



November 13, 2012

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551

Mr. Robert E. Feldman  
Executive Secretary  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> Street, N.W.  
Washington, D.C. 20429

Mr. John G. Walsh  
Acting Comptroller of the Currency  
Office of the Comptroller of the Currency  
250 E Street, S.W.  
Washington, D.C. 20219

Mr. David A. Stawick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

Re: Prohibitions and Restrictions on Proprietary Trading and Treatment of Separately Managed Accounts in Bona Fide Seeding Programs of Bank Owned Asset Managers.

Dear Sirs and Madams,

The Association of Institutional INVESTORS (the “Association”)<sup>1</sup> appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System (“Board”), the Office of the Comptroller of the Currency (“OCC”), the Federal Deposit Insurance Corporation (“FDIC”), the Commodity Futures Trading Commission (“CFTC”), and the Securities and Exchange Commission (“SEC”) (together the “Agencies”) proposed rule titled “Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private

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<sup>1</sup> The Association of Institutional INVESTORS is an association of some of the oldest, largest, and most trusted investment advisers in the United States. Our clients are primarily institutional investment entities that serve the interests of individual investors through public and private pension plans, foundations, and registered investment companies. Collectively, our member firms manage ERISA pension, 401(k), mutual fund, and personal investments on behalf of more than 100 million American workers and retirees. Our clients rely on us to prudently manage participants’ retirements, savings, and investments. This reliance is built, in part, upon the fiduciary duty owed to these organizations and individuals. We recognize the significance of this role, and our comments are intended to reflect not just the concerns of the Association, but also the concerns of the companies, labor unions, municipalities, families, and individuals we ultimately serve.

Equity Funds” (the “Proposed Rule”). In particular, the Association is submitting this letter in order to express our views about the proprietary trading restrictions under the Proposed Rule and the treatment of banking entities that invest in separately managed accounts for the purpose of conducting bona fide seeding programs to establish performance records of investment strategies for their advisory clients (“bona fide seed accounts”). To that end, the Association is seeking confirmation from the Agencies that seeding and managing investment strategies in bona fide seed accounts does not constitute proprietary trading under the Proposed Rule’s proprietary trading restrictions.

## **I. Seeding Activity is Distinguishable from Proprietary Trading**

### **A. Purpose of Seeding Programs.**

Consistent with industry market practice, as a fiduciary, asset managers seek to test and innovate investment strategies through deployment and management of their own capital. Asset managers focused primarily on the institutional client segment typically seed a limited amount of capital in a separate account. The ultimate goal of this seeding activity is to develop new products and diversify the asset manager’s inventory of investment strategies and products available to its fiduciary clients and prospects. This practice is essential to investors in their efforts in selecting and constructing an appropriate and sound investment program.

The single purpose of investing in bona fide seed accounts is to establish a track record that can be shared with existing and prospective institutional clients to demonstrate the viability of an investment thesis underlying a particular investment strategy. An essential element of the due diligence process for institutional clients seeking new investment management services is the ability to review substantive evidence of proven investment performance over a sufficient period of time, often as much as three years or longer. Bona fide seed accounts are often the only practical mechanism to accurately reflect track records and to aid investors in gaining a better understanding of the risks, trading approach, and other portfolio characteristics over time.

An asset manager’s ability to maintain a robust seeding program and consequently a diversified product suite is essential to its fiduciary clients in their efforts to construct an appropriate and sound investment program. Ultimately, clients are better served when in receipt of all the facts pertinent to an investment strategy, including actual investment performance that has been established over a suitable time period. “Paper portfolios,” which provide simulated but not actual performance, are often not a practical substitute and are generally not acceptable alternatives to actual performance when asset management clients are evaluating the strategy of an investment manager.

### **B. Seeding Program: Process and Governance.**

Bona fide seed accounts managed by asset management firms are readily distinguishable from the proprietary trading accounts of banking entities that the Proposed Rules are intended to limit. The seeding process itself is generally initiated through certain governance committees comprised of senior management personnel (e.g., investment or product committees) and requires initial approval of an investment strategy thesis. To create a substantive track record, the relevant governance committee generally makes the decision to allocate a portion of the overall seed pool to be managed in accordance with the investment objective and guidelines of the strategy. The total seed allocation

is limited to an amount that is no greater than what is reasonably required to implement the seed strategy. If the performance of the seed strategy demonstrates its viability for marketing to the investment community, then the initial seed investment is recalled to the banking entity's larger seed pool to be reinvested in other investment strategy theses at a later date. If the seed portfolio fails (e.g., the track record shows consistent negative performance or other factors exist such as related expenses or little third party client interest), it will ultimately be wound down, and, as noted above, immediately recalled to the banking entity's larger seed pool.

As noted above, seeding activity is generally subject to rigorous governance and oversight, entailing regular monitoring by functions such as investment, risk, operations and compliance within the banking entity. In many instances, seeding programs are governed by formal governance committees which report into or are a part of a firm's larger governance structure. Further, seeding activity is normally conducted within the fiduciary asset management arm of the banking entity, the activities of which are generally governed by the fiduciary and prudential standards under the Investment Advisers Act of 1940, the Employee Retirement Income Security Act of 1974 (ERISA), or common law. With respect to portfolio management controls, portfolio managers are not incentivized by means of increased compensation relative to investment performance during the seeding period and regularly provide reporting up to the appropriate governance committees.

## **II. Suggested Conditions of Seeding Activity so as Not to Constitute Proprietary Trading**

The Association is proposing that the Agencies expressly clarify that seeding and managing investment strategies in bona fide seed accounts do not constitute proprietary trading under the Proposed Rule's proprietary trading restrictions. The Association believes it would be appropriate for the Agencies to set forth certain factors (as described below) that a banking entity must demonstrate for bona fide seed accounts to be excluded under the Proposed Rule, including:

- The seeding activity is undertaken by the fiduciary arm of the banking entity
- The seeding activity is undertaken solely in connection with bona fide product development, the purpose of which is to test proposed or existing investment strategies for potential investment by third party investors
- The seeding activity, including allocation of seed capital, is subject to firm governance and/or formal committee oversight
- The seed allocation is limited to an amount that is no greater than what is reasonably required to implement the particular seed strategy and affirmed by the relevant governance oversight committee
- During the seeding period, portfolio managers are not compensated or incentivized relative to investment performance and are required to manage seed capital in accordance with a written investment objective and guidelines
- Upon establishment of a track record, generally within three years, and the receipt of third-party client money, seed accounts are closed and the initial investment is recalled to the seed pool

### III. Conclusion

The Association recognizes the challenges the Agencies have in attempting to draft regulations to limit potentially risky banking activities while permitting banks and specifically bank-owned asset managers the ability to continue to bring to market innovative and diversified investment products for their fiduciary clients through the operation of bona fide seeding programs. However, the Association believes it is important from a safety and soundness perspective to not put banking entities at a competitive disadvantage to non-affiliated investment managers when the activity is one that would not involve a risk to the insured bank's capital. We believe that this seeding contemplated by this letter is one that allows investment managers to remain competitive in the market place and is the type of fiduciary advisory activity that Congress did not intend to prohibit. The Association thanks the Agencies for the opportunity to provide our suggestions regarding how the Proposed Rule could be clarified so that the proprietary trading restrictions thereunder do not prohibit banking entities from carrying out bona fide seeding programs that ultimately serve to benefit third-party investors. We would be happy to discuss this letter at your convenience. Please feel free to contact me with any questions you may have at [jgidman@loomissayles.com](mailto:jgidman@loomissayles.com) or (617) 748-1748.

On behalf of the Association of Institutional INVESTORS,



John Gidman  
President