November 5, 2010

Financial Stability Oversight Council
C/o United States Department of the Treasury Office of Domestic Finance
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships With Hedge Funds and Private Equity Funds (Docket FSOC-2010-0002-0001) (Filed www.regulations.gov)

Dear Members of the Financial Stability Oversight Council:

Better Markets, Inc. appreciates the opportunity to provide comments to the Financial Stability Oversight Council ("FSOC") in response to the Request for Information published on October 6, 2010, in connection with the FSOC "Volcker Rule" study and implementation recommendations required under §619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

Better Markets is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular in the rulemaking process associated with the implementation of the Dodd-Frank Act. Our comments here focus generally on the prohibition on proprietary trading and questions 1 through 12.

Key Principles

As with any significant legislation, it is too easy to get lost in layers of arguments and extended discussions about what this word or that phrase means. Such jockeying for interpretive and analytic supremacy often obscures what is clear and critical. That is why any discussion or analysis of the Volcker Rule should be guided by the following key principles:

1. FSOC Must Directly Confront the "Hide and Disguise" Strategy to Evade the Law.

2. The Statutory Prohibition on Proprietary Trading is Unambiguous, Unequivocal and Has No Exceptions.

3. Swift, Certain and Substantial Penalties Must be Publicly Imposed on Traders and Management Alike for Any Violations of the Volcker Rule Under a Strict Liability Standard.

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4. Follow the Money: Bonus Pools & Other Already Collected, Readily Available Data Provide a Roadmap for How the Money Is Made and Where the Risks Are.

5. Baseless and Unsupported Arguments About Harm Allegedly Arising From the Volcker Rule Must be Rejected

6. The Risk of an Actual Second Great Depression and the More than $20 Trillion Cost of the 2008 Financial Crisis Must Be Considered in any Cost-Benefit Analysis.

Discussion

FSOC Must Directly Confront the "Hide and Disguise" Strategy to Evade the Law.

FSOC must recognize that there are too many in the financial industry who do not take the Volcker rule, the Dodd-Frank Act or regulators very seriously. This is nothing less than an egregious direct challenge to the authority of FSOC and its member agencies.

In fact, it is not an overstatement to say that there is and will continue to be an effort to engage in a "hide and disguise" strategy whereby proprietary trading is continued by camouflaging it as something else or simply engaging in fraudulent conduct. As one noted long-time observer of our financial markets remarked recently, "[t]he banks have no intention of ceasing their prop trading. They are merely disguising the activity, by giving it some other name." Bloomberg, October 27, 2010, "Wall Street Proprietary Trading Goes Under Cover," Michael Lewis (author of The Big Short).

As he reported,

> "One trader ... said that from here on out, if he wants to take a proprietary position in a credit, he will argue that he bought the position because a customer wanted to sell the position, and he was providing liquidity; and in order to keep the trade on, he would merely offer the bonds 10 basis points higher than the offered side, so that he will in effect never get lifted out of the position, while being able to say that he is offering the bonds for sale to clients, but no one wants 'em. When the trade finally gets to where he wants it – i.e., either realizing full profit, or slaughtered by losses – he will then sell it on the bid side and move on." Id.

Stating the obvious, the author observed, "there are a hundred different ways to claim to be acting as an agent or for a customer." Id.

If this effort to evade and subvert the law and the critically important work of regulators is not confronted directly, expressly and forcefully, then we believe that the entire legislative and regulatory effort will be in jeopardy. Moreover, if such an irresponsible and cavalier attitude regarding breaking the law were to become pervasive, the likelihood of another catastrophic financial crisis is almost assured.

FSOC (and the individual regulatory agencies and departments) must make unequivocally clear that full compliance with the law is expected and any violations of the law, willful or not, will result in swift and severe penalties (discussed further below).

Confronting this direct challenge to the FSOC and the regulatory agencies is their most important first task. Individual traders, their supervisors, senior management and the Board of Directors all must be told and understand that the culture of "anything goes" has ended. Whether they like it or not, a new legal architecture is going to be in place that changes the way they do business.

Anything less will invite evasion and noncompliance and the credibility of FSOC and its member agencies will be irreparably damaged. Worst of all, our economy will, once again, be put at grave risk by those seeking only to line their own pockets at the expense of everyone else, including importantly the American taxpayer and the American economy. That cannot be tolerated. (See the last section of this comment letter for a detailing of such costs.)

The Statutory Prohibition on Proprietary Trading is Unambiguous, Unequivocal and Has *No* Exceptions.

The basis of the entire discussion of *how* to implement the statutory requirement of the Volcker Rule is the text of the provision itself: "a banking entity shall not engage in proprietary trading." Section 13(a)(1)[1] states "PROHIBITION. – Unless otherwise provided in this section, a banking entity **shall not** – (A) engage in proprietary trading; ...." (Emphasis added)[2] Importantly, there is nothing "otherwise provided in this section" that limits the straightforward, unambiguous and unqualified prohibition on proprietary trading.

In stark, clear and direct contrast, what is "otherwise provided in this section" relates to Section 13(a)(1)(B): "a banking entity shall not -- ...(B) acquire or retain *any* equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund." (Emphasis added) Thus, while appearing to be a blanket prohibition, we find in paragraph (4) that it is directly and clearly "otherwise provided": "(4) DE MINIMIS INVESTMENT – (A) IN GENERAL. – A banking entity *may* make and retain an investment in a hedge fund or private equity fund...." (Emphasis added)

Given the juxtaposition of (A) and (B) and the subsequent explicit exception to (B) and no such exception to (A), the long-standing standard rules of statutory construction

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[1] All comments are to Section 619 of the Dodd-Frank Act, but the references herein are to the provisions of Section 13 of the Bank Holding Company Act of 1956, which Section 619 adds.

[2] See Sec. 13(a)(2) and the cross-referenced provisions for the application of the Volcker Rule to NonBank Financial Companies Supervised By the Federal Reserve Board.

compel the conclusion that there are no exceptions whatever to the prohibition on proprietary trading. This is in contrast to the de minimis exception provided for investments in a hedge fund or private equity fund (according to the terms of the statute).

Indeed, because the drafters of the statute plainly knew how to and did include an exception (and a "de minimis" exception at that) and did not do so for the proprietary trading prohibition, the statute makes clear that there is not even a de minimis exception to the absolute prohibition on proprietary trading. That means that the prohibition must be applied strictly.

True, the statute has a finite list of "permitted activities," but they are *by definition* not proprietary trading or exceptions to the prohibition on proprietary trading. That is the only reason they are permitted at all.

There should be no confusion about this: the Permitted Activities are permitted because they are not proprietary trading. For example, sec. 13(d)(1)(B) permits "The purchase, sale, acquisition, or disposition of securities and other instruments described in subsection (h)(4) in connection with underwriting or market-making-related activities, to the extent that any such activities permitted in this subparagraph are designed not to exceed the reasonably expected near term demands of clients, customers or counterparties." While there may be genuine disagreements regarding precisely what "underwriting or market-making-related activities" are, no one can reasonably argue that such activities are proprietary trading.[3]

Indeed, the drafters of these provisions were directly and expressly concerned that those seeking to evade the prohibition on proprietary trading might try to inaccurately argue that such prohibited activities were nonetheless allowed under the Permitted Activities. For example, the term "in facilitation of customer relations" was removed from the final version of the statute regarding the Permitted Activity of underwriting and market making for that very reason. (And, an express Anti-Evasion provision was included, which is discussed below in the next section.)

As if this statutory construction and prohibition were not clear enough, and even though the Permitted Activities are not proprietary trading, the Permitted Activities are subject to even further limitations in the statute itself and by an express grant of authority to the

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[3] Unsurprisingly, some with an enormous economic interest in continuing to engage in high risk proprietary trading nonetheless make this argument. It is, however, not supportable or reasonable. As the statute makes clear, proprietary trading is a bank trading for its own account in its own interest: "The term 'proprietary trading',... means *engaging as a principal for the trading account of the banking entity*...in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future, any option on any such security, derivative, or contract, or any *other* security or financial instrument" that the appropriate regulator determines. Sec. 13(h)(4). (Emphsis added) The baselessness of claiming that this is necessary for clients is discussed further below.

regulators: Sec. 13(d)(1) "...subject to the limitations under paragraph (2) [detailed below] *and* any restrictions or limitations that the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodities Futures Trading Commission, may determine ...." (Emphasis added)

Thus, to ensure that the prohibition on proprietary trading is not eroded or compromised by the Permitted Activities, even assuming they are not used to evade or subvert the prohibition, the statute provides for further limitations on the Permitted Activities:

Sec. 13 (d)(2) "LIMITATION ON PERMITTED ACTIVITIES. –

"(A) IN GENERAL. – No transaction, class of transactions, or activity may be deemed a permitted activity under paragraph (1) if the transaction, class of transactions, or activity –

"(i) would involve or result in a material conflict of interest ... between the banking entity and its clients, customers, or counterparties;

"(ii) would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies...;

"(iii) would pose a threat to the safety and soundness of such banking entity; or

"(iv) would pose a threat to the financial stability of the United States."

And, if all that were not enough to ensure proprietary trading was prohibited and that the permitted activities did not themselves enable risky conduct, the statute then grants regulators yet more express authority to impose additional limitations. For example, in Sec. 13(d)(3) "Capital and Quantitative Limitations," regulators are granted the authority to impose "additional capital requirements and quantitative limitations, including diversification requirements, regarding the activities permitted ...."

Thus, all the provisions of the section related to the prohibition on proprietary trading, taken together, make the unambiguous prohibition even stronger. Therefore, FSOC in its study and recommendations of the Volcker Rule must ensure that the prohibition on proprietary trading has no exceptions and no loopholes. Indeed, the statute makes clear that not even a de minimus amount of proprietary trading is to be permitted.

That is the basis from which all the analysis and interpretation of the statute must proceed. For example, the Permitted Activities must be defined and enforced in a manner that ensures that there is no proprietary trading.[4] If one interpretation raises the risk or

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[4] For example, one characteristic common to all the Permitted Activities is that the market risk taken on by the financial entity engaging in the activity can be offset in the market without adversely affecting the performance of the activity. FSOC should state clearly that prompt action to offset market risks by covering and hedging transactions is an essential element in determining whether such trading is a Permitted Activity or not.

possibility of proprietary trading, then the statutory mandate requires that it must be rejected for an interpretation that poses no such risk or possibility.

Swift, Certain and Substantial Penalties Must be Publicly Imposed on Traders and Management Alike for Any Violations of the Volcker Rule Under a Strict Liability Standard.

The regulatory system for the Volcker Rule *cannot* be constructed to require regulators to find a needle in a haystack when the "needle hiders" are extremely sophisticated, highly motivated and richly rewarded. Of course, they also have vastly more resources and much greater ability to hide and disguise their conduct than the regulatory agencies.

The most senior operating, financial and compliance management at financial institutions must be responsible for full compliance with the Volcker Rule and they must be held accountable for such compliance. It has to be their job to ensure that potential "needle hiders" are supervised, monitored, caught and punished and, if they fail at their job, then management must be punished as well.

This is what the statute contemplates in the "Anti-Evasion" provisions in Section 13(e): the appropriate regulators "shall" issue regulations "regarding internal controls and recordkeeping, in order to insure compliance with this section," i.e., prohibition on proprietary trading. Because senior management is always the first line of defense, these regulations must require that the appropriate officers be directly involved in compliance and be held accountable. Among other things, one or more of these officers should be required to certify periodically that the banking entity has fully complied with the law or that it has promptly disclosed to the appropriate regulators each transaction or set of transactions which violated the law.

Self-policing, self-correction and self-reporting have to be the cornerstone of any effective compliance regime, but that will only work if the most senior management is involved and explicitly accountable.

Also as contemplated by the statute, strict liability should be the standard imposed for violations of the Volcker Rule. The reason is obvious: anything less will inevitably result in unending disputes, encourage game playing, and defeat deterrence.

Indeed, not only does the statute contemplate strict liability, it also requires regulators to order the termination of the activity and/or disposition of the investment. For example, Section 13(e)(2) provides for the "Termination of Activities or Investments" on a strict liability basis: "whenever [a regulator] has a reasonable cause to believe that a banking entity or nonbank financial company supervised by the Board ... has made an investment or engaged in an activity in a manner that functions as an evasion of the requirements of this section (including through an abuse of any permitted activity) or otherwise violates the restrictions under this section... *shall order*...[the] terminat[ion of] the activity and, as relevant, dispose of the investment." (Emphasis added)

This explicitly mandated action is in addition to all the other authority the appropriate regulatory agencies have to penalize violations of law. Thus, termination and/or disposition of the violating trade are *the statutorily minimum* action regulators *must* take.

However, such a sanction by itself would be grossly insufficient to obtain compliance with the law. Indeed, it might actually encourage violations because termination or disposition of the investment merely forfeits the upside, but has *no meaningful downside*.

As is painfully obvious, financial institutions are populated with risk-takers and only by concretely affecting their risk/benefit calculations *before* any violation occurs will there be any hope of compliance with the Volcker Rule.

The FSOC must create a sliding scale of very strong penalties to ensure that violating the Volcker Rule does not simply become a cost of doing business. There must be substantial fines and penalties for any violation of the rule and such penalties must be imposed swiftly. For example, if a regulator has reasonable cause to believe the rule has been violated then it must be empowered to impose immediately an administrative penalty of (1) 10 times the gross profit or loss from the trade, (2) a six month bar on the trader responsible for the trade, and (3) a cease and desist order to the firm. If there is a second violation, then the penalties should double, a preliminary injunction should issue against the firm, and the responsible member of management should be barred for six months from being affiliated with any financial institution.

To ensure compliance and obtain deterrence, while incentivizing a robust comprehensive internal compliance system supported by aggressive management oversight, a financial institution could avoid the penalties only if it detects, corrects and reports the violation to regulators promptly. The institution must also sanction all employees involved in the violation and those sanctions must be publicly reported.

Without very significant sanctions and public reporting, there will be no deterrence and, without deterrence, there will be little compliance with the Volcker rule.

Follow the Money: Bonus Pools & Other Already Collected, Readily Available Data Provide a Roadmap for How the Money is Made and Where the Risks Are.

Financial institutions and their personnel already collect and precisely track, aggregate, analyze and disseminate every meaningful piece of information related to their business, including all trading, throughout the day and at the end of every day, week, month and quarter. Conveniently, it is all electronically gathered, sorted, stored and can be readily transmitted to any appropriate recipient.

Just one example, in an interview with Bloomberg Business Week published in April 2010, Goldman Sachs' CFO David Viniar said "I personally see the profit and loss statement of each of our 44 business units every single night." You can be sure that the finance officers below him do as well (and they also review every piece of information that gets rolled up into the P&L for their respective business units) because the CFO

might call with a question. And, you can be sure that the CFO's superiors are also routinely reviewing financial information.

This data gathering is particularly true for any activity where the firm's own capital is at risk or might be at risk, which is the case with any proprietary trading. Financial institutions have robust and specific approval and monitoring procedures whenever the firm's capital is put at risk. Importantly, all those processes have comprehensive record keeping requirements at the trade or deal level, the business unit level, the finance department level, the management monitoring level and in compliance as well.

Because regulators will be requesting information specific to an institution's businesses and activities, such information should be readily available as a routine matter. Therefore, any institution claiming *not* to have such requested data should be required to report that fact in writing to that institution's Board of Directors, Audit Committee, accountants and lawyers.[5]

Importantly, however, the FSCO and regulators should not limit themselves to the traditional data gathered and reviewed. For example, one of the most important, and the most illuminating, data collections at every financial institution is the bonus pool as it is assembled month-by-month to quarter-by-quarter to annual finalization and distribution.

Few items receive more or closer attention than the components of the bonus pool. It simply cannot be overstated the amount of time, effort and energy that is directed to assembling, analyzing, designating (prior to year end) and allocating (at year end) the amounts and recipients of monies in the bonus pool. And, all of this information is gathered and tracked scrupulously by, among others, each person who will be fighting for the largest bonus possible based on their claimed contribution to the firm's profits (and/or other bonus components).

Reverse engineering the bonus pool (as well as the P&L) will show regulators precisely where the money is being made (and lost), by whom and as a result of what activity. This is an invaluable roadmap. The famous saying is as true today as it was decades ago (albeit in a very different context): follow the money and it will lead you to most of the answers you need.

Use Available Trade Data Under Dodd-Frank to Monitor Compliance.

Section 727 of the Dodd-Frank Act requires the "real time" reporting of trade data by market participants, including all of those subject to the prohibition against proprietary

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[5] It is important to remember that the gathering and review of this data in a robust and nimble electronic system is already required by numerous rules, regulations and statutes as well as by compliance and outside auditors (not to mention the Audit Committee). In particular, the outside auditors must annually determine whether the company has an effective and comprehensive system of internal controls.

trading. The purpose of the provision is to make *swap transaction and pricing data* available to the public in such form and at such times as the Commission determines appropriate to enhance *price discovery*. For this purpose to be achieved, the data for each transaction must be time-stamped.

Permitted Activities, by their nature, involve prompt coverage of market risk by reversing and hedging transactions. The profit or loss from the Permitted Activity is generally defined by "bid/ask" spreads in the market since positions should not be held for periods which expose the financial institutions to market risk. Prevailing "bid/ask" spreads should be available from Designated Contract Markets and Swap Execution Facilities.

The data provided by those financial institutions prohibited from proprietary trading can be used to monitor compliance in an efficient way. This data can be tested periodically to determine if the profit and loss experienced by a financial institution exceeds the ranges which market conditions suggest should be expected. Profit or loss beyond expected ranges indicates non-compliance and can be investigated and either explained or subject to enforcement. It neither conclusively proves compliance or non-compliance. However, it is an effective tool to monitor the behavior using the best indicator of disguised proprietary trading - unexpected profits or losses to the financial institutions where there should have been hedging to minimize the risk arising from a genuinely customer-based trade.

Baseless and Unsupported Arguments About Harm Allegedly Arising From the Volcker Rule Must be Rejected

Saying something doesn't make it true.

First and most importantly, proprietary trading is NOT prohibited in the United States as some have commented. Proprietary trading is prohibited at only certain specific financial institutions, as made very clear in the statute.

The point of that limited prohibition is so that only those institutions that would be supported by the Federal government in the event of a crisis or that are so systemically significant that their failure might cause a collapse of the entire financial system (and therefore would not be allowed to fail) do not engage in highly risky trading activities. Anyone and any institution can engage in such activities, including proprietary trading, just not those institutions that will have to be bailed out by the taxpayers when their bets go wrong, as they did in September 2008.

Put another way, if a financial institution wants to bet large amounts of money for itself, then it has to take all of the losses itself just as it'll take all of the profits. Taxpayers will not be covering their bets when they go wrong nor will that institution cause a collapse of the economic system.

Not a very radical idea. Bet away, but not with taxpayer money. That's what the Volcker rule ensures.

Remember, proprietary trading is nothing more than a financial institution making bets with its own money for its own account (although through borrowed money the bets are often also with other people's money).

Some have said that stopping a bank from such self-interested betting will put that bank at a competitive disadvantage. How? They never really say. It's usually just a bald assertion. That's because the assertion is ludicrous on its face.

What company is going to say, "I'm not going to a bank to service my needs unless that bank can make bets (often highly leveraged and, therefore, often highly risky) with its own money so that it can make lots, lots more money for itself?" Truthfully, none are.

Put another way, a company needs banking services and has to choose between two identical financial institutions with the sole difference being one engages in proprietary trading and the other does not. What company is going to say, "I'm only going to the bank that makes huge bets with its own money so that it can pay itself unimaginably large bonuses?" It's really not plausible that a bank trading for its own account, seeking to obtain vast amounts of money to pay to itself, would be viewed as a positive by any unaffiliated, disinterested or independent party seeking a bank for its own business.

Indeed, there is a very good case to be made that a bank engaging in proprietary trading should be avoided because it may well be on the other side of the very trade they are putting their customers in. Given their superior access to information (including customer order flow) and their much greater market sophistication due to their expertise and continuous market activities, financial institutions engaging in proprietary trading should be scrutinized very carefully before anyone does business with them.[6]

Another criticism of the Volcker Rule that will not withstand analysis is the claim that prohibiting certain financial institutions from proprietary trading is "arbitrarily separating different elements of the capital formation process." Proprietary trading plays no role in capital formation.

Proprietary trading is a financial institution trading for its own account to make money for itself. That may be capital accumulation for the lucky bonus recipients, but it isn't capital formation and it isn't an activity that taxpayers should have to bail out when the betting goes against the financial institution. It produces nothing more than large

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[6] And, if a business nonetheless wanted to do business only with a bank that engaged in proprietary trading, it could and it could do so here in the US. It would just have to do so with one of the many financial institutions that are not so large, complex or interconnected that they are too big to fail. The only deprivation such a company would suffer would be banking at a firm that taxpayers would NOT bail out if its proprietary bets went wrong.

amounts of money for the bank trading for its own account. That is not what anyone would understand to be part of the "capital formation process."

Self-serving arguments against regulatory reform simply do not withstand analysis and should be scrutinized very carefully. For example, financial institutions and their lobbyists (i.e., Institute of International Finance) often claim that almost any regulation will cause them to lend less money, which will hurt economic growth. A favorite target is increased capital requirements.

However, studies have shown that simply is not the case. See Wall Street Journal, "Studies Question Bank Capital Fears," David Enrich, August 4, 2010.

Another example would be the argument that proprietary trading shouldn't be limited because it would "hurt shareholders of the Banks that have been forced by the Volcker Rule to divest from profitable lines of business." But, as discussed in more detail below, the truth is that all those shareholders would have been wiped out in September 2008, but for the massive and hugely expensive bailouts by our government and governments throughout the world.

Moreover, if there is another financial crisis, whether it turns out to be the Second Great Depression or is, again, prevented by government intervention, then the shareholders are going to suffer many, many multiples of any so-called harm arising from the application the Volcker Rule.

Maybe most importantly, there is a glaring omission in the anti-reform, anti-Volcker Rule comments: the actual unprecedented costs to the taxpayers and our country of the financial crisis of 2008. They insist regulators must worry about the banks and other financial institutions and the shareholders and all sorts of other things, but they never seem to get around to worrying about the taxpayers and all those who have suffered so much as a result of the financial crisis.

Those taxpayers and those costs are the subject of the next section,

The Risk of an Actual Second Great Depression and the More than $20 Trillion Cost of the 2008 Financial Crisis Must Be Considered in any Cost-Benefit Analysis.

We do not believe that a cost/benefit analysis will provide any appropriate metrics for evaluation the statutory prohibition on proprietary trading (because there are no exceptions to the prohibition). However, to the extent that it is advocated or considered for *any* purpose, any cost/benefit analysis must include the likely costs of the risk of a financial crisis materializing in the future as it did in September 2008. While all those costs of that crisis are not yet known, all of the direct and indirect costs of the financial crisis that are now known must be considered.

However, before those substantial costs are even considered, an alternative cost analysis *must* first be considered. While we now know that the massive and unprecedented

intervention by governments succeeded in preventing the financial crisis of September 2008 from spiraling into a Second Great Depression, that was not inevitable and not known at the time.

That is to say, any consideration on a cost/benefit basis of this regulation or that regulation must consider the possibility of an actual Second Great Depression occurring next time. There is no guarantee one will be avoided and, therefore, the risk that another Great Depression will occur next time must be calculated into any cost/benefit analysis. As we know, wishing away tail risk is a fool's errand. Such risks materialize more frequently than assumed and their outsized consequences and devastating impact have to be considered.

Recall, in the days after the failure of Lehman Brothers, the financial system essentially shut down.[7] The short term funding market (essential not only for Wall Street and financial institutions, but also for everything from the payroll of America's largest corporations to the smallest Main Street business) stopped functioning altogether. That freeze spread like a deadly frost throughout the national and, then, the international finance system. As is well known, that finance system is the circulatory system that keeps the economy functioning. Without the finance system working, the US and world economies would stop functioning as well.

It was only a matter of days after the collapse of Lehman that an economic calamity on the scale of the Great Depression, or worse, would likely have materialized.[8] *THAT* risk has to be included in any cost/benefit analysis.

For example, if someone claims that the cost of increasing capital requirements will be a reduction in the amount of credit available and, thereby, a reduction in the amount of economic growth (both hotly contested issues),[9] then that alleged cost (i.e., reduction in credit or growth) must be balanced against the cost of a complete financial collapse.

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[7] While absolutely necessary, it's understandable that few want to remember those days of fear and foreboding. Some because it reflects poorly on them (Wall Street, financial institutions, academics, regulators, politicians), some because the rescue actions have become politically toxic (politicians), some because some of those actions are now viewed as short term good, but long term bad (politicians, bankers), some because it puts a lie to after-the-fact self-exonerations (Wall Street, financial institutions, academics, regulators, politicians), and some because it causes people to think about how it happened in the first place (all of the above).

[8] This is not an exaggeration or even a remote possibility. Remember that the war now known as the First World War was known as the Great War and believed to be the war to end all wars. However, that only lasted until the next great war, which caused the Great War to be renamed the First World War and the second great war to be named the Second World War. What we now refer to as the Great Depression may well be known to future generations as merely the First Great Depression.

[9] See Wall Street Journal, "Studies Question Bank Capital Fears," David Enrich, August 4, 2010.

But, that is not all. In addition to considering the cost that would arise due to an actual future financial collapse and a Second Great Depression, any cost/benefit analysis must also consider the actual costs incurred in *preventing* the total collapse of the financial system and avoiding the Second Great Depression in connection with the financial crisis of 2008.

That is to say, one does not have to guess at what the cost of a financial crisis might be *if* it were to materialize. While it is true that every financial crisis is unique in at least some respects, using the costs of the most recent crisis as a proxy for the likely costs of the next crisis is more than reasonable. That is particularly true here where the rules under consideration and evaluation are intended and designed to prevent the next financial crisis.

True, those costs are difficult to calculate and more difficult to get agreement on. However, Bloomberg News has done the most comprehensive and rigorous compilations of such costs. It has estimated that the US government and the Federal Reserve has spent, lent or committed $8.2 trillion from the beginning of the crisis through December 2009. Bloomberg, "Taxpayer Pledges Fall to $8.2 Trillion in US Bailout," Bob Ivry, December 23, 2009; see also Bloomberg, "Financial Rescue Nears GDP as Pledges To $12.8 Trillion," Mark Pittman and Bob Ivry, March 31, 2009.

All of the information supporting the $8.2 trillion amount comes from public sources, but it is nonetheless incomplete. Indeed, Bloomberg News sued to obtain additional information that the government has refused to disclose.[10] See Bloomberg, "Treasury Shields Citigroup as Deletions Undercut Disclosure," Bob Ivry, October 25, 2010. Given that *the* reason the Bloomberg News' calculation might not be accurate is due to government non-disclosure (whether due to good, bad or indifferent reasons), the government should not question the validity of the amount of $8.2 trillion unless it discloses sufficient information to determine the accuracy and completeness of an alternate number.

The $8.2 trillion includes financial crisis intervention programs at the Federal Reserve Board, the FDIC, the Treasury, HUD, plus fiscal stimulus programs.[11]

But, those costs are still grossly incomplete. For example, it does not include the devastating costs of the more than 15 million Americans still without work. The number of Americans unemployed or under-employed (working part time because they cannot

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[10] The Dodd-Frank Act also includes a provision that requires the GAO to do a limited audit of some of the actions previously taken by the Federal Reserve Board. That audit is due to be completed in December 2010, which should enable a more informed analysis.

[11] This is much broader than merely the TARP program, which is the most visible of all the programs and often misunderstood to be the universe of government actions.

find full time work) has hovered near 20% of the workforce for a significant time now. One of five Americans is a truly terrible cost that the financial crisis and the associated recession has inflicted on the country.

That un- and underemployment has caused tremendous costs far beyond those individual people. For example, "The recession has directly hit more than half of the nation's working adults, pushing them into unemployment, pay cuts, reduced hours at work or part-time jobs." Washington Post, "Recession cut into employment for half of working adults, study says," Michael Fletcher, June 30, 2010, citing Pew Research Center study.

The Bloomberg costs also did not include lost stock market wealth or housing wealth, which Treasury Department chief economist Alan Krueger stated fell by approximately $17 trillion between 2007 and 2009 because of the financial crisis. The Hill, "Financial Crisis Cost Households $17 Trillion, Treasury Official Says," Jay Heflin, May 3, 2010.

Other than the loss in housing wealth, this does not include all the other costs of more than 6 million homes already foreclosed on or the 3.5 million more expected to be foreclosed on by the end of 2012. The New York Times, "The Foreclosure Crisis," Editorial, October 14, 2010. Shockingly, foreclosures are not only continuing, but the rate of foreclosures is increasing. Bloomberg, "US Home Seizures Reach Record Amid Foreclosure Review," Dan Levy, October 14, 2010.

These costs, of course, also cascade into other costs: delayed retirements, more than 40 million Americans on food stamps, declining mobility in the US (due to job and housing lock), increased Medicaid recipients, decreased use of health care by working poor and middle class, tens of millions of people owning homes worth significantly less than they paid for them, entire neighborhoods and communities hollowed out by foreclosures and developer abandonment, the dramatic drop in tax receipts causing all sorts of services to be cut, from firefighters, police, teachers, to home health aids, elderly transportation, etc., and the list of costs goes on and on.

Also, moving interest rates to near zero and keeping them there for an extended period of time has provided money at virtually no cost to dealer banks, which can then lend or invest that money at higher rates. However, historically low to zero interest rates are also what every saver and most retired people in America have been receiving since September 2008. In addition to delayed retirements and other consequences, that policy has resulted in a massive transfer of wealth from savers to financial institutions.

All those costs and more should be carefully weighed when evaluating NOT to implement a regulation because those are the all too real costs of this crisis and, no doubt, the next financial crisis. It is, therefore, a huge benefit to avoid those costs again.

Thus, the Bloomberg calculation of $8.2 trillion is really the floor, the least amount that the crisis has cost the United States. When everything else is added in, even ignoring the incalculable, but devastating human costs, the actual costs will almost certainly exceed $20 trillion. And, those costs are still going up. For example, the $600 billion action

announced by the Federal Reserve Board this week (colloquially referred to as "QE2") is a direct response to and *cost* of the financial crisis of 2008. This action was taken to "spur" the economy, which remains mired in a deep recession more than 2 years after the financial crisis of September 2008.[12]

Avoiding all these costs is *THE benefit* that must be considered when doing any cost/benefit analysis. For example, it would be improper in the extreme to try to calculate the "benefit" of increased capital requirements against the "cost" of reduced lending without also including the *benefit* of avoiding another crisis *and* avoiding the massive costs of such a crisis.

That is true for any isolated or macro cost benefit analysis. What is the cost of *not* regulating in one way or the other in terms of risking an actual Second Great Depression or taking very costly measures to prevent and possibly having to spend another $20-plus trillion dollars? That is the question that must be asked by FSOC and its member regulatory agencies when ever they engage in a cost/benefit analysis.

Conclusion

The key principles set forth here should guide the FSOC study of the Volcker Rule and should inform all of its recommendations to the regulatory agencies, which themselves should be guided by these key principles.

We hope these comments are useful in your study and recommendations.

Sincerely,

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[12] And, none of this even includes the cost of greatly increasing "moral hazard" by making the implicit possibility of a Federal bailout of "too big to fail" financial institutions explicit and by extending that bailout and federal backstop to parts of the financial system where there was not even an assumed backstop. Moreover, there is another uncalculated cost: many too big to fail institutions actually increased in size and scope as a result of the financial crisis of 2008, dramatically increasing concentration and posing an even greater risk to the financial system and economy.