The Effects of the Volcker Rule on Corporate Bond Trading: Evidence from the Underwriting Exemption*

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Abstract

Using a novel within-dealer, within-security identification strategy, we examine intended and unintended effects of the Volcker rule on covered firms' corporate bond trading using dealer-identified regulatory data. We use the underwriting exemption to isolate the Volcker rule's effects separate from other post-crisis changes in bank regulation and broader trends in market liquidity. We find no evidence of the rule's intended reduction in the riskiness of covered firms' trading in corporate bonds. We find significant adverse liquidity effects on covered firms' corporate bond trading with 20-45 basis points higher costs for customers even for roundtrip trades of shorter duration. These effects do not appear to be transitional. The Volcker rule appears to have increased the cost of the liquidity provided by covered firms and has not decreased the liquidity risk exposure of covered firms.

JEL classification: G28, G21, G23.

Keywords: Banking regulation, Volcker rule, heightened prudential regulation, corporate bonds, market liquidity, regulatory impact analysis.

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