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 a 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. The Volcker rule has decreased the market share of covered firms. Customers appear to be trading more with non-bank dealers, who have not been subject to any enhanced prudential standards since the 2008 financial crisis. These effects do not appear to be transitional.

JEL classification: G28, G21, G23.

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

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