the broader economy?

**KELLEHER:** Not yet. I mean that -- we still have a long way to go under Dodd-Frank. We not just need living wills, and resolution authority at the front. The -- the Fed has to get in place a whole variety of liquidity, capital leverage requirements. That has to be married up to the back end on resolution authority, which is the FDIC's orderly liquidation authority. They've gone very far in that. They just announced recently, an international agreement with the U.K. on resolution and -- and the president of the bank in England was just here discussing that with the head of the FDIC publicly.

But you take all of these things, and you put them in place. If they get put in place in good faith by people intending to achieve the objective of ending Too-Big-To-Fail, including importantly, banning proprietary trading, and limiting the investment in hedge funds, et cetera, you could be at a place at a point in time where you do eliminate the Too-Big-To-Fail.

B. MILLER: I'm puzzled by the -- the hand wringing over the idea that intent could be a factor in the law. Although Wendell Holmes said intent is a concept that runs throughout the law. That -- that a dog knows whether he's been kicked, or stumbled over. It is something we deduce from circumstances all the time in our -- in our common -- in our ordinary lives, and it's a common legal concept that we frequently have to deduce from -- from consequences.

Can you think of other areas in the law in which important consequences may depend upon determinations of intent?

**KELLEHER:** Every single criminal prosecution. Every single civil litigation, contracts. I mean it's a fairly routine concept, intent. But the important thing about this -- I just don't -- I think it's a phony argument that we have to discern the intent of a trader to figure out whether it's a prop trade or not. That's just not factually accurate, and you -- you don't -- don't take my word for it, talk to real traders. Talk to people who run desks, how it really works. There's documentation. So intent isn't involved there.

But you know where intent is interestingly involved is if you're going to hold somebody accountable under the law. And we haven't seen that happen in connection with the financial crisis at the largest banks. There's no executives who have been held accountable in any serious way. Basically the banks have used shareholder money to pay big fines to move on.

So it would be nice actually of people who are worried about intent, would think about determining the intent of people who engaged in some pretty egregious conduct before the financial crisis, took billions of dollars in bonuses, and stuck the American people with the bill. They might want to look at the intent of those actions.

**B. MILLER:** The proposed rules, or some of the discussion does it -- does it -- do they outline circumstances that might suggest what the intent was? So whether it's proprietary trading, or market making, or hedging? And what are some of the circumstances that might -- that might indicate what the intent was?

**KELLEHER:** Well you're going to know because if you look at the traders book, the book -- the trader has an allocation as to risk to the bank...

**HAYWORTH:** The gentleman's time has expired. Mr. Luetkemeyer is called on for five minutes?

**LUETKEMEYER:** Thank you Madam Chair. Mr. Stevens, I'll start with you. You handled a mutual fund investment company, and are -- are the director for the Investment Company Institute, and I know that you talked in your testimony with regards to mutual funds, and they need to be out of the Volcker Rule umbrella. Can you elaborate on it just a little bit? Can you differentiate between mutual funds, and hedge funds, and why you think -- how -- how they don't interplay, and shouldn't be considered here in respect to the rule?

**STEVENS:** Thank you for your question, Congressman. This is really a very bright line. And I think everyone understands it quite well, and Congress drew it in the Volcker Rule. Mutual funds and other registered investment companies under the Investment Company Act in 1940, are subject to all of the major federal securities laws. In fact, there is not more heavily regulated financial product in the market today.

Mutual funds are required, for example, under the statute to avoid the full range of potential conflicts of interest with their sponsors. They are subject to a very specific governance regime. They're subject to an enormous amount of transparency in terms of their disclosure to investors. They're subject to restrictions in the way that their portfolios work, and the kinds of -- the kinds of investment strategies that they can pursue. Hedge funds, on the other hand, are subject to none of that.

They are private investment companies. Their advisers, after Dodd-Frank have to be registered with the SEC. But the hedge fund can pursue whatever strategies it wishes, provided only that it's either sold to a sophisticated group of investors, and I put quotes around "sophisticated," because that's another issue that seems to be addressed at some point, or to a very limited number of investors. Now the -- the key thing, in addition, is that other markets outside of the United States are subject to similar sort of dichotomies in -- in terms of the funds that are made available in the market so that there are, for many purposes, funds that look very much like U.S. registered funds, U.S. mutual funds that are sold outside of the United States.

And in very many instances, are sponsored by American fund advisers. Our point is that both of those kinds of funds, both the U.S. funds and the non-U.S. funds that look like American mutual funds, should be outside of the coverage funds provisions, and the banking entities of the Volcker act, and we hope the -- the regulatory agencies will clarify that.

**LUETKEMEYER:** Mr. Plunkett, do you agree with that? I mean you -- you handle investments of a similar nature.

**PLUNKETT:** Yes, Congressman. Foreign funds -- many foreign funds such as UCITS funds in -- in Europe and certain funds, OIGs in the -- in the U.K., are already heavily regulated and very similar to U.S. mutual funds. And the regulators really need to make a distinction between what types of funds are really sought to be covered by Volcker Rule, and -- and what should be excluded, which should include -- the exclusion should include all -- all U.S. mutual funds.

**LUETKEMEYER:** Thank you. Mr. Quaadman, we haven't talked at all hardly today yet with regards to getting an extension for all of the entities that are going to have to comply with the Volcker Rule, because at this point, not all the rules are out there. Not all of the rules -- the -- the final rule hasn't been set, an

interpretation of it. There's sort of a nebulous framework out there, but you know, you've got two years to comply from July 21, and the clock is ticking. And yet, there's nothing there for you to comply with, technically. At least my understanding of it.

**QUAADMAN:** Right.

**LUETKEMEYER:** And so my question to you is, are -- are -- are all of you working in coordination to try and get an extension of the Federal Reserve compliance period here so -- until the rules are -- are promulgated, and -- and finalized, that you actually know what you're going to be doing so you can have the proper amount of time to comply?

**QUAADMAN:** Yeah, I think that's a -- that's a great question. That's why I mentioned in my opening statement, why we think the Bachus-Hensarling request for an extension of time is important. One thing I want to say as well, because I think this has been bantered about, but I think it -- it also is emblematic of the problems with the Volcker Rule itself, one of the -- one of the examples that's been used here has been the London Whale example, right?

But with the financial institution and where that occurred, there are dozens of regulators who are embedded in that institution, go there every day, or are supposed to be looking at the activities of that bank. To this day, they can't tell you if that was a proprietary trade or not. So if they cannot tell you if that was a proprietary trade or not, for -- for a corporate treasurer who has gone to the capital markets every day, that's going to have to go through intense regulatory scrutiny as to when they go out and sell their bonds, or their stocks, you know, how are they going to have any certainty for how the market is going to react? Or the regulators are going to react?

**LUETKEMEYER:** I appreciate your comments, my time is up. Thank you I yield back.

**HAYWORTH:** Mr. Lynch of Massachusetts is recognized for five minutes?

**LYNCH:** Thank you Madam Chair. Let me ask you on that point, Mr. **Kelleher**, is there a -- is there a legitimate claim here that some folks couldn't distinguish between proprietary and non-proprietary?

**KELLEHER:** My answer would be, it's clearly proprietary and I agree with JPMorgan Chase CEO, Jamie Dimon both in the House and the Senate and said, I can't tell you if it is, or it is not. I guarantee you if it was not, he would have said that.

**LYNCH:** Right.

**KELLEHER:** I don't think there's really any doubt of anybody who is independent looking at what happened there, and what the trade was. Based on what we now know, there's still a lot that we don't know, but based on what we know, it's pretty clearly a proprietary trade.

**LYNCH:** OK, thank you. Mr. **Kelleher** what I really want to do, is follow up on my -- my friend's line of questioning, Mr. Miller from North Carolina. Regarding the HSBC case that was announced yesterday, we really aren't talking about just Too-Big-To-Fail in this case. Now, just to -- to sort of regurgitate the facts here, HSBC yesterday entered into a deferred prosecution agreement with the Justice Department, after they had admitted that they violated the Bank Secrecy Act, and the International Emergency Economic Powers Act, and the Trading with the Enemy Act.

They actually conducted illegal transactions with -- with Cuba, Iran, Libya, Sudan, and Burma, all countries that were subject to the sanctions enforced by the Office of Foreign Asset Control at the time of the transaction. So -- and -- and there's no question that they knew what they were doing. They actually scrubbed some of the reports so that it wouldn't -- wouldn't flag what they were doing. But this -- this -- what troubles me greatly is they agreed to a \$1.92 billion penalty but that the Justice Department agreed not to prosecute, because they were afraid of what the financial reverberations would be to the market.

So, these folks aren't just Too-Big-To-Fail, they're too big to indict, to steal a phrase from the New York

Times editorial yesterday. And it would seem to me that the Volcker Rule would be very helpful in stopping these banks from getting so -- so enormous that -- that any -- that -- that they become immune from prosecution, which defeats the entire purpose here. How -- how do we get at that? How do we get at that situation where these banks are clearly violating, knowingly violating the law, and doing so at risk to the -- the entire markets?

How do we -- how do we not prosecute these guys, and -- and just put a little slap on them, and allow them to -- to continue to do what they've been doing?

**KELLEHER:** Everybody knows that unpunished crime does not deter crime. In fact, unpunished crime incentivizes and rewards crime, and ends up with more crime. So it may be the case that HCBC or other banks are too big to indict. Because you don't want to have them collapse. And there's the constant example of Arthur Andersen as the accounting firm. But that doesn't mean that individuals can't, and shouldn't be prosecuted and put in jail. A bank may be too big to indict, but there's no banker who is too big to indict.

And without a -- accountability, be it for egregious conduct engaged in, in the run up to the financial crisis, or be it HSBC or otherwise, the failure to hold senior executives accountable, and other executives, officers and employees who knowingly break the law. You don't do that, you green light them to do it more. And you're exactly right in terms of proprietary trading. The problem of proprietary trading is the riches, and the rewards are so massive, the temptation is so huge because the rewards are so high, that it has to be limited. And it's one of the key ways to cut down on high risk activity at taxpayer backed banks, that risk failure and taxpayer bailout.

But both of those go together. But some accountability and prosecution of individuals, whether a banker or not, shouldn't be limited because you're concerned about the institution itself.

**LYNCH:** All right. I haven't read the entire deferred prosecution agreement, but the only thing that I can see through in these documents is that there was a partial -- a partial clawback of some of the bonuses that were given to -- to some of the -- the officers of the bank. That -- that was it. Now I understand that the Brits are also going to move forward with their own prosecution so maybe -- maybe because it is a -- a London based institution, maybe -- maybe it'll come during that prosecution.

But I -- I still think, I agree with your statement that there should have been much more severe consequences for these folks. Actually money laundering for Cuba, Iran, Libya, Sudan and Burma in the face of the sanctions that Congress has placed.

**HAYWORTH:** And the gentleman's time has expired.

**LYNCH:** Thank you Madam Chair. Thank you, Sir. Mr. Stivers is recognized by the chair for five minutes?

**STIVERS:** Thank you Madam Chair. My first question is for Mr. Quadman. Why do you think it's important to look at the Volcker Rule in conjunction with other regulatory structures such as the Basel-III?

**QUADMAN:** Sure, because all of those actually work in conjunction with one another. And that's why I tried to describe that in our opening statement of all the different ways that -- that a corporate treasurer has to raise cash to mitigate risk. Each one of those is -- plays off one another. Which is why the only alternative they would have is those markets start to get shut down, or they're shut out of markets or the costs are too high, that they just have to park cash. And that actually has other economic consequences to it.

**STIVERS:** And does the impact of these multiple regulatory structures make the U.S. more, or less competitive in global financial markets?

**QUADMAN:** It makes it less competitive. Because the Volcker Rule is a unilateral action by the United States, which is why we think there should be international coordination if we're going to go down that road. But we've also seen even with Basel-III, while we started to look at implementing regulations, European regulators were already saying that they had to delay it. So, we need to make sure everybody is playing on

the same playing field, and that hasn't been the case so far.

**STIVERS:** OK, thank you. And I guess this question is for Mr. Hambrecht. You talked a little bit about, you know different solutions, but you've got experience in the capital markets, and I'm just curious. Do you believe that market making is proprietary trading?

**HAMBRECHT:** No.

**STIVERS:** OK, whose money is at risk in market making?

**HAMBRECHT:** Market making -- there's so...

**FRANK:** You've got to pull that mike -- pull that mike closer to you. Don't worry about eye contact. It's more important that we hear you, than we see each other.

**HAMBRECHT:** OK.

(LAUGHTER)

Excuse me, Mr. Chairman. Let me -- let me try and answer your question this way, I personally think that trading efficiency has increased enormously because of technology, not because of market makers. So the rise of these so-called dark rules, for example which are really computer matching systems. They match the buyer and seller, and they take the dealer out of the equation. I think they're the people that have lowered the trading costs and equity.

And I do think that will happen in depth. This is the BlackRock approach that they just announced. So to me, market making is -- is matching the buyer with the seller at the least possible cost.

**STIVERS:** And -- and I did that -- I worked at the Ohio company in the 1990s, and I can assure you that it was the Ohio Company's money at risk. It was -- it's proprietary -- market making is proprietary trading. I mean it's the only example inside of -- I agree with Mr. **Kelleher**, with a lot of everything he said. And I guess I'll let Mr. **Kelleher**, and maybe the whole panel tell me if you think -- because clearly proprietary -- or market making is a company putting their money at risk, to provide liquidity in the markets. They have to offer both a bid and an ask, and they're supposed to make money on the spread.

But they have inventory, and it's their money at risk. And does anybody believe that these companies that are market makers don't have inventory? And therefore their assets are not at risk? Let me ask it that way all the way down the panel, and yes or no answers are fine.

**BARTH (?):** I don't believe market making is speculative trading.

**STIVERS:** I -- I didn't ask was it speculative trading, I asked if it was proprietary trading? I asked if they have their money at risk, which is the whole point here.

**BARTH (?):** Yes.

**STIVERS:** Thank you.

**HAMBRECHT (?):** I would answer it, if they choose so. I think most market makers try to come out flat.

**STIVERS:** I -- I -- I agree, but -- OK.

**HAMBRECHT (?):** And much of it is matching. And we put in our comment letters to -- in connection with this rule showing that for example, the big banks actually don't keep inventories hardly at all anymore. If you look at the actual facts, they don't. So it's a...

**STIVERS:** The goal is to not have inventory, I'll give you that.

(CROSSTALK)

**HAMBRECHT (?)**: (Inaudible) don't have that.

**STIVERS**: Right. Well they, meet their...

(CROSSTALK)

**STIVERS**: But their goal is to provide -- I mean they're in the market to provide liquidity, therefore, if there's a big short term imbalance, they will -- could obviously end up with inventory at the end of the day. Therefore, they have money at risk. Let's keep going down the panel?

**PLUNKETT**: Congressman, I think it's important to note that the Volcker Rule is intended to prohibit proprietary trading, not every instance of principle trading. When banks do take on their book to create inventory, in order to have securities that they can sell to asset managers, for instance, or other clients and investors.

**QUAADMAN** I think with regulators having problems distinguishing between the two, which is why it's been so problematic to even come up with a rule.

**STEVENS**: I think Mr. Plunkett hit the nail on the head. It's not so simple a world. There are kinds of principle trading that would be market making, kinds of principle trading that would be proprietary trading, as the Congress sought to address in -- in the -- in the provision. And drawing a line between two different kinds of principle trading can be hard.

(CROSSTALK)

**HAYWORTH**: And the gentleman's time...

(CROSSTALK)

**STIVERS**: Thank you. It appears my time has expired, but that illustrates how difficult...

(CROSSTALK)

**HAYWORTH**: Mr. Green of Texas is recognized for five minutes?

**GREEN**: Thank you Madam Chair. I'd like to join those in saluting Chairperson Bachus for his outstanding work with the committee, and of course my very dear friend, Ranking Member Frank for his outstanding service to the committee and to our country. And I would also just like to mention Mr. Himes because of some very thoughtful comments he made yesterday on the question of derivatives. Mr. **Kelleher**, are you of the opinion that intentionality trumps over manifestations when it comes to ascertaining whether or not we have proprietary trading, versus market making?

Or are overt manifestations what we look for in the actions of those who engage in these practices?

**KELLEHER**: I -- I don't think that we need to define the intent of the trader. I think that you can tell by looking at their book, and the desk's book. And you check with compliance and risk in capital. And then you look at the bonus pool as it gets rolled up week by week, quarter by quarter. You can find out exactly what type of trade it was. You don't have to figure out what somebody's thinking in their head as to whether it's proprietary or not. That doesn't mean 100 percent of the time.

**GREEN**: Yes, Sir.

**KELLEHER**: But the vast majority...

(CROSSTALK)

**GREEN:** (Inaudible) someone who does believe that we have to -- have to understand what the -- the person was actually intending to do, as opposed to what the person's overt manifestations indicate.

**QUAADMAN (?):** Well, Mr. Green if I could just answer? As I said in my opening statement, we believe that capital requirements are actually an easier way to go. And one example with the Volcker Rule, the Volcker Rule establishes the bright line of a 60 day period, that if you hold a security more than 60 days, it's presumed to be proprietary trading. Now you can have a company that has hundreds of bonds they may not even move for 90 days. There's no ability to move -- match a buyer and seller for a 90 day period. That's not unusual.

And in fact, that's not unusual in the stock market either, which is why with the JOBS Act, Congress actually has mandated that the SEC look at whether or not decimalization should be needed for smaller issuances, because they can't move over a specific period of time.

**GREEN:** I take it from what you've said that it's the actions that really count, not the intentionality?

**QUAADMAN (?):** We think it's -- we think it's difficult for the regulators, one to define rules that give markets the certainty that they need. And that's why we think that capital requirements are an easier way to go.

**GREEN:** I understand, but you and I seem to be talking past each other. So let me try to focus. If -- if we have a -- a circumstance where in the -- the actor indicates, yes I did it, but I didn't intend to do it. Are you concluding that this would not be proprietary trading?

**QUAADMAN (?):** Well I think as the example I used earlier, with the London trade example. The regulators who embedded in that institution cannot tell you whether or not that was a proprietary trade months after that occurred. And that hasn't been disputed here. So I think that shows exactly why it is almost impossible to define if something is proprietary or not.

**GREEN:** Mr. **Kelleher**, let me allow you to respond please?

**KELLEHER:** Well I think in terms of the London Whale, I don't think there's really any dispute. The dispute, if there is one comes from the timing of the trade. When the trade was originally put on, it appears that in the public record that there was an argument to be made that it was a hedge. It was congruent with an existing portfolio. What -- and the CEO refers to it as this kind of ambiguous -- but he says it kind of morphed into something else.

Well the truth is, at banks things don't morph. People make decisions, and then they execute those decisions. And what happened, decisions were made at JPMorgan Chase, to change a highly liquid, low risk, what appears to be an actual hedge into something that was a straight out flat prop trade, and a very complex derivative play. So at the end of the day that they were in, and what they couldn't get out of, and what cost them money was a prop trade.

I don't have any doubt it's going to come out. But it was originally, it's -- while we don't have the evidence yet because it's not in the public record, it appears that that may have been a hedge. A hedge then, and it would -- it looks like it would have even been a hedge under the Volcker Rule and the law if it was applicable at the time, but not what it supposedly -- what it was changed into.

(UNKNOWN): Mr. Green, if I could just add for one second and maybe this would help is that, this is one of the reasons why we feel there should be a reproposal. Because you've had this proposal out there for so long, the regulators have asked so many different questions, it's important I think, for everybody that if they can repropose the rule, allow everybody to take another look at it, determine whether or not there's certainty there. Then we can figure out if it needs to be fixed or not.

**KELLEHER (?):** 18,000 comment letters, something around 2,000 meetings, 99 percent of them with industry, they need more input? And I'll note for the record anyway, because the answer wasn't there, Mr. Quaadman agrees with me and you. When it comes to proprietary trading, actions will tell you what you need to know.

**HAYWORTH:** And the gentleman's time has expired.

**GREEN:** I yield back.

**HAYWORTH:** Thank you Mr. Green. Mr. Huizenga is recognized for five minutes?

**HUIZENGA:** Thank you Madam Chair. And at this point I'd like to actually turn it over to my -- my good friend and colleague from Texas, Quico Canseco for the balance of my time.

**HAYWORTH:** The gentleman yields to Mr. Canseco.

**CANSECO:** Thank you. Thank you for yielding. Mr. Barth, I want to pick up where -- where we left off. And as I understand the way the rule is currently drafted, it says that a firm could not make money if an asset they hold increases in value after the acquire it. So, a firm would have to -- have no incentive whatsoever to acquire an asset that is priced very low. Wouldn't that add to systemic risk in the financial system? Especially in a time of crisis when assets -- asset values plummet?

**BARTH:** Yes asset values indeed to fluctuate a great deal over short periods of time, and that's in my view, a problem with the Volcker Rule. It talks about a relatively short period of time in which the intent is to gain from a price increase rather than serve a customer. I think that's the problem. I think there is still difficulty, despite what some other people believe about the Volcker Rule. May I just add one word about Too-Big-To-Fail, the issue is capital.

If institutions have too little capital, of course they can have a lot of assets. So I think capital requirements, liquidity requirements are a way to deal with Too-Big-To-Fail. I don't think the Volcker Rule is a way to deal with Too-Big-To-Fail.

**CANSECO:** So, you mentioned in your testimony that you believe that the Volcker Rule is based on an incorrect premise, or an incorrect assumption. Why is it an incorrect premise? And is there anywhere where the Volcker Rule can be implemented that would avoid problems in the future?

**BARTH:** I -- I think I perhaps should say is, or may be an incorrect premise. And the reason I say that based on the hearings that were held earlier this year, there was talk about the fact that many people now are willing to concede the fact that the proprietary trading was not the cause of the financial crisis, which was severe in the United States. And nobody has presented any evidence suggesting that of all the costs associated with the crisis, proprietary trading had accounted for a large proportion of those costs.

Now the concern, that is going forward in the future, it's speculative in my view. What's really speculative is to say that the Volcker Rule is going to prevent a future crisis. I think that's sure speculation. There is no evidence whatsoever based upon its role in previous crises in this country, or any other country around the world.

**CANSECO:** Do you believe that if other countries do not implement a Volcker - Volcker like rule, then trading that would be prohibited in the U.S. will move overseas?

**BARTH:** Yes. I think that's a distinct possibility. I know Mr. **Kelleher** did talk about the Lincoln (ph) report and Vicker's report. And one might describe them as Volcker like, but clearly I do -- do not believe that the solution of future crises is -- is the Volcker. And indeed business could migrate across national borders, go into other countries. And that would be a concern for U.S. banks in terms of the competitiveness.

**CANSECO:** Thank you, Professor. Mr. Quadman, there are reports that regulators could potentially come out with three different versions of the so-called Volcker rule. Could you comment on the confusion that would result if that were the case?

**QUADMAN:** Let me give you one example. We took a group of corporate treasurers up to meet with all of the regulators involved in the Volcker Rule earlier this year, and the day literally started with one regulator saying, we're going to look at this by trade-by-trade analysis. And we ended the day with the regulator



saying, well if you develop principles, and you're conforming to those principles, you're going to conform with the rule, you're going to be compliant with the rule.

They're talking about the same rule. What I think is important here is we need to have a rule that works. We need to have regulators on the same page. And -- and we're not getting there. That's one of the reasons why last year, actually a year ago now, we sent a letter in just on cost benefit analysis, because you had five different regulators with five different legal standards. And we thought they should conform to the economic analysis and rigorous economic analysis that was proposed by President Obama in Executive Order 13563, so that they were all looking at it in the same way.

And unfortunately as this Volcker Rule consideration has continued on, we've just seen divergence instead of convergence, and unfortunately a system that may not work.

**CANSECO:** Thank you very much. I yield back the balance of my time.

**HAYWORTH:** Thank you Mr. Canseco. Mrs. Maloney of New York is recognized for five minutes?

**MALONEY:** I thank all -- all the panelists. I -- I would like to put in the record a series of articles that points out how proprietary trading was really prosecuted, and some of our most respected banks had to pay fines of over \$500 million for what was described as an abuse. Knowingly selling to their customers products that they knew were faulty, and then shorting them. So how you say that's not part of the financial crisis, I -- I -- I beg to differ.

There are many parts of the financial crisis, the subprime crisis was part of it. But those that took those instruments, those subprime documents and then sold them to their trusted clients causing their loss and making a profit is not a policy that I would like to be continued in our -- in our great country. I think markets run on trust, and we have to restore the trust of -- of our great country.

I -- I would like to say -- I would like to place in the bank -- into the record, a list of banks that have voluntarily - voluntarily given up proprietary trading, conforming to the Volcker Rule before it takes effect. I -- I wrote both the Federal Reserve and the OCC, asking what is the status of the Volcker Rule? What are our banks doing? The OCC wrote back and said that six of the largest banks in our great country are already adhering to the Volcker Rule.

And these institutions are; CitiBank, JPMorgan Chase, Bank of America, Wells Fargo, and PNC Bank. I have not heard from -- from the Federal Reserve, even though I wrote my letter in September, they haven't gotten back to me. But they have unwound -- they have the -- the trading moved off. They're no longer doing proprietary trading in -- in many of the banks in the district that I am privileged to represent. So, it's being taken seriously by -- by the financial sector, and financial leaders of some of our major institutions. They are adhering to it.

I -- I have three major points that I would like to put in the record for this purpose of the hearing on the Volcker Rule. And some of you have underscored them. First, a stable financial system with robust financial markets can only exist with clear, comprehensible rules of the road. And as proposed, the regulations implementing the Volcker Rule would not follow this simple principle of clarity. The complexity of the regulatory proposals to implement the Volcker Rule must not be carried forward into its final form.

Many of you talked about the complexity. It has to be very clear to the market, and I believe that our -- our regulators can do it. Secondly the five agencies responsible for implementing -- implementing this rule should resolve their differences, and put forward a consistent set of regulations. Several different, and potentially conflicting sets of expectations could leave the American financial industry in total disarray, an outcome that is both undesirable, and unnecessary.

So I speak to the regulators that they've got to be coordinated on this. And finally, our regulators must remain mindful of the important exceptions that Congress clearly provided in the Volcker Rule for market making and hedging activities for the purpose of -- of -- of helping their clients. In respect to market making, Congress understood that adequate liquidity is absolutely essential to well functioning financial markets. And

banks play an essential role in providing that liquidity.

Banks must have clear authority to engage in customer related trading in order to make markets and strong U.S. financial markets so critical to growing companies and -- and our economy, and our jobs. And -- and also the hedging is also an essential tool that financial institutions use to safely manage their exposure, and ultimately to protect the American investors, and depositors. So I -- I wanted to -- to -- to talk about that and -- and the one person's testimony that I didn't hear, I had to go testify at a transportation committee, was Mr. Stevens.

So I -- I want to point out that when the Senate added the Volcker Rule to Dodd-Frank it was not -- it did not come out of this body, but the Senate added it. The -- the clear intent was to limit a bank's ability to sponsor, or invest in hedge funds and private equity funds. And Mr. Stevens, can you describe some of the key consumer protections that -- that are different from registered mutual funds, and from the kinds of entities that the Volcker Rule is intended to prevent banks from...

**HAYWORTH:** The gentlelady's time has expired. Mr. Stevens can you answer very quickly? I apologize for that.

**STEVENS:** In very simple terms, we are subject to a very comprehensive scheme of regulation under all of the federal securities laws. The hedge funds are subject to none of that.

**MALONEY:** Very -- very briefly, can I say one thing...

(CROSSTALK)

**HAYWORTH:** Ms. Maloney your time has expired. We want to get to Mr. Carney if we can. I apologize...

(CROSSTALK)

**MALONEY:** Sorry -- sorry.

(CROSSTALK)

**HAYWORTH:** Oh, and Mrs. Maloney's documents will be entered into the record without objection.

Mr. Carney is recognized for five minutes.

**CARNEY:** Thank you Madam Chair. I thank the panel for coming today. I've been fascinated by this discussion, a little confused by -- by some of it. I have a vote, so I'll try to be -- try to be quick. I want to go back to Congressman Stiver's line of questioning around the distinction between proprietary trading, and market making. Mr. **Kelleher**, and Mr. Hambrecht, I think you both believe that it's pretty simple to determine that, and that you don't really need to look at intent.

But doesn't the proposed rule call for a plan that the -- the entity would submit and describe what their intent would be in these -- this -- these kind of practices? Isn't that what the proposed rule suggests?

**KELLEHER:** I -- I don't believe so. But in -- even if one were to argue, and many have argued that that's what it does require, there's going to be a final rule and there's several ways -- we filed four separate comment letters on this suggesting...

**CARNEY:** So you're -- you're view is that you don't have to focus on intent? You can do it by looking at the compensation -- deconstructing the compensation package?

**KELLEHER (?):** Well, and the economic interest at the time. I mean I'm told by people who make a living, and an incredibly good living, trading and running desks at the biggest banks in this country, that this is not a complex problem...

(CROSSTALK)

**CARNEY:** Not a hard problem?

(CROSSTALK)

**KELLEHER:** ...pretty clear at the time.

**CARNEY:** The complaints that I've heard from market participants is that it's -- you know the distinction between a permitted activity, market making, and a prohibited activity, prop trading. Clearly prop desks and all that, they've been eliminated, that's easy. But you know holding -- buying securities to hold to sell later, are much more difficult to determine. But you don't think so?

**KELLEHER:** Well, even for market making, the trader and the -- and the desk that the traders work for all have allocations as to how much risk they can take on for the firm. So, they're not willy-nilly in terms of market making, what they're doing or not doing. They know it and are tracking it minute to minute. The other thing at a macro level, all -- any bank can do any -- you know all the market making they want.

All it's going to do is run basically a hedge, its book or flat book. If you want to hedge the book, a legitimately hedged book, you can do all the market making and anything that you want. The other thing is, and we've laid this out in our comment letters, much of the complaints about the need for inventory, particularly in the derivative space, there's no evidence that they -- that banks are keeping that inventory anyway today, nevermind tomorrow.

So when you actually look at the facts, as opposed to the claims, the application of the rule to the actual market making activities that they claim to engage in, either -- are actually done at a very low level, and can be done relatively easily in compliance with the law.

**CARNEY:** So you don't think -- you don't think it's that -- Mr. Hambrecht, do you -- your view of that?

**HAMBRECHT:** I -- I agree with Mr. **Kelleher**. I think it's normally very clear what the -- the goal of making a market is. And if it's to keep it an orderly market, and to keep basically the -- the right to get close to the order flow as it is with most specialists, there's an obligation to put out some capital to keep an orderly market. But that's always based on the premise that you're going to move your stock along.

(CROSSTALK)

**CARNEY:** It'll be as obvious to the regulator as it is to the manager of the -- of the...

**HAMBRECHT:** Oh yeah, I -- I think the idea that regulators can't figure it out, just isn't true. You know we -- we deal with the SEC all the time. They know -- they know what capital markets look like.

**CARNEY:** Fair -- fair enough. So -- so what about the -- Mr. Quaadman's notion that we should approach it through capital requirements as opposed to prohibitions I guess?

**QUAADMAN:** Well, my position would be any exemption you give should have additional capital requirements or margin requirements placed on it. And as -- as an added safeguard...

**CARNEY:** So you don't dismiss it as a -- as an effective tool?

**QUAADMAN:** No I -- it's an added safeguard that someone can't build these mass positions and suddenly people find out about it when it's too late.

**HAMBRECHT (?):** Capital has to be a compliment to the other rules.

**CARNEY:** Fair enough. So one more -- one more question about that. What would you say to Mr. Quaadman's concerns about the company treasurers, and what they would have to do with respect to

holding more capital given the -- the various rules and regulations that are coming down?

**HAMBRECHT (?)**: Well I think it has -- I think it has very little effect on -- on cash balances in corporations. I mean that's much more a function of taxes and future needs of capital. I think basically most corporate treasurers would tell you that the technology that's been brought into markets today has made costs -- transaction costs come down significantly. And that they can raise money now on a much lower cost.

I mean you look at equity trading. It's gone from what used to be anywhere from 1 percent to 5 percent, down to 10 percent of 1 percent.

(CROSSTALK)

**HAMBRECHT**: And that will happen in the debt market.

**CARNEY**: Thank you very much to the whole panel. I found your testimony very helpful.

**HAYWORTH**: And the gentleman's time is expired. The chair thanks the panel for their testimonies. And the chair notes that some members may have additional questions for the panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record. The hearing is adjourned.

END

**LOAD-DATE**: December 18, 2012