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Via Electronic Filing

Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, D.C. 20219

Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

Wellington Management Company, LLP (Wellington Management) appreciates the opportunity to provide the agencies (the Agencies) charged with issuing rules implementing new Section 13 of the Bank Holding Company Act of 1956 (the Volcker Rule) with comments on the notice of proposed rulemaking issued in October 2011 (the Proposed Rule).[1] Wellington Management is a privately owned, investment management firm registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940 (the Advisers Act) that provides investment services to mutual funds, employee benefit plans, endowments, foundations and other institutions. As of December 31, 2011, our firm served as an investment adviser to more than 1,900 clients and had investment management authority with respect to approximately $651 billion in assets. Wellington Management's investment services include portfolio management styles and approaches in equities, fixed income securities, currencies and commodities, and asset allocation across these asset categories.

Our only business is the management of securities and other assets on behalf of our clients. We neither invest for our own account nor execute trades as a broker/dealer for client accounts we manage. As an asset manager, we are not covered by the Volcker Rule. However, as a fiduciary to our clients, we are deeply concerned about the Proposed Rule and its consequences for markets, investors, and issuers. We are particularly concerned about the proposed implementation of the Volcker Rule's market-making exemption. In our view, the Proposed Rule will significantly impair US markets by unnecessarily constraining banks' market-making, block facilitation, and other counterparty activities and will harm our clients, who rely upon banks to provide these services.

[1]Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 76 Fed. Reg. 68,846 (November 7, 2011).

Introduction
As set out in the release, the Agencies' stated goal is to implement the new ban on proprietary trading by banking entities without compromising the entities' ability to provide important financial services to their customers. While we believe that this reflects the clear language and intent of the Volcker Rule, which includes express exemptions for market making and other activities enumerated by Congress, we do not believe that the Proposed Rule meets that goal. In particular, we believe that the Proposed Rule's presumption of prohibited activity, combined with its complexity and lack of clarity as to how the Agencies will assess compliance, does not provide banking entities with sufficient latitude to engage in essential, bona fide market making. This adverse outcome would conflict with Congress' intent to preserve market making and would impose significant costs in the form of wider spreads, increased market volatility, reduced liquidity, and diminished price transparency, with no equivalent benefit to banking entities' safety and soundness.

Market Making Is Essential to Efficient Markets
Market makers play an essential role in virtually all securities and other financial instrument markets. While all market participants in some sense provide liquidity and contribute to price discovery, most do so only episodically as a result of implementing their own investment strategies and objectives. For market makers, providing liquidity and price discovery to other market participants on a consistent and reliable basis is core to their business. They actively supply liquidity, thus reducing market volatility and lowering trading costs, by absorbing temporary order imbalances. In short, a market maker will buy when a party wants to sell, and sell when a different party wants to buy. A market maker also regularly quotes both a buy and a sell price against which other market participants can reliably trade, greatly assisting efficient price discovery. Importantly, market makers seek to engage in these activities continually throughout a market cycle and to provide ongoing services to diverse market participants. Their activities ultimately reduce the risk premium that investors require for new issues and thus lower an issuer's cost of capital. As a result, market making also plays a critical role in fostering capital formation and driving economic growth.

To engage in these activities, market makers must have the ability to maintain active exposures to the capital markets. Market making often involves taking principal positions and holding inventory to facilitate customer transactions. Dealers must also continually replenish their inventories in anticipation of potential customer demand. In highly liquid, exchange-traded markets, such as large-capitalization equity securities, market makers can reasonably expect to quickly purchase or sell such positions. However, market makers face much greater uncertainty in less-liquid markets that trade on a principal basis, such as corporate fixed income securities or smaller-capitalization equity securities. As a result, while the level of risk may vary, taking principal market risk is necessary to, and a fundamental part of, market making.

Proposal's Unnecessary Constraints on Market-Making Activities for Clients
The Agencies, as well as Congress itself, acknowledge the importance of market making to US financial markets. For that reason, clearly delineating proprietary trading from market making is essential to effectuating the Volcker Rule's clear language and intent. Unfortunately, we believe that the Proposed Rule fails to do so through the combination of its broad presumption of prohibited activity, its complexity, and its lack of clarity as to how the Agencies will assess compliance.

Unwarranted Presumption of Proprietary Trading
Underlying the Proposed Rule is the presumption that all principal trading constitutes prohibited, proprietary trading, unless it qualifies for a narrowly tailored exemption. Because taking principal market risk is a fundamental part of market making, we believe that this broad presumption will significantly restrict banking entities' ability to engage in bona fide market making. By assuming that all principal positions represent banned proprietary trading, the Proposed Rule inevitably compromises the distinction that Congress drew between proprietary trading, on the one hand, and permitted market-making, on the other. Even the most straightforward example of market-making activity on behalf of customers would face the new and uncertain compliance burden of overcoming this presumption. In our view, this framework does not reflect the Volcker Rule's intent and cannot be implemented by banking entities without unnecessarily constraining market making.[2] We strongly encourage the Agencies to remove this presumption from any final rule. We believe that doing so would do much to preserve market making, while presenting little incremental systemic risk. A well-designed compliance and metric-based reporting framework should on its own be sufficient to detect attempts to conceal significant proprietary trading in the guise of customer-facing trading activity.

Complex and Impractical Approach to the Market-Making Exemption
To distinguish permitted market making from proprietary trading, the Proposed Rule sets out a complex, multi-faceted approach, which consists of seven separate criteria, including detailed commentary on six basic principles that each Agency proposes to apply independently and at least 17 different quantitative metrics. However, the rule offers little guidance on how to integrate and assess these criteria, principles, and metrics. For example, the Proposed Rule indicates that the Agencies will scrutinize, among other factors, the level of risk "required to provide intermediation services," the ratio of "Spread Profit and Loss" to "Portfolio Profit and Loss" to determine a trading unit's source of revenues and "reasonably expected near-term customer demands" to assess principal positions and risks. However, it draws no clear lines and provides little indication of the boundary between permissible and impermissible activity with respect to those criteria. In addition, many proposed criteria, such as the appropriate level of risk required to provide market-making services for customers, will vary considerably in different markets.

[2]*See* 156 Cong. Rec. S5,906 (daily ed. July 15, 2010) (statement of Sen. Bayh): "With respect to the Volcker Rule, the conference report states that banking entities are not prohibited from purchasing and disposing of securities and other instruments in connection with underwriting or market-making activities, provided that activity does not exceed the reasonably expected near-term demands of clients, customers, or counterparties. I want to clarify this language would allow banks to maintain an appropriate dealer inventory and residual risk positions, which are essential parts of the market-making function. Without that flexibility, market makers would not be able to provide liquidity to markets."

Further complicating the market-making exemption is the fact that some criteria proposed by the Agencies, such as reasonable expectations of customer demand or changes in the market value of positions, cannot be precisely predicted or hedged. From time to time, market makers will inevitably purchase securities based on a reasonable estimate of customer demand that does not materialize, or acquire a position from a customer that appreciates in price prior to its subsequent sale. Despite these facts, the Proposed Rule suggests that compliance with the exemption's numerous factors and criteria may be judged at various levels of granularity — from aggregate trading activities of a single trading desk, to a series of transactions occurring at one or more trading desks, to a single significant transaction.

Finally, the Proposed Rule's market-making exemption appears to assume that one can effectively hedge any transaction required to build inventory. Effective hedges may be unavailable in less-liquid markets. As a result, a banking entity offering market-making services in these markets will have some exposure to price movements in securities acquired from, or on behalf of, customers. In addition, hedging can be costly, especially in relation to the relative risk of a transaction and the effectiveness of the hedge. An exemption that effectively requires customer-facing businesses and personnel to hedge every principal position acquired to facilitate transactions would further discourage essential market-making activity.

While separating proprietary trading from permitted market making may involve subtle distinctions, we believe that the Proposed Rule's approach is overly complex. In our view, the fundamental difference between a banking entity's market-making activities and any proprietary trading is the emphasis on seeking to meet customer needs on a consistent and reliable basis throughout a market cycle. We believe that many of the abstract uncertainties presented by the Proposed Rule can be addressed by relying on factors such as the percentage of trades with customers, relative levels and age of inventories, aggregate VAR, VAR with respect to specific sectors or issuers, primary sources of revenues, and other measures that (i) can be assessed, particularly over time, for patterns that are strongly indicative of market making on behalf of customers, and (ii) are within a trading desk's reasonable control (unlike customer demand or market volatility).[3] Relevant thresholds for these factors could be developed for each specific market or sector based on data reported to the Agencies.

Of equal importance is the need to assess these factors at an appropriate level of granularity. As a practical matter, we do not believe that any attempt to assess this exemption at the level of individual transactions is workable. In our view, the appropriate level of granularity at which the market-making exemption should operate is at each trading desk or "aggregation unit."

[3] *See* 156 Cong. Rec. S5,896 (daily ed. Jul, 15, 2010) (statement of Sen. Merkley) "Market making is a customer service whereby a firm assists its customers by providing two-sided markets for speedy acquisition or disposition of certain financial instruments. Done properly, it is not a speculative enterprise, and revenues for the firm should largely arise from the provision of credit provided, and not from the capital gains earned on the change in the price of instruments held in the firm's accounts. Academic literature sets out the distinctions between making markets for customers and holding speculative positions in assets, but in general, the two types of trading are distinguishable by the volume of trading, the size of the positions, the length of time that positions remains open, and the volatility of profits and losses, among other factors. Regulations implementing this permitted activity should focus on these types of factors to assist regulators in distinguishing between financial firms assisting their clients versus those engaged in proprietary trading."

Serious Consequences for Markets, Investors, and Issuers if Not Remedied
If implemented as currently drafted, the Proposed Rule will inevitably have a chilling effect on banking entities' bona fide market-making activities.[4] We believe that this outcome will impose significant market costs and adversely impact markets' breadth (i.e., the range of issuances for which there is a transparent and orderly market) and depth (i.e., the relative liquidity with which a particular issuance trades in the market). In our view, some market makers are likely to exit certain market sectors as a result, while the remaining firms are expected to concentrate their market-making activities on only the most liquid issuances. In addition, we expect market makers to become less willing to assume principal market risk across all market sectors, even in highly liquid issuances. Finally, these adverse effects will be significantly magnified in periods of high market volatility, as increased market risk compounds the regulatory uncertainty around the Agencies' proposed criteria, such as the required level of risk for intermediation and expected customer demand. As a result, market-making activity is most likely to decline during periods in which it is most needed, further exacerbating market stress and volatility. These added costs and risks will be borne by the ultimate beneficiaries of our nation's capital markets, primarily individual savers and American corporations seeking to compete in increasingly global markets for goods and services.

First, constraints on market-making activity will result in wider spreads for publicly traded securities. Those wider spreads will consist of both the overall spread (i.e., the risk premium required versus US Treasuries) and the bid-offer spread (i.e., the difference between the highest price a buyer of a security is willing to pay and the lowest price a seller is willing to offer). In our view, participants in markets adversely impacted by the Proposed Rule will inevitably require a higher risk premium, or a wider overall spread, to compensate for the diminished liquidity and predictability of secondary markets. Bid-offer spreads will similarly need to widen, absent a willing and available market maker or natural order flow, to attract new market participants to provide liquidity and assume principal risk. In addition, the Proposed Rule inadvertently provides an incentive for banking entities to widen the bid-offer spread that they quote to customers because a wider spread would help them to exit positions taken to facilitate customer trades more quickly and with less regulatory risk.[5] In general, the less liquid a security is, the wider spreads will be and the greater the costs imposed on pension plans, mutual funds, and other investors. For example, if quotation spreads in the secondary market for corporate bonds widen 10 basis points, or 0.75% on an average maturity of 5 – 10 years to account for diminished market liquidity, the estimated annual cost to savers would be approximately $29 billion, based on daily transaction volume reported in TRACE for investment-grade and high-yield bonds.

[4]We acknowledge that market-making activity may shift to non-banking entities in response to the Volcker Rule, but we do not believe that those firms can readily replace the traditional and important role played by banks. In addition, a significant shift in market making away from banking entities required to comply with capital requirements and other regulations limiting their risk-taking to financial institutions that are not subject to these same obligations raises other risks for markets and for counterparties.

[5]The Proposed Rule's requirement that revenues from market making have to be derived from fees, commissions, bid-ask spreads or other similar income, rather than price appreciation, provides another incentive to widen quoted spreads.

Second, as liquidity decreases and bid-offer spreads widen, markets become less transparent. Determining the price of a security — a key role of functioning markets — will become more challenging. Impaired liquidity and price discovery will increase market risk. While all investors will bear this increased risk, it will likely have a significant impact on our clients, as large block trade orders become more costly and more challenging to execute. In particular, periods of extreme market stress are likely to exacerbate these costs and challenges, which could force investors such as mutual funds and pension plans to accept distressed prices to fund redemptions or to pay current benefits.

Finally, as markets become less liquid and less transparent, businesses will find it more costly to raise capital. New and smaller issuers in particular will likely see their ability to raise capital significantly restricted as investors become less comfortable with the liquidity and predictability of secondary markets for those issues. As an example, new issuance in the US investment-grade corporate and high-yield markets will total roughly $950 billion in 2011. Based on issuer concessions this year in response to periods of high volatility and impaired liquidity, the Proposed Rule's effect on investment-grade corporate and high-yield borrowing costs could range between 10 – 25 basis points, which would represent additional costs to issuers of between $7 – $18 billion annually. These costs will not only reduce the amount of capital available to fund new businesses and other corporate activities, they will also adversely impact the markets for securitized asset-backed products. Any increase in the costs of issuance for these products will be passed along to consumers in the form of higher interest rates for auto loans, mortgages, and other consumer loans.

Conclusion
We urge the Agencies to revise the Proposed Rule in order to preserve the ability of banking entities to engage in critical market-making activities for their customers. We believe that the Agencies should remove the overly broad presumption of prohibited activity and provide clearer and more practical guidance on how the Agencies will integrate and assess compliance with the market-making exemption. In our view, that guidance should include the appropriate level of granularity at which the market-making exemption operates and should adopt determinative factors that (i) can be assessed, particularly over time, for patterns that are strongly indicative of market-making activities on behalf of customers, and (ii) are within a trading desk's or aggregation unit's reasonable control.

We appreciate your consideration of this letter.

Sincerely,

Perry M. Traquina

Perry M. Traquina
President and Chief Executive Officer