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February 13, 2012

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE,  
Washington, DC, 20549-1090

**RE: File No. S7-41-11, NABL Comments on SEC Release No. 34-65545**

Dear Ms. Murphy:

The National Association of Bond Lawyers (“NABL”) respectfully submits the enclosed response to the Securities and Exchange Commission (“SEC”) solicitation of comments related to SEC Release No. 34-65545; File No. S7-41-11. The comments were prepared by an ad hoc subcommittee of the NABL Securities Law and Disclosure Committee and the NABL Municipal Law Committee comprised of those individuals listed on Exhibit A and was approved by the NABL Board of Directors.

NABL exists to promote the integrity of the municipal securities market by advancing the understanding of and compliance with the law affecting public finance. A professional association incorporated in 1979, NABL has approximately 3,000 members and is headquartered in Washington, DC.

If you have any questions concerning the comments, please feel free to the NABL Governmental Affairs Office at (202) 503-3302 ([lwyman@nabl.org](mailto:lwyman@nabl.org)).

Thank you in advance for your consideration of these comments.

Sincerely,

Kristin H.R. Franceschi

**COMMENTS OF**  
**THE NATIONAL ASSOCIATION OF BOND LAWYERS**  
**REGARDING**  
**PROPOSED RULES ON RESTRICTIONS ON PROPRIETARY**  
**TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH,**  
**HEDGE FUNDS AND PRIVATE EQUITY FUNDS**

On November 7, 2011, the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (“Board”), the Federal Deposit Insurance Corporation (“FDIC”), and the Securities and Exchange Commission (“SEC”, together with OCC, the Board, and FDIC, the “Agencies”) published a proposed rule that would implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (the “Dodd-Frank Act”), which, among other things, contains prohibitions and restrictions on the ability of a bank to engage in proprietary trading. The prohibition on proprietary trading contained in the proposed rule does not apply to the purchase or sale of “[a]n obligation of any State or any political subdivision thereof.”

The Agencies note in the proposed rule that, consistent with the statutory language of Section 619 of the Dodd-Frank Act, the proposed rule does not extend the government obligations exemption to transactions in obligations of an *agency* of any State or political subdivision thereof. However, the Agencies request comment on whether they should adopt an additional exemption for proprietary trading in State or municipal agency obligations. As more particularly described below, the National Association of Bond Lawyers (“NABL”) writes to urge that careful consideration be given to the precise language to be used in any exemptions for proprietary trading so that the types of exemptions provided (or not provided) are both consistent with current municipal market products and yet flexible enough to accommodate future product development. We are aware of public comments made by others that any restriction of the ability to conduct proprietary trading of municipal securities may adversely affect the liquidity in the municipal market and, as a result, increase borrowing costs to municipal issuers. Those comments should be investigated and appropriately considered prior to any final action being taken with respect to the restrictions on proprietary trading.

These comments were prepared by an ad hoc subcommittee of the NABL Securities Law and Disclosure Committee and the NABL Municipal Law Committee comprising those individuals listed on Exhibit A and was approved by the NABL Board of Directors. NABL is an organization of approximately 2,800 public finance attorneys that exists to promote the integrity of the municipal market by advancing the understanding of and compliance with the law affecting public finance. We respectfully provide this submission in furtherance of that mission.

***Volcker Rule and Municipal Securities***

Section 619 of the Dodd-Frank Act (sometimes referred to as the “Volcker Rule”) contains prohibitions and restrictions on the ability of a bank to engage in proprietary trading similar in nature to prohibitions and restrictions contained in the 1933 Glass-Steagall Act.<sup>1</sup> The Volcker Rule’s prohibition on proprietary trading excludes numerous permitted activities listed in Section 619(d). Among these

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<sup>1</sup> For an overview of restrictions on investment and trading in municipal securities by banks prior to passage of the Dodd-Frank Act (including those restrictions found in the Glass-Steagall Act and the Gramm-Leach-Bliley Act), see Melanie L. Fein, *Securities Activities of Banks* §§ 7.02 & 7.02 (3<sup>rd</sup> Edition 2006).

permitted activities is the “purchase, sale, acquisition, or disposition of . . . obligations of any State or of any political subdivision thereof.” Importantly, Section 619(d)(1)(J) also excludes from the Volcker Rule’s prohibition on proprietary trading “[s]uch other activity as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission determine, by rule, . . . would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.”

The Agencies have requested comment on a proposed rule that would implement the Volcker Rule.<sup>2</sup> Under the proposed rule, the prohibition on proprietary trading does not apply to the purchase or sale of “[a]n obligation of any State or any political subdivision thereof.” Such obligations include “both general obligations and limited obligations, such as revenue bonds.”<sup>3</sup> The Agencies note in the proposed rule that, consistent with the statutory language of Section 619 of the Dodd-Frank Act, which expressly references agencies in the context of United States obligations, the proposed rule does not extend the municipal obligations exemption to transactions in obligations of an *agency* of any State or political subdivision thereof.<sup>4</sup> However, the Agencies request comment on whether they should adopt an additional exemption for proprietary trading in State or municipal agency obligations. The Agencies further request whether the definition of “municipal security” in Section 3(a)(29) of the Securities Exchange Act of 1934 (the “34 Act”) would be helpful in determining the proper scope of this exemption from the Volcker Rule.

The Agencies’ approach in the proposed rule is similar to the approach taken under Glass-Steagall in 1933 in that it relies upon the definition of political subdivision; however, the municipal market is significantly different from the municipal market that existed in 1933. The number and type of entities that issue municipal securities has increased exponentially and, depending upon the definition of “political subdivision”, the obligations of many of these entities would be outside the permitted exception.

We are not advocating for any particular change in the exemption under the proposed rule. We note, however, that in a preliminary study required by the Dodd-Frank Act, the Financial Stability Oversight Council (the “FSOC”), the body tasked under the Dodd-Frank Act with comprehensive monitoring to ensure the stability of the financial system, characterized municipal securities as low-risk investments. Further, the FSOC noted that banks serve as a critical source of liquidity in the municipal securities market.<sup>5</sup> In light of these findings and the language of the proposed rule to exempt “both general obligations and limited obligations, such as revenue bonds,”<sup>6</sup> we feel it is important to provide the Agencies with information about the nature of the current municipal market, the types of issuers participating in the market and the types of securities being issued by those issuers, all in an effort to enhance the ability of the Agencies to craft a final rule that will achieve the desired goal of the Agencies. By limiting the municipal security exemption to “obligations of any State or of any political subdivision

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<sup>2</sup> “Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, Proposed Rule”, *Federal Register* 76 (November 7, 2011): 68846-68972.

<sup>3</sup> *Id.* at 68948.

<sup>4</sup> *Id.* at 68875 n. 165.

<sup>5</sup> Financial Stability Oversight Council, *Study & Recommendations On Prohibitions On Proprietary Trading & Certain Relationships With Hedge Funds & Private Equity Funds* 46 (January 2011) (available at <http://alturl.com/zkonr>).

<sup>6</sup> “Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, Proposed Rule”, *Federal Register* 76 (November 7, 2011): 68846, 68948.

thereof,” the exemption excludes the securities of many types of municipal issuers whose securities would be of no greater risk (and may, in fact, present less risk) than securities of political subdivisions.<sup>7</sup>

### ***The Universe of Municipal Securities Issuers and Municipal Securities.***

The municipal market is large and diverse, comprising some 55,000 issuers and some \$2.8 trillion in debt securities. Municipal issuers include not only states and traditional political subdivisions, such as cities, counties and townships, but also entities providing limited or special public services such as electric, water, sewer or natural gas utility authorities, flood control districts, community development districts, transportation authorities, and a host of others. The types of debt obligations issued by municipal issuers are also varied and numerous. So-called “general obligation bonds” are typically secured by the full faith and credit of the issuer and, in some jurisdictions, the unlimited taxing power of the issuer. “Revenue bonds” may be secured by specific enterprise activities (such as water and sewer utilities or stormwater revenues) or by discrete revenues sources such as sales tax or utility tax. There are lease participation transactions entered into by school districts and other entities that are neither general obligation nor revenue bonds but rather secured by a covenant to budget and appropriate from all legally available revenues. Additionally, there are conduit bond transactions undertaken to provide financing for non-profit health, educational and other entities as well as for economic development projects. To limit the exemption provided under the Rule to “states and political subdivisions” would make an arbitrary distinction on the basis of the nature of the issuing entity rather than the relative creditworthiness or risk of the security itself.

### ***Use of 34 Act Definition of “Municipal Security” as a Starting Point for Volcker Rule Purposes***

We respectfully suggest a good starting point for the exemption language would be the 34 Act definition of “municipal security”<sup>8</sup> in that there is an established body of law and market practice utilizing

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<sup>7</sup> See generally Robert A. Fippinger, *The Securities Law of Public Finance* §§ 1:1 *et seq.* and §§ 2:1 *et seq.* (3<sup>rd</sup> Edition 2011) (describing the diversity of municipal securities and outlining the manner in which the federal securities laws have been tailored to accommodate this diversity); Eugene McQuillen, *The Law of Municipal Corporations* §§ 1:1 *et seq.* and §§ 2:1 *et seq.* (3<sup>rd</sup> Edition 2010) (tracing the rise of municipal issuers and describing the nature and kinds of municipal issuers).

<sup>8</sup> The 34 Act definition, set forth in Section 3(a)(29), is as follows:

The term “municipal securities” means securities which are direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond (as defined in section 103(c)(2) of the Internal Revenue Code of 1954) the interest on which is excludable from gross income under section 103(a)(1) of such Code if, by reason of the application of paragraph (4) or (6) of section 103(c) of such Code (determined as if paragraphs (4)(A), (5), and (7) were not included in such section 103(c)), paragraph (1) of such section 103(c) does not apply to such security.

We note that the United States Congress last modified the 34 Act definition of “municipal security” in 1970. After 1970, Congress made numerous changes to the Internal Revenue Code. A more modern, “cleaned-up” version of the 34 Act definition of “municipal security” might read as follows:

The term “municipal securities” means securities which are direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any

and interpreting this concept. The 34 Act definition of “municipal security” has a well settled meaning that has been developed over many years of judicial and administrative interpretation.<sup>9</sup> Because this definition has a well settled meaning, use of the definition will aid smooth implementation of the Volcker Rule. In addition, use of the 34 Act definition of municipal security in the Volcker Rule exemption would be consistent with the clear intent to exempt a broad range of municipal securities, as evidenced by the current language of the proposed rule exempting “both general obligations and limited obligations, such as revenue bonds.” Contrary to this clear intent, by limiting the municipal security exemption to “obligations of any State or of any political subdivision thereof,” the exemption in the proposed rule excludes the securities of many types of municipal issuers.

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political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an exempt facility bond (as defined in section 142(a) of the Internal Revenue Code of 1986), determined as if paragraph (7) were not included in section 142(a), or a qualified small issue bond (as defined in section 144(a) of such Code) the interest on which is excludable from gross income under section 103(a) of such Code if, by reason of the application of paragraph (1) of section 141(e) of such Code paragraph (1) of section 103(b) does not apply to such security.

<sup>9</sup> See generally Robert A. Fippinger, *The Securities Law of Public Finance* §§ 1:1 *et seq.* and §§ 2:1 *et seq.* (3<sup>rd</sup> Edition 2011) (describing the diversity of municipal securities and outlining the manner in which the federal securities laws have been tailored to accommodate this diversity). The 34 Act grants to the SEC broad powers to regulate broker-dealer firms and other entities functioning in the municipal securities marketplace. Section 3(a)(29) of the 34 Act operates to define which securities are subject to SEC municipal securities oversight. Courts and administrative agencies also have interpreted over the years the meaning of Section 3(a)(2) of the Securities Act of 1933 (the “33 Act”); that provision governs whether municipal securities are exempt from the registration requirements of the 33 Act.

**EXHIBIT A**

**MEMBERS OF NABL SECURITIES LAW AND DISCLOSURE COMMITTEE  
AND THE NABL MUNICIPAL LAW COMMITTEE  
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