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Ms. Jennifer Johnson
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WR HAMBRECHT+CO

William R. Hambrecht
Chairman and CEO

WR Hambrecht + Co
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February 8, 2012

RE: Proposed Rule to Implement Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Dear Sirs and Madams:

I write in response to the request for public comment on the proposed rule to implement the Volcker Rule, embodied in section 13 of the Bank Holding Company Act.

The Volcker Rule Establishes a Strong Wall Between Risky Trading and Depository Banking

The Volcker Rule seeks to establish a strong wall between hedge fund-like risk taking and the banks that hold customer deposits It does so through its ban on proprietary trading, which requires a fundamental reworking of the scope of the trading activities of our largest securities and derivatives dealer banks, as well as strong limitations on off-balance sheet funds. These limits are necessary to restore restraints on leverage that in recent years have appeared not to apply to our nation's "too big to fail" financial institutions, and in doing so, minimize the risk of another systemic financial crisis.

Indeed, the recent bankruptcy of MF Global Holdings dramatically reinforces the need for a strong version of the Volcker Rule, which limits market-making to activities that serve clients and abide by prudent margin requirements. MF Global was leveraged by 34 times its equity and used its funds to take a large position in European debt.

Implement Margin Requirements and Limits on the Use of Customer Cash For Market Making Activities

The heart of the Volcker Rule is its prohibition on proprietary trading combined with the permission to engage in market-making and hedging. While I am pleased that the proposed rule mandates the collection of meaningful data and metrics, the proposed rule does not adequately address the key issue of leverage and the funding mechanisms which can drive excessive leverage.

The central role of excessive leverage at large broker-dealer banks in triggering the financial crisis is well known and reviewed in my attached report. In my four decades of experience in the financial markets, I have found that the best way to separate impermissible proprietary trading from permitted market-making is to require that dealers performing a market making function must i) abide by the same margin rules that apply to clients and ii) set aside cash balances from securities lending (and other similar activities) as restricted cash for customers. The effect of these restrictions will be to lower leverage and impose reasonable margin requirements on trading accounts. This will incentivize banks to engage in trades which are more profitable relative to risk, which market-making almost always is. At the same time, it will allow banks to legitimately respond to client needs. The result would be significantly enhanced control of systemic risk, as leveraged and crowded trades would be reduced, and any damage that could unfold from these positions will be significantly smaller.

You have the power to impose such margin requirements directly through the authority to set quantitative limits on activities that is granted in the new Section 13(d)(3) of the Bank Holding Company Act, as well as through restrictions on the terms of securities lending and repurchase agreements, discussed below.

Limit Risks from Securities Lending and Repurchase Agreement Financing

The proposed rule entirely exempts "repo" and "securities lending" transactions from the coverage of the Volcker Rule. By issuing this blanket exemption from oversight, the proposed rule overlooks the significant risks that emerge from securities lending and repo financing. Since these mechanisms are key drivers of leverage at large broker-dealer banks, the exemption also represents a missed opportunity to limit leverage at such institutions.

The basic risk management practices that worked for many years under the Glass-Steagall Act to restrain the risk of securities lending should be reinforced:

(1) Lending only on exchange traded instruments; and
(2) Immediately selling out those positions that exceeded explicit margin requirements.

Complex derivatives and structured products cannot be reliably valued, and should not be part of securities lending or repo activities.

I believe additional attention should be given to limiting the risks that emerge from reliance on "repo" funding. Not only is it only available to the largest banks, it is, like cash balances from securities lending, subject to little lender discipline and as such, at any signs of trouble, the market shuts down quickly. Indeed, a classic "bank run" by repo lenders was a key triggering mechanism in the financial crisis of 2008.

Rather than entirely exempt these important funding mechanisms, I believe that the better approach would be to require those transactions be included within the Volcker Rule's trading account definition and subject them to limitations that work to restrict leverage to reasonable levels. Such limits should work to restrict intra-day as well as end-of-day leverage.

Conclusion

I have set forth additional details in the attached report, *Making the Volcker Rule Work for America: A Pragmatic Alternative to Exemptions*, which was delivered to a conference sponsored by Americans for Financial Reform November 9, 2011 in Washington, D.C. If you have any questions, please do not hesitate to contact me.

Sincerely,

Bill Hambrecht

Making the Volcker Rule Work for America: A Pragmatic Alternative to Exemptions

November 9, 2011

William R. Hambrecht
Chairman
WR Hambrecht + Co., LLC
Pier 1, Bay 3, San Francisco, CA 94111

The Volcker Rule

The Volcker Rule was first proposed in the wake of the Financial Crisis of 2008, and called for a direct ban on proprietary trading. However, as the crisis began to subside, the proposal's inclusion in the Dodd-Frank Act was changed to allow banks to continue proprietary trading with defined limitations. Its intent, of course, was to limit the major banks from engaging in speculative trading that would endanger customer deposits or accounts; and in particular, limit the bank's scope of trading and any systemic risk that would create a "too big to fail" crisis.

The subsequent debate and inclusion of exemptions has led to much debate on how to define certain aspects of the Act. At the most basic level, the vital question is whether a trade is providing liquidity to the marketplace to help a client, or whether it is a proprietary trade. In today's environment of sophisticated derivative instruments and algorithms, the answer to this question is incredibly difficult for even the most astute managers to know.

The intent of the Volcker Rule is to eliminate highly leveraged speculative trading from financial institutions that carry customer funds and securities. To this end, we would propose that the Volker Rule be more effectively implemented by simplifying the criteria by simply requiring broker-dealers to abide by margin requirements in all their trading activity.

Financial Crisis

While the Financial Crisis of 2008 had far reaching and deleterious effects throughout virtually every level of the global economy, the epicenter of the crisis itself was largely confined to six "bulge" broker-dealers: The Bear Stearns Companies, Inc.; Citigroup, Inc.; Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Lehman Brothers Holdings Inc.; and Morgan Stanley.

In 2002, these broker-dealers were allowed by the Securities Exchange Commission to increase their leverage from 12-13x to 30x the value of their equity, a freedom that no other financial institution was afforded. The leverage limits were regulatory guidelines, not statutory requirements, as the existing net capital rules allowed almost unlimited leverage. This increase in large part led to a catastrophic financial failure felt the world-over in 2008. In the wake of this crisis, two of the above broker-dealers failed, three came perilously close to failure, and one had a strong enough commercial bank balance sheet to weather the storm.

Also caught up in the wake of this crisis were literally hundreds of hedge funds, broker-dealers, and commercial banks, which although sorely wounded, survived the bubble with minimum or no government support. Because of the existing discipline of margin requirements and lenders, there were no failures that threatened the financial system as a whole.

When taking a closer look at these six broker-dealers, some striking similarities emerge which clearly left each in an extremely vulnerable position.

The Key to Almost Unlimited Leverage – The Broker-Dealer Capital Adequacy Rule

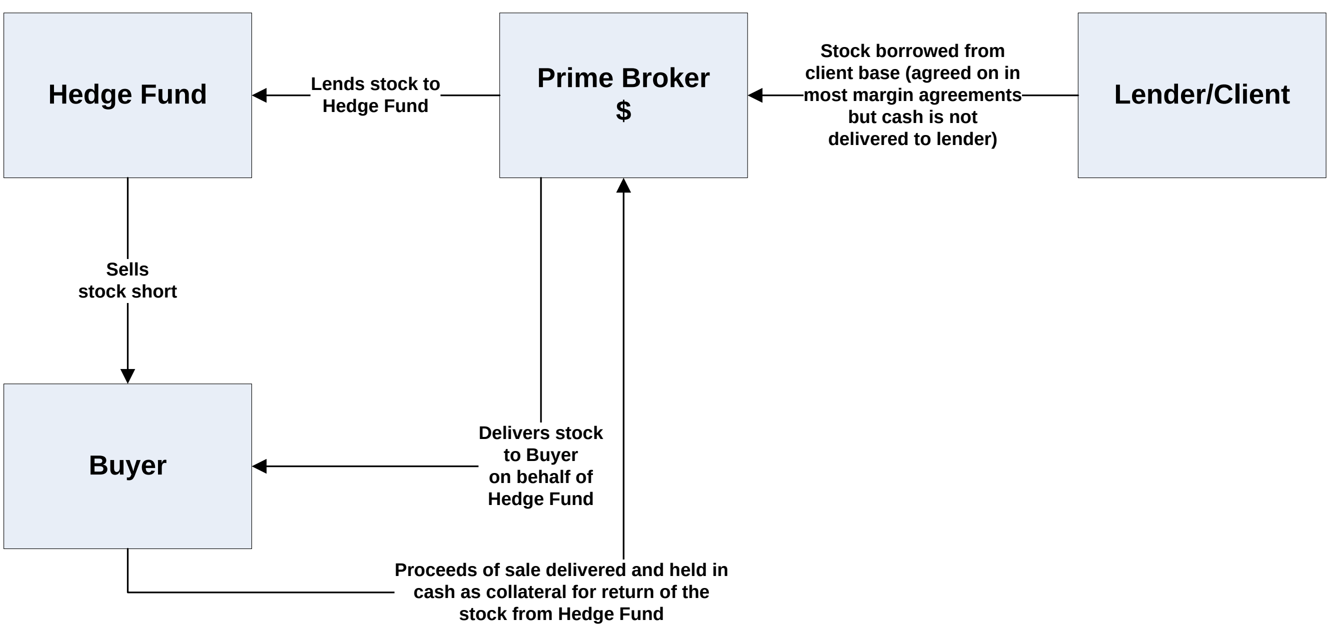
Broker-dealers liquidity is measured by a daily Capital Adequacy Rule which is designed to limit capital commitments. As broker-dealers, trading accounts are exempt from normal margin rules that control the leverage of other active trading hedge funds and individuals. The rationale behind this is that as market makers, they are providing liquidity to the market and their leverage is otherwise kept in check by capital adequacy rules. In practice, however, even though they have to get "down" to 30x leverage by market close, many trade up to 3 or 4 times that during the course of the trading day, which provides a substantial loophole as capital adequacy is calculated at the end of the day. During the Financial Crisis of 2008, these enormous capital risks were rationalized by hedges of large short positions that were assumed to act rationally, but in reality seldom do in a crisis environment.

The question also arises as to just how much liquidity is really created by this leverage effect, as so much of exchange based trading today has moved to so called "dark pools" which are essentially providing a "matching" platform for buyers and sellers. While it is difficult to find reliable data, we estimate that specialist trading has ranged from 3-9% of total volume, and bulge firms now account for 25-30% of dark pool trading in competition with customer matching orders. Agency fees have fallen to 10-20 mils per share, indicating that equity trading is a very competitive market. Debt and other instruments have much less transparency, so it is difficult to estimate volumes.

The Key to "Free" Money and Leverage – The Prime Brokerage Business

Most of the six broker-dealers that teetered during the Financial Crisis were major players in the "prime brokerage" business. Since most hedge funds are short sellers to protect against major declines, these prime brokers were the overwhelming beneficiaries of the credit balances created by short sales (see Flow Chart 1 below).

Flow Chart 1



The process described in Flow Chart 1 created cash balances at the prime brokerage that effectively helped finance the broker-dealers' massive trading accounts without paying interest and without any lender discipline. The remaining cash needed to finance these accounts came largely from the repo market and overnight loans. These loans are largely governed by balance sheet scale and are generally made only to the very large banks.

Both sources of cash are subject to little lender discipline and as such, at any signs of trouble, the market shuts down quickly. In this case, the repo market will "dry up" after the morning repayment, and the hedge funds will move their accounts to a "safer" home, forcing the prime broker to return the collateral cash when the short position is moved to another broker.

This constitutes a proverbial "run on the bank," not by commercial bank depositors, but by hedge funds and repo lenders. This is why the CEO of Bear, Stearns in February 2008 could claim over $20 billion of cash at the start of the week, and have virtually run out of cash by the end of the same week (see Exhibit 1, Lehman Brothers and Bear, Stearns Balance Sheets).

Transparent Markets – Where the Market Fails

In a normal market environment, when leverage reaches a certain threshold, the owner of the trading position is forced to liquidate or reduce his position and pay off the lender. In the 2008 financial crisis, this did not occur as the mortgage securitization market was an over-the-counter market dominated by a small number of firms where tacit cooperation and self-interest among traders led to markets being maintained at unrealistic valuations despite the underlying assets of the mortgage securities steady decline.

By the time that the risk was identified, there was no one in the marketplace willing to buy the positions, and therefore, the traders tried to hold pricing levels in the hope that other firms or funds would step in and purchase the positions. When no buyers materialized, these firms were forced to liquidate, resulting in huge and dramatic losses. For example, Merrill Lynch's CDO assets were valued at $30.6 billion as of mid-June of 2008, yet were sold in July 2088 for $7 billion. This downturn should not have been so dramatic and a more transparent marketplace should have reflected a more moderate market decline over a longer period of time.

A Solution that Worked in the Past

The Volcker Rule has often been compared to the Glass-Steagall Act of 1933, which was enacted as a result of the stock market crash on 1929. And, many observers of the Glass-Steagall Act point out that the underwriting abuses that it purportedly targeted were not the real problem. The basic issue, as is the case in almost any financial panic, was excessive leverage. The Securities Exchange Act of 1934 passed control of margin requirements to the Federal Reserve System in order to give them control over leverage. This worked reasonably well for almost 70 years, and during that time the United States enjoyed global leadership in equity and debt markets.

The governing principles for the majority of those seven decades were as follows:

(1) Lending only on exchange traded instruments; and

(2) Immediately selling out those positions that exceeded explicit margin requirements.

In the final analysis, exempting a small group of broker-dealers from margin requirements ultimately allowed an enormous buildup of leverage that did not become apparent until it was too late. Allowing broker-dealers to trade in any instrument, but uniformly require that they adhere to margin account requirements, would create a level playing field among all market participants and would put an effective and proven governor on leverage.

It is important to recognize that the leverage created in the system by the six aforementioned broker-dealers was legal, and the participants were not some rogue operators, but rather were the leading financial institutions in the marketplace. As trading technology commoditized traditional broker-dealer agency activity and eroded brokerage fees, the major firms moved aggressively towards proprietary activities to maintain their financial scale.

Traders will look for any legal advantage to improve their position, and leverage allows them to operate on a far larger scale. Leaving any loophole open will likely entice a trader to utilize it, which puts the onus on the regulatory system to recognize the inherent danger that underlies such practices. Only a strict reliance on margin requirements will provide the kind of leverage governor needed to prevent threats to our financial system.

The recent bankruptcy of MF Global Holdings only reinforces the weakness of the capital adequacy rule, which allowed a broker-dealer to use its own balance sheet to support large trading positions. MF Global was leveraged by 34x its equity and used these funds to take a large position in European debt, yet was likely in compliance with the net capital rule.

Summary

We would recommend that the appropriate regulators (SEC and FED) be given the explicit direction to control leverage of the banks and broker-dealers by extending margin requirements to their trading accounts. We would also propose that cash balances from stock lending be transferred as collateral to customer accounts as restricted cash. We think both recommendations are appropriate for implementation of the Volcker Rule to limit speculative and leveraged trading.

Exhibit 1

Lehman Brothers and Bear, Stearns Balance Sheets

Lehman Brothers

Balance Sheet						
						Press Release
Balance Sheet as of:	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
	May-31-2007	**Aug-31-2007**	**Nov-30-2007**	**Feb-29-2008**	**May-31-2008**	**Aug-31-2008**
Currency	***USD***	***USD***	***USD***	***USD***	***USD***	***USD***
ASSETS						
Cash And Equivalents	5,293.0	7,048.0	7,286.0	7,564.0	6,513.0	-
Cash & Securities Segregated	7,154.0	10,579.0	12,743.0	16,569.0	13,031.0	-
Securities Owned	218,112.0	-	-	268,070.0	226,378.0	-
Securities Purch. Under Agreem. To Resell	130,953.0	144,774.0	162,635.0	210,166.0	169,684.0	-
Securities Borrowed	118,118.0	142,653.0	138,599.0	158,515.0	124,842.0	-
Accounts Receivable	37,148.0	38,391.0	43,277.0	52,399.0	41,721.0	-
Gross Property, Plant & Equipment	5,716.0	5,999.0	6,299.0	6,756.0	6,975.0	-
Accumulated Depreciation	(2,197.0)	(2,322.0)	(2,438.0)	(2,567.0)	(2,697.0)	-
Net Property, Plant & Equipment	**3,519.0**	**3,677.0**	**3,861.0**	**4,189.0**	**4,278.0**	**-**
Goodwill	-	-	3,137.0	-	-	-
Other Intangibles	3,652.0	4,108.0	990.0	4,112.0	4,101.0	-
Invest. in Debt and Equity Securities	-	246,542.0	246,617.0	-	-	-
Trading Asset Securities	-	35,711.0	44,595.0	-	-	-
Other Current Assets	8,317.0	20,044.0	21,917.0	-	-	-
Deferred Tax Assets, LT	-	-	2,309.0	-	-	-
Other Long-Term Assets	73,595.0	5,689.0	3,097.0	64,451.0	48,884.0	-
Total Assets	**605,861.0**	**659,216.0**	**691,063.0**	**786,035.0**	**639,432.0**	**-**
LIABILITIES						
Accounts Payable	50,471.0	51,829.0	64,307.0	84,552.0	61,086.0	-
Accrued Exp.	15,172.0	17,157.0	16,039.0	11,596.0	9,802.0	-
Short-term Borrowings	203,097.0	268,394.0	269,296.0	292,528.0	222,233.0	-
Curr. Port. of LT Debt	17,144.0	13,997.0	16,801.0	18,510.0	20,991.0	-
Long-Term Debt	100,819.0	120,331.0	123,150.0	123,309.0	123,178.0	-
Trust Pref. Securities	-	-	-	4,976.0	5,004.0	-
Other Current Liabilities	168,015.0	140,840.0	149,617.0	196,903.0	141,507.0	-
Other Non-Current Liabilities	30,014.0	24,935.0	29,363.0	28,829.0	29,355.0	-
Total Liabilities	**584,732.0**	**637,483.0**	**668,573.0**	**761,203.0**	**613,156.0**	**-**
Pref. Stock, Redeemable	1,095.0	1,095.0	1,095.0	2,993.0	6,993.0	-
Total Pref. Equity	**1,095.0**	**1,095.0**	**1,095.0**	**2,993.0**	**6,993.0**	**6,993.0**
Common Stock	61.0	61.0	61.0	61.0	61.0	-
Additional Paid In Capital	9,610.0	9,802.0	9,733.0	11,129.0	11,268.0	-
Retained Earnings	18,133.0	18,915.0	19,698.0	19,880.0	16,901.0	-
Treasury Stock	(5,560.0)	(5,658.0)	(5,524.0)	(5,149.0)	(4,922.0)	-
Comprehensive Inc. and Other	(2,210.0)	(2,482.0)	(2,573.0)	(4,082.0)	(4,025.0)	-
Total Common Equity	**20,034.0**	**20,638.0**	**21,395.0**	**21,839.0**	**19,283.0**	**19,283.0**
Total Equity	**21,129.0**	**21,733.0**	**22,490.0**	**24,832.0**	**26,276.0**	**26,276.0**
Total Liabilities And Equity	**605,861.0**	**659,216.0**	**691,063.0**	**786,035.0**	**639,432.0**	**-**

Bear, Stearns

Balance Sheet						
Balance Sheet as of:	Restated Q4 Nov-30-2006	Q1 Feb-28-2007	Q2 May-31-2007	Q3 Aug-31-2007	Q4 Nov-30-2007	Q1 Feb-29-2008
Currency	*USD*	*USD*	*USD*	*USD*	*USD*	*USD*
ASSETS						
Cash And Equivalents	4,595.0	5,891.3	11,178.3	18,142.6	21,406.0	20,786.0
Cash & Securities Segregated	8,804.0	9,125.9	4,652.6	13,459.8	12,890.0	14,910.0
Securities Owned	109,200.0	134,410.3	136,410.7	126,869.8	122,518.0	118,201.0
Securities Purch. Under Agreem. To Resell	38,838.0	37,248.0	42,271.7	32,144.2	27,878.0	26,888.0
Securities Borrowed	80,523.0	84,014.6	92,049.7	80,039.0	82,245.0	87,143.0
Accounts Receivable	35,601.0	39,837.3	45,828.4	42,264.5	52,737.0	52,844.0
Other Receivables	745.0	892.8	1,156.0	1,055.9	785.0	488.0
Gross Property, Plant & Equipment	1,632.0	1,700.3	1,607.0	1,689.8	1,754.0	1,804.0
Accumulated Depreciation	(1,152.0)	(1,192.1)	(1,059.9)	(1,104.1)	(1,149.0)	(1,196.0)
Net Property, Plant & Equipment	**480.0**	**508.2**	**547.1**	**585.6**	**605.0**	**608.0**
Invest. in Debt and Equity Securities	31,067.0	41,482.6	49,985.1	42,655.2	34,539.0	31,031.0
Deferred Tax Assets, LT	1,431.0	-	-	-	1,464.0	-
Other Long-Term Assets	39,149.0	41,100.8	39,224.0	39,874.5	38,295.0	46,096.0
Total Assets	**350,433.0**	**394,511.9**	**423,303.7**	**397,091.0**	**395,362.0**	**398,995.0**
LIABILITIES						
Accounts Payable	76,386.0	80,984.5	88,565.6	73,805.7	87,305.0	97,274.0
Accrued Exp.	4,018.0	2,076.0	2,956.8	3,060.8	2,952.0	1,213.0
Short-term Borrowings	122,128.0	143,080.3	152,955.6	148,084.4	143,804.0	135,972.0
Curr. Port. of LT Debt	-	-	-	1,362.0	9,586.0	7,166.0
Long-Term Debt	83,650.0	97,880.9	109,451.0	102,169.1	89,294.0	91,063.0
Trust Pref. Securities	-	262.5	262.5	262.5	263.0	263.0
Other Current Liabilities	30,392.0	32,144.3	33,533.7	33,398.8	30,315.0	35,034.0
Other Non-Current Liabilities	21,730.0	24,809.5	22,270.4	21,947.3	20,050.0	19,114.0
Total Liabilities	**338,304.0**	**381,238.0**	**409,995.6**	**384,090.5**	**383,569.0**	**387,099.0**
Pref. Stock, Redeemable	359.0	359.2	359.2	351.6	352.0	352.0
Pref. Stock, Other	-	-	-	-	-	-
Total Pref. Equity	**359.0**	**359.2**	**359.2**	**351.6**	**352.0**	**352.0**
Common Stock	185.0	184.8	184.8	184.8	185.0	185.0
Additional Paid In Capital	4,579.0	4,902.7	4,936.9	4,966.3	4,986.0	5,619.0
Retained Earnings	9,385.0	9,894.9	10,211.3	10,338.2	9,441.0	9,419.0
Treasury Stock	(4,445.0)	(4,610.6)	(4,888.2)	(5,339.4)	(5,641.0)	(2,913.0)
Comprehensive Inc. and Other	2,066.0	2,543.0	2,504.1	2,499.0	2,470.0	(766.0)
Total Common Equity	**11,770.0**	**12,914.8**	**12,948.9**	**12,648.8**	**11,441.0**	**11,544.0**
Minority Interest	-	-	-	-	-	-
Total Equity	**12,129.0**	**13,273.9**	**13,308.1**	**13,000.5**	**11,793.0**	**11,896.0**
Total Liabilities And Equity	**350,433.0**	**394,511.9**	**423,303.7**	**397,091.0**	**395,362.0**	**398,995.0**

Exhibit 2

New York Times
Published October 21, 2011

Volcker Rule, Once Simple, Now Boggles

By JAMES B. STEWART

When Paul Volcker called for new rules in 2009 to curb risk-taking by banks, and thus avoid making taxpayers liable in the future for the kind of reckless speculation that caused the financial crisis and resulting bailout, he outlined his proposal in a three-page letter to the president.

Last year, when the Dodd-Frank Wall Street Reform and Consumer Protection Act went to Congress, the Volcker Rule that it contained took up 10 pages.

Last week, when the proposed regulations for the Volcker Rule finally emerged for public comment, the text had swelled to 298 pages and was accompanied by more than 1,300 questions about 400 topics.

Wall Street firms have spent countless millions of dollars trying to water down the original Volcker proposal and have succeeded in inserting numerous exemptions. Now they're claiming it's too complex to understand and too costly to adopt.

Having read at least some of the proposed regulations — I made it through about five pages before sinking in a sea of acronyms — I can assure you that the banks are right about that. Even the helpful summary prepared by Sullivan & Cromwell, a law firm that represents big banks and that has associates who no doubt wrote the summary over several all-nighters, runs a dense 41 pages.

In numerous interviews this week with people across the political spectrum, I couldn't find anyone who actually supports this behemoth — including Mr. Volcker, whose name it bears.

"I don't like it, but there it is," Mr. Volcker told me in his first public comments on the sprawling proposal.

"I'd write a much simpler bill. I'd love to see a four-page bill that bans proprietary trading and makes the board and chief executive responsible for compliance. And I'd have strong regulators. If the banks didn't comply with the spirit of the bill, they'd go after them."

He says he likes the fact that the proposed regulations, complex as they are, make top management and boards responsible for compliance. "If they think it's too complicated, they have no one to blame but themselves," he said of the banks.

Do we need to go back to the drawing board?

“Here’s the key word in the rules: ‘exemption,’ ” former Senator Ted Kaufman, Democrat of Delaware, told me. “Let me tell you, as soon as you see that, it’s pronounced ‘loophole.’ That’s what it means in English.” Mr. Kaufman, now teaching at Duke University School of Law, earlier proposed a tougher version of the Volcker Rule, which was voted down in the Senate. “We’ve been through this before,” he said. “I know these folks, these Wall Street guys. I went to school with them. They’re smart as hell. You give them the smallest little hole, and they’ll run through it.”

“I support the concept of the Volcker Rule,” Representative Peter Welch, Democrat of Vermont, said, “but these rules aren’t going to be effective. We’ve taken something simple and made it complex. The fact that it’s 300 pages shows the banks pushing back and having it both ways.”

And these are Democratic critics of the proposed regulations. An overwhelming number of Republicans oppose them, as they have virtually every aspect of Dodd-Frank. Even Senator Richard Shelby, Republican of Alabama, the ranking member of the Senate Committee on Banking, Housing and Urban affairs, who was the lone Republican to support the tougher Brown-Kaufman legislation, dismisses the latest incarnation.

“This proposal, however, is filled with central questions that Congress should have answered before even drafting Dodd-Frank,” said Jonathan Graffeo, a spokesman for Senator Shelby. “Instead, Congress willfully ignored the ramifications of its actions, just as it did in repealing Glass-Steagall.”

Yet the Volcker Rule, or something like it, could be the most important reform measure to emerge from the financial crisis.

If there was any doubt about that, this week the Securities and Exchange Commission unveiled its latest charges involving mortgage-backed securities. In what may be a new low for conduct by a major Wall Street firm in the walk-up to the financial crisis, Citigroup settled charges (without admitting or denying guilt) that it defrauded investors by creating a package of mortgage-backed securities for which it selected a pool of mortgages likely to default, bet against the security for the bank’s benefit by shorting it and then foisted it off on unwitting investors without disclosing any of this.

According to the S.E.C., one trader characterized this particular security in an all-too-candid e-mail as “possibly the best short EVER!”

Compared with this, Goldman Sachs mortgage traders look like Boy Scouts. In settling its fraud charges for $550 million last year, Goldman was accused by the S.E.C. of being the middleman in a similar deal, allowing the hedge fund manager John Paulson to help choose the mortgages and then bet against them without disclosing this to the other parties.

Citigroup dispensed with a Paulson figure altogether, grabbing those lucrative roles for itself. The S.E.C. said Citigroup earned fees of $34 million on this travesty and generated net profits of at least $126 million. (In a statement, Citigroup said it was pleased to put the matter behind it and has since "returned to the basics of banking.") Nonetheless, Citigroup is paying just $285 million to settle the charges, and, needless to say, its chief executive at the time the deal was marketed and closed, Charles Prince, will pay nothing.

I asked an S.E.C. enforcement lawyer if he could assure me that a transaction so brazenly fraudulent — not to mention risky, since a naked short ranks at or near the top of high-risk strategies — would be unambiguously prohibited under the proposed Volcker regulations. "There are some tricky definitions in there," he said. "Could this be interpreted as hedging? But this was a naked short by the bank, and I believe it would be prohibited."

I found this less than reassuring, since you can bet that if there was a way to call it hedging, lawyers would find it, and at the very least, years of costly litigation would result.

Last week I stopped by to see the financier Henry Kaufman, a former managing director of Salomon Brothers, a former Lehman Brothers board member and author of "The Road to Financial Reformation" (and no relation to Ted Kaufman, the former senator), who has been arguing for years that the proposed Volcker Rule doesn't go far enough.

"Nobody listened," he said. Mr. Kaufman has witnessed, by his count, 15 major financial crises since he and his family fled the Nazis when he was 10 years old.

"Paul Volcker and I are the same age," 84, he observed. "Paul wanted to take an aspect of risk-taking out of the financial conglomerates. That's a worthy endeavor. But the history of regulation shows that the private sector pushes back and waters it down. Dodd-Frank didn't want to address the longer-term consequences of 'too big to fail.' The 10 largest banks held 10 percent of the assets in 1990; today they control over 70 percent. This trend accelerated in 2008. The 'too big to fail' got even bigger."

"My view is that we should break up the big financial conglomerates and separate investment banking," he continued. "Otherwise we're going to have ongoing government intervention in the credit allocation process. That threatens economic democracy, and the U.S. is the last bastion of economic democracy."

Financial concentration also worries Congressman Welch, who has called for an antitrust investigation into whether big banks recently colluded to charge debit card fees. "We need a strong financial sector," he said. "But it should be in service to the real economy, the productive economy. The large banks have become trading platforms. They make the real money on the trading desks. The depositors, the consumers, become a base to fund that trading activity. There should be a separation and there certainly should not be a taxpayer backstop for their losses. Contrast this to the Main Street banks facing severe pressures from the big banks. Their model is more traditional, in service to the productive economy. In Washington the debate is about the needs of the large banks, but there's no debate about the basic function of these banks. Do we want the financial sector to be in the service of the producing economy, or vice versa? It's time we call the question."

Former Senator Kaufman, Congressman Welch and Mr. Kaufman are all part of a chorus calling for a return to the separation of commercial and investment banking once embodied in the Depression-era Glass-Steagall Act, which was repealed in 1999.

"The need for 300 pages of rules just shows you're trying to define something indefinable," Mr. Kaufman said. "I think Paul Volcker is great, but let's step back and ask, why are we doing this? We're doing this because we don't want banks with federal deposit insurance to be involved in risky investments. There's a simple solution. We didn't have that problem for over 60 years because we had Glass-Steagall. It worked, we changed it and guess what, we got into trouble. I want to go back to what worked for 60 years. That's a very conservative position."

Critics of a return to Glass-Steagall note that Lehman Brothers was an investment bank, and Glass-Steagall would not have prevented its failure. Goldman Sachs and Morgan Stanley were investment banks (and would probably be so again), and yet they were still too big to fail.

Mr. Volcker said that reinstating Glass-Steagall was unrealistic in today's political climate. "It was a magnificent piece of legislation that didn't need any regulations," he said. "Do you think they could rewrite Glass-Steagall today without 300 pages?"

Even if Glass-Steagall isn't a panacea, it would be a start. It would put a firewall around federally insured institutions, protecting taxpayers and helping contain the crisis as well as potential future ones.

"I don't know if this Congress will address this," Ted Kaufman said. "I won't try to forecast. But I believe from the bottom of my being that we'll eventually have to restore Glass-Steagall. The only question is, How much agony do we have to go through before we do it? We know the solution, but do we have the will?"

In the meantime, "It scares the hell out of me. We can't afford to have this happen again."