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CalPERS

February 13, 2012

John Walsh, Acting Comptroller
Office of the Comptroller of the Currency
Independence Square
250 E Street, SW
Washington, DC 20219

Jennifer J. Johnson, Secretary
Federal Reserve System
20th and C Streets, NW
Washington, DC 20551

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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

RE: PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS

Dear Ladies and Gentlemen:

I am writing on behalf of the California Public Employees' Retirement System (CalPERS), the largest public pension fund in the United States, with approximately $234 billion in global assets and equity holdings in approximately 11,000 publicly traded companies. CalPERS provides retirement benefits to more than 1.6 million public workers, retirees, and their families and beneficiaries.

CalPERS strongly supports the efforts by the Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation and Securities and Exchange Commission (the "Agencies") to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protections Act (Dodd-Frank), commonly referred to as the "Volcker Rule." The present system of bank regulation allows too much downside risk in the financial system, and we applaud the Agencies' efforts to minimize that risk.

The Volcker Rule will help reduce the risks brokerage operations pose to their financial holding companies and, if effectively implemented, will help mitigate the risks SIFI's (Systemically Important Financial Institutions) pose to the overall financial system. Accordingly, we support the rule's intent to ensure that a bank's trading activity is consistent with underwriting and market making related activities and not prohibited proprietary trading.

With this in mind, we would like to offer the following observations on the proposed rules by the Agencies.

- Implementation of the Volcker rule will increase the cost of transacting and reduce liquidity to all markets (e.g., equity, fixed income, derivative) where SIFI's conduct proprietary trading. Thus, we acknowledge that the systemic protections afforded by the Volcker Rule come at price. Specifically to the debt markets, it will impose higher transaction costs and cause spreads to rise. Thus, our portfolio values will be reduced due to the higher spread or yield investors demand to compensate for the higher transaction costs. In addition, when we do transact in our portfolios, the cost will be higher. Since our portfolio turnover rate is relatively low, the expected rise in annual transaction costs is an acceptable cost for reducing risk in the financial system. However, institutions with higher turnover, like hedge funds, mutual funds or other high volume traders, are likely to be more negatively impacted by the increased transaction costs.

- We believe that a decline in bank proprietary trading will increase the volatility of the corporate bond market, especially during times of economic weakness or periods where risk taking declines. However, corporate bond portfolio managers have experienced many different periods when markets have been illiquid:1997 – Asian Crisis, 1998 - Long Term Capital, 2000 – Tech Bubble Crash, 2001-2002 Corporate Malfeasance, and 2009 Recession/Financial Crisis. We believe, post the implementation of the Volcker rule,that the market will adapt. Portfolio managers will increase their use of CDS to reduce economic risk to specific bond positions as the liquidation process of cash bonds takes more time. We also believe that alternative market matching networks will be developed to match and cross sellers with buyers. The Agencies should seek to increase the disclosure of trade data in TRACE by increasing the universe of securities covered and to include greater disclosure on size of trades. This will provide investors with more transparency on price discovery during periods when markets are illiquid. The Agencies should plan in advance to measure and monitor how the implementation of the Volcker rule impacts the markets and whether unintended risks develop as transaction volume moves to alternative markets, counterparties or pools of liquidity.

- The Agencies' common framework, applied to all covered financial institutions, should communicate the acceptable level of position limits, P&L, inventory turnover, customer facing trades and portfolio risk limits based on specific market size, volatility and correlation of risks. This will ensure that the implementation of the rules is consistently applied across all SIFIs and a priority is established for deviations from the rules and enforcement.

- We believe that a daily trade level and backward assessment of what constitutes market making versus proprietary trading may be impractical and impose onerous reporting requirements on both banks and regulators.

- As asset managers, not unlike market makers, we manage the daily mark to market risk and correlation of positions and know how a position's size and weight can impact results. Our experience in this area suggests that regulators consider a softer stance on inventory accumulation that is held for a short time period (1-5 days) if it is "right sized" relative to a bank's capital, volatility and potential investor demand. At the same time, we would suggest that regulators use a vintaging methodology that would create disincentives for market makers to hold positions beyond a short term period, by imposing increasingly higher capital requirements on aged inventory and identified portfolio risks. We think this less stringent implementation may help ease the impact on investor liquidity needs during all market environments.

- Treasury futures should be treated in a consistent manner as US treasury debt and be exempt from proprietary trading rules. Treasury futures have a return profile similar to cash treasuries and are used by many market participants and primary dealers as hedging instruments. We would also advocate allowing inventory in dollar denominated Sovereign bonds for short time periods, subject to vintaging rules that require increased capital based on the age of a position, as described above.

- For the Volcker Rule to work effectively, it should be implemented globally. Without multilateral agreements with regulators in other countries, establishing Volcker type restrictions on US financial market making institutions may put them at a competitive disadvantage. Simply imposing a ban on proprietary trading by US financial institutions, without comparable restrictions in the global marketplace, would reduce systemic risk to the US financial system but would likely result in increased counterparty risk for investors that execute trades with off shore counterparties that provide better liquidity.

- Dodd Frank and the Volcker Rule represent the most significant reregulation of the banking industry since Glass-Steagall. With the implementation of these rules, the SEC should also promulgate enhanced and expanded financial reporting requirements for SIFI's, at both the holding company and significant operating company levels. SIFI's are complex financial institutions that have and will continue to require significant invested capital from the debt markets. During the last financial crisis, management teams were reluctant to provide increased detail and segmentation of risks to investors, arguing that disclosure informs competitors of important trade secrets. SEC disclosure directives should be broad in the scope of risks covered (interest rates, credit, liquidity, geographic, product, concentration, etc.) and provide quantitative (not qualitative) measures of risk with standardized computation methods to ensure comparability across time and institutions. Lastly, debt holders should be seeking greater transparency from SIFI's due to the powers given to the FDIC, in the Dodd-Frank Bill, to carry out an orderly liquidations of SIFI's, in a manner that maximizes the value of the institution's assets and ensures that creditors and shareholders bear any loss without putting the financial system at risk.

- Finally, most financial institutions fail due to the write down of poor quality assets that are the result of poor underwriting decisions. In the prior crisis, many SIFI's were not under stress because of proprietary trading losses of their market making function, but because of the retention of poor quality assets after underwriting securities and unsuccessfully distributing that risk. Many SIFI's underwrote and retained risk in Sub Prime mortgages, CDO tranches, and the High Yield debt of LBO issuers that needed to be written down. Thus, we suggest the Agencies consider whether they have sufficient provisions to reduce the risk posed by this very common revenue generating activity that poses heightened financial risk at the top of economic cycles.

Thank you for considering our comments. If you have any questions, please do not hesitate to contact me at (916) 795-2062.

Sincerely,

JANINE GUILLOT
Chief Operating Investment Officer
CalPERS

Cc: Joe Dear, Chief Investment Officer – CalPERS
Curtis Ishii, Senior Investment Officer – CalPERS
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