

February 13, 2012

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

Office of the Comptroller of the
Currency
250 E Street SW
Mail Stop 2-3
Washington, D.C. 20219

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

Department of the Treasury
Office of Domestic Finance
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20520

Mr. David A. Stawick,
Secretary of the Commission
Commodity Futures Trading
Commission
1155 21st Street, N.W.
Washington, D.C. 20551

Re: Comments on Notice of Proposed Rulemaking on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds

Federal Reserve Docket No. R-1432 and RIN 7100 AD 82; FDIC RIN 3064-AD85; OCC Docket ID OCC-2011-14; SEC File No. S7-41-11; CFTC RIN 3038-AD05

Dear Ladies and Gentlemen:

State Street Global Advisors (“SSgA”)¹, the investment advisory arm of State Street Corporation, appreciates the opportunity to comment to 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”) on the Agencies’ notice of proposed rulemaking (the “Proposal” or “Proposed Rules”) to implement new Section 13 of the Bank Holding Company Act of 1956, commonly referred to as the Volcker Rule (“Volcker Rule”). SSgA is a global leader in asset management, entrusted with \$1.87 trillion in assets as of December 31, 2011, from public and private retirement plans, large corporations, non-profit organizations, endowments and foundations, sovereign wealth funds, insurance companies, banks, central banks, and registered investment companies.

While SSgA appreciates the difficult task faced by the Agencies in implementing the Volcker Rule, we are concerned that many parts of the Proposal are inconsistent with Congressional intent and may inadvertently harm our clients. SSgA believes that as currently drafted, the Proposal may disrupt financial intermediation services and reduce liquidity in capital markets, leading to substantial costs that will be borne by our clients.

Accordingly, SSgA strongly supports the recommendations and views stated in comment letters on the Proposal submitted by many of the industry associations and in particular, the comment letter submitted by the Securities Industry and Financial Markets Association (“SIFMA”) jointly with other trade associations, by the Investment Company Institute (“ICI”), the American Bankers Association (“ABA”) and the Association of Institutional INVESTORS (“AII”) (collectively, “Trade Association Letters”), which letters have requested that the Agencies reconsider how they implement the Volcker Rule. SSgA urges the Agencies, in considering new approaches to implementation, to evaluate carefully the costs and benefits of various alternatives in order to ensure that the final rule does not unnecessarily impose costs on investors, businesses, and the financial system in general. As currently drafted, we believe the costs resulting from the Proposal far outweigh any perceived benefits that might result.

In addition to supporting the aforementioned comment letters, SSgA writes separately to address the following problems with the Proposal:

¹ In the United States, SSgA operates as a division of State Street Bank and Trust Company, and through its U.S. registered investment advisor, SSgA Funds Management, Inc. Outside of the U.S., SSgA provides investment advisory and fund management through various subsidiaries regulated in the jurisdictions in which they operate.

- The Proposal’s market making-related permitted activity is defined too narrowly, thereby unduly restricting *bona fide* market making activity. As a consequence, the Proposal may undermine the safety and soundness of financial markets and impose unnecessary costs on the financial industry and investors;
- The permitted activities are drafted too narrowly to accommodate the unique structure of the exchange-traded fund (“ETF”) market. The Agencies should clarify that banking entities can act as Authorized Participants for, and make markets in, ETFs;
- The Agencies should provide an exemption from the “Super 23A” limits on services a banking entity can provide “covered funds” for traditional custodial services, particularly provisional credit extended to funds as part of the securities settlement process;
- The proposal contains an overly broad definition of “Covered Fund” and proposes an exclusion from the definition of “covered fund” and “banking entity” for those non-U.S. funds that operate within similar investment limitations imposed on SEC-registered funds;
- The Agencies should confirm that the definition of “banking entity” does not include registered investment companies or collective investment funds that are exempt from the Investment Company Act of 1940 under sections 3(c)(3) and 3(c)(11) to enable those funds to continue to engage in their businesses;
- The Agencies should revise the attribution rules in § __.12 of the Proposal so that they do not prohibit banking entity affiliate-sponsored funds from investing in third-party funds; and
- The Agencies should implement a process designed to grant banking entities a two-year extension for bona fide purposes of seeding an investment strategy that will *ultimately be* offered to clients once a track record is established.

I. The Proposal’s market making-related permitted activity is defined too narrowly, thereby unduly restricting *bona fide* market making activity. As a consequence, the Proposal may undermine the safety and soundness of financial markets and impose unnecessary costs on the financial industry and investors.

As a large institutional asset manager, SSgA is concerned that the Proposal, if implemented, could disrupt the capital markets and in turn harm our clients. In enacting the Volcker Rule, Congress explicitly permitted banking entities to engage in market making-related activities. The Agencies, however,

have adopted rigid criteria that a banking entity must satisfy in order for its activities to be considered permissible. SSgA believes the Proposal's conditions will impede *bona fide* market making and therefore will undermine the safety and soundness of financial markets and impose unnecessary costs on the financial industry and investors. Consequently, SSgA supports the recommendation contained in the Trade Association Letters and other industry association comment letters to remove these criteria from the rule.

An underlying issue with the Proposal's approach to the market making-related permitted activity is that it seems to assume that all markets resemble a predominately agency-based model. That is, the Proposal appears to presume that (i) all markets are exchange-based with displayed trading interests, (ii) all securities are highly liquid, making price discovery efficient, and (iii) all securities are fungible. The Proposal also seems to treat market makers as intermediaries akin to mere agents. SSgA strongly believes that this agency equity-based view of market making, however, does not account for the reality of market making in all security types, because market makers regularly act as principals, not mere agents, in serving customers and markets are often characterized by trading over-the-counter ("OTC") in liquid and illiquid instruments.

The Proposal significantly under appreciates, therefore, that market makers perform a crucial role to investors by intermediating between market participants to supply liquidity, thereby serving as an intermediary over time and in size. To fulfill this function effectively, market makers need flexibility to warehouse securities as inventory for a period of time until they find a market participant appropriately willing to take the other side of the trade. To perform this intermediation function, market makers may need to hold positions for some period of time, naturally exposing themselves to price movements. In some cases, there could be substantial price movements. As proposed, the rule compels market makers to hedge this price exposure. However, in compelling market makers to hedge all price exposure, this will only serve to increase the cost of intermediation. Therefore, in a significant number of cases – particularly in less liquid markets – a market maker's revenue will come from appreciation in the value of its positions and perhaps not "primarily" from fees, commissions, or spreads.²

The role of market maker as principal intermediary is particularly important in less liquid markets, such as the market for fixed income securities.

² The requirements that a market maker hold itself out as being willing to buy and sell on a regular or continuous basis and that its activities be designed not to exceed customers' reasonably expected near-term demands similarly fail to account for, and therefore would impede, the market making function. For a lengthier discussion explaining why specific market making criteria are overly restrictive, see the SIFMA comment letter on proprietary trading.

For example, the U.S. corporate bond market is significantly more fragmented than the listed equities market and has many individual bonds with very little trading activity. In the S&P 100 alone there are over 4000 issuances longer than one year with the average constituent holding \$22 billion debt in this timeframe while the average capitalization of an S&P 100 company is \$76.6 billion. The demand for these multiple issues is often diffuse and limited. These debt securities, moreover, trade on OTC markets, where liquidity is fragmented across multiple issues. Accordingly, market makers serve as the primary liquidity providers in these markets and find it necessary to hold inventory in order to meet investor demand.

Market makers do more than merely act as simple agents in equities markets as well. An S&P 100 index constituent, for instance, has one equity issue traded on several global exchanges and electronic trading networks. The security is liquid, with an average daily trading volume in 2011 of 5 million shares. To that end, institutional investors often need market makers to execute a large block trade that exceeds the displayed liquidity at a particular time. In order to execute the block trade and avoid exerting downward pressure on the market price, the market maker may need flexibility to hedge and/or to hold the excess shares in inventory.

Under the Proposal, these types of principal market making activities are impacted by the “sources of revenue” restriction. The proposal requires the market maker to attempt to hedge the principal position in an effort to mitigate risk as well as any profit or loss from a change in market price of the securities held in inventory. An overly prescriptive set of criteria for hedging that limits the market makers flexibility will ultimately drive the cost of intermediation higher for our clients. In addition, while hedging is possible with certain types of securities, for many other securities it will be an imperfect effort at best.

Because the rigid market making criteria do not account for many of the nuances of market making, the Proposal risks impeding *bona fide* market making. Specifically, SSgA is concerned that narrow criteria such as the sources of revenue restriction described above will limit the ability of market makers to hold inventory and will otherwise curtail performance of the market making function.

If the Proposal prevents market makers subject to the Volcker Rule from maintaining their inventories and instead requires them to unload their positions rapidly, or hedge them at an inopportune time, market makers may charge higher fees to customers, such as in the form of higher bid-ask spreads, or worse, may refuse to enter into a trade or exit a market making activity entirely.³ As a result,

³ See Darrell Duffie, Stanford University, *Market Making Under the Proposed Volcker Rule*, at 4 (Jan. 16, 2012) (Because the market making criteria will “discourage the use of market making discretion . . . some banks may wish to exit the market making business” or “reduce the amount of capital that [they] devote[] to market making”).

the Proposal could significantly decrease liquidity and increase price volatility—which will particularly affect fixed income markets that are already less liquid—imposing substantial costs on both investors and businesses. SSgA is particularly concerned about the following costs it foresees:

- *Costs to businesses.* If liquidity decreases significantly in a particular asset class, that asset class may no longer be suitable for certain investors who, for regulatory or business purposes, require a minimum amount of liquidity and price transparency. The resulting smaller and less diverse investor base will increase volatility in that asset class, causing investors to demand higher risk premia to supply credit to issuing companies. For fixed income assets, the smaller and less diverse investor base will expose investors to more idiosyncratic risk, again leading them to demand higher premia and increasing costs to issuers.
- *Costs to investors.* A reduction in liquidity will harm investors by causing trading costs and liquidity premia for investors to increase. This will alter how investors weigh a particular exposure against such transaction costs, making it more difficult for investors to dynamically manage their exposures and risks. The reduction in liquidity may also lead to mark-to-market losses on existing holdings.

The Proposal, therefore, could significantly disrupt the current market apparatus without taking any steps to replace it.

As an alternative, one way to implement the rules as drafted by Congress is to simply clearly define the difference between “principal” market making activities and “proprietary trading,” the latter being the actual target of the Volcker rule.

Proprietary trading is generally characterized by trading methods and styles that do not support client intermediation for institutional and individual investors and we would urge the Agencies to focus the Proposal more narrowly on these proprietary trading strategies. Eliminating this type of behavior can be accomplished without eliminating all profits from principal market making activities that benefit institutional and individual investors. To eliminate the profit available to a “principal” market maker may simply drive the banks out of providing this valuable service to the financial system without first ensuring a replacement service provider exists. Principal market making activities are essentially a utility service that is provided to the financial system.

Perhaps the regulation of this type of financial market making service should be performed similarly to that of other regulated industries. For example, so long as there is a reasonable return on assets in the business (with limited

leverage) the activities could be considered *bona fide* market making activities and the banks be allowed to conduct these activities and make a profit doing so. A simple periodic report to the bank regulators indicating the amount of capital deployed in the principal market making business along with a calculation of the returns and leverage employed in the business should be adequate for the regulators to draw the conclusion that the activities are not “proprietary” in nature but *bona fide* market making activities. This would greatly alleviate the concerns the banks have about the significant oversight and compliance risk they will have implementing the Proposal as drafted.

Rather than applying a definition of proprietary as making any money from market making activities (which the Proposal implies), the rules should allow for principal market making activities to generate a reasonable return on the capital employed in the business.

Accordingly, we join in the Trade Association Letters and other industry association commenters in recommending that the Agencies remove the rigid market making-related criteria, which are inappropriately premised on an equity trading model, from the rule and replace them with standards that will accommodate and permit *bona fide* market making.

II. The permitted activities are drafted too narrowly to accommodate the unique structure of the exchange-traded fund (“ETF”) market. The Agencies should clarify that banking entities can act as Authorized Participants for, and make markets in, ETFs.

ETFs have been actively embraced by institutional and retail investors and have grown to be an important component of U.S. capital markets. In fact, as of 2011, an estimated 3.5 million, or 3 percent, of U.S. households owned ETFs and as of September 2011, ETFs represented assets of approximately \$951 billion.⁴

Banking entities are significant players in the ETF market⁵ and play two important roles. First, banking entities act as Authorized Participants (“APs”)⁶ engaging in arbitrage transactions that serve to maintain the market price for ETF

⁴ Investment Company Institute, Frequently Asked Questions About the U.S. ETF Market, available at http://www.ici.org/etf_resources/background/faqs_etfs_market.

⁵ The proportion of total creation and redemption activity owing to APs who are banking entities varies significantly from ETF to ETF, but we estimate that APs who are banking entities generally comprise from 20% to 100% of the creations and redemption activity for individual ETFs, averaging around 35% of all creation and redemption activity across all ETFs.

⁶ Authorized Participants are large institutional investors who have entered into an agreement permitting them to purchase and sell shares directly with the ETF at the ETF’s net asset value. ETFs only transact directly with APs; all other investors must purchase or sell ETF shares on the secondary market.

shares close to the ETF's net asset value ("NAV"). Second, banking entities provide liquidity to the ETF markets by informally making markets in ETF shares; this liquidity serves to limit the size of bid-ask spreads for the ETF shares. The Proposal threatens to prohibit or at least discourage banking entities from either: (i) acting as APs; or (ii) providing liquidity for ETF shares. If banking entities are unable to perform these two important roles, individual investors in ETFs will find their investment more expensive due to: (i) higher premiums and discounts versus the ETF's NAV; and (ii) higher transaction costs in the form of increased bid-ask spreads. Furthermore, the types of trading activities associated with ETF trading do not pose the significant risks to banking entities or end investors that the Proposal is seeking to limit. Accordingly, SSgA joins other commenters in recommending that the Agencies revise the Proposal to ensure banking entities may continue to perform these activities.

AP arbitrage is essential for minimizing premiums and discounts between ETF market prices and NAVs. Specifically, when ETF shares trade at premiums to ETFs, APs will purchase the shares comprising the ETF's portfolio (e.g., the 500 securities of the S&P 500) and deliver those shares to the ETF in exchange for ETF shares (e.g., shares of the SPDR S&P500 ETF). The AP will then sell the newly created ETF shares on the market. This increases the supply of ETF shares and reduces the prevailing market price for such shares on the secondary market. The same transaction works in reverse when ETF shares are at a discount. The AP will acquire ETF shares on the secondary market (e.g., shares of the SPDR S&P500), redeem them to the ETF in exchange for the shares comprising the ETF's portfolio (e.g., the 500 securities comprising the S&P500), and sell those shares on the secondary market.⁷ This arbitrage process is essential to maintaining minimal premiums/discounts, and many banking entities serve as active APs.

Banking entities are also critical in providing liquidity for ETF shares, which is essential to narrow the bid-ask spread associated with market transactions. As with all listed equities, transactions in ETF shares on the secondary market are effected at a small spread to the market price, either a "bid" (the price paid to a seller), which is typically slightly lower than prevailing market price, or an "ask" (the price paid by a buyer), which is typically higher than prevailing market price. The more liquid the security, the smaller the difference will be between the "bid" and the "ask." Banking entities provide liquidity to ETFs as they engage in market transactions, either for hedging purposes or in connection with the establishment of a new ETF. In this role, a banking entity may arbitrage the premium/discount spreads outside of the ETF (i.e., purchasing

⁷ Investment Company Institute, Frequently Asked Questions About ETF Basics and Structure, available at http://www.ici.org/etf_resources/background/faqs_etfs_basics ("The ability of authorized participants to create or redeem ETF shares at the end of each trading day [] helps an ETF trade at market prices that approximate the underlying market value of the portfolio.").

ETF shares at a discount and re-selling them at a premium); however, this sort of transaction requires that the banking entity be able to take not only the principal position in the ETF shares, but also to take a corresponding hedging position in the ETF's underlying shares. These transactions not only limit the premiums and discounts associated with ETF shares, but the additional liquidity also allows for tighter bid-ask spreads on the ETF shares.

Under the Proposal, banking entities would be prohibited or discouraged from engaging in either one of the activities outlined above. The Proposal would generally prohibit banking entities from engaging in proprietary trading. As a result, banking entities would be unable to purchase either the ETF shares or the shares underlying the ETF's portfolio for the purposes of effecting a premium/discount arbitrage unless these transactions are included in one of the permitted activities. There are two potential categories of permitted activities that could apply to banking entities transacting in ETFs, but it is unclear whether the permitted activities for underwriting or market making would allow banking entities to continue to serve these critical functions in the ETF market. The Proposal could therefore disrupt a market that is large, liquid, transparent, and highly regulated, harming retail and institutional investors alike.

First, the underwriting exemption does not clearly fit the activities of a banking entity serving as an AP. Under existing rules, whether an AP is an "underwriter" is a facts and circumstances test. The AP could be viewed as engaging in an underwriting activity when it creates or redeems ETF shares because it is effectuating a distribution of securities; however, APs are generally reluctant to concede that they are, in fact, statutory underwriters because they do not perform all of the activities associated with the underwriting of an operating company. If an AP were to rely on the permitted activity of underwriting, the AP could be subject to heightened risk of incurring underwriting liability on the issuance of ETF shares traded by the AP. As a result, bank entities required to rely on the underwriter permitted activity would be less willing to perform in this capacity.

Further, the activities of banking entities do not fit comfortably within the Proposal's definition of underwriting. For example, suppose the banking entity, acting as an AP, cannot sell all of the ETF shares it has created. This may prove problematic under the underwriting permitted activity, which requires that the underwriting be "designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties."⁸

Likewise, the permitted activity of market making does not clearly cover AP activities with respect to ETFs. As explained above, APs often engage in price arbitrage as part of their market making activities, which maintains an

⁸ Proposal § __.4(a)(2)(v).

efficient market in ETFs. In the Proposal, however, the Agencies suggest such arbitrage trading would not fall within permitted market making-related activities.⁹ Although transactions executed by market makers are often done for customers, the “on behalf of customers” permitted activity is also defined so narrowly in the Proposal that it appears not to encompass the creation and redemption transactions. Further, APs are under no obligation to make markets in ETFs shares and requiring such an obligation (as contemplated in the Proposal) would significantly discourage banking entities from acting in this capacity as well.

Finally, the transactions described above do not create the risks associated with proprietary trading that the Proposal is intended to address. First, when APs are transacting with an ETF for their own account, APs typically enter into an offsetting transaction in the underlying portfolio securities. This cancels out the investment risk and limits the AP’s exposure to the difference between the market price for ETF shares and the ETF’s NAV. As discussed above, the ability for APs and other market participants to capture this value serves as a limit on the amount the market price will deviate from the ETF’s NAV and therefore the risk assumed by the banking entities.

If banking entities cannot function effectively in the ETF market or are discouraged from participating in the ETF market, end investors in ETFs will see their costs increase due to larger premiums and discounts between market price and NAV and wider bid-ask spreads. These additional costs are not outweighed by any significant benefit in the form of investor protection since banking entity transactions do not entail significant risk to investors or the banking entities themselves. For these reasons, SSgA joins other commenters in asking the Agencies to clarify that the activities of banking entities in these ETF markets will be regarded as permitted activities.

III. Overly broad definition of “covered fund” and proposed exclusion from the definition of “covered fund” and “banking entity” those non-U.S. funds that operate within similar investment limitations imposed on SEC-registered funds.

The proposed definition of “covered fund” is overly broad. As drafted, it captures, among others entities, virtually all foreign funds (including those established in well-regulated jurisdictions such as the United Kingdom and Japan), all funds that trade futures, swaps or other commodity interests to any extent (including U.S. mutual funds) as well as many other entities that do not exhibit traditional hedge fund or private equity fund characteristics. Such a sweeping approach is inconsistent with Congressional intent as well as the findings and recommendations of the Financial Stability Oversight Committee (“FSOC”) in its

⁹ See Proposal at 68,871.

study on the Volcker Rule (“**FSOC Study**”). As described more fully below, broadly defining “covered fund” may significantly disrupt the custody and administrative operations of literally hundreds of funds for which SSgA acts as investment manager globally, virtually none of which bear the characteristics of traditional hedge or private equity funds.

SSgA strongly support industry recommendations that the Agencies define “covered fund” in a way that focuses on the attributes of traditional hedge funds and private equity funds. Specifically, SSgA supports the approaches to the definition of “covered fund” set forth in the SIFMA letter, the ICI letter, the ICI Global letter and the Trade Association Letters generally. However, because there are numerous types of funds organized in foreign jurisdictions that bear no resemblance to hedge or private equity funds but that may not be publicly offered or organized for “retail” investors as those terms are understood in the context of U.S. laws and regulation, SSgA recommends that the Agencies establish a non-exclusive safe harbor within the definition of “covered fund” for non-U.S. investment funds whose investment program is consistent with that which is permitted for U.S. registered investment companies. This safe harbor proposal is described more fully below.

1. Proposed definition of “covered fund” is inconsistent with Congressional intent and FSOC Recommendations

By adopting a definition of “covered fund” that fails to distinguish between traditional hedge funds and private equity funds, on the one hand, and the broad range of legal entities that solely rely on the exemptions in Section 3(c)(1) or 3(c)(7) of the Investment Company Act, on the other, the Agencies failed to give effect to Congressional intent and the recommendations in the FSOC Study.

The legislative history of the Volcker Rule indicates that Congress expected the Agencies to narrow the definition of “hedge fund” and “private equity fund” to avoid “excessive regulation” and to ensure that the Volcker Rule only applies to traditional hedge funds and private equity funds.¹⁰ Similarly, in addressing commenters’ concern “that the statutory definition of hedge fund and private equity fund unintentionally includes corporate structures and entities that

¹⁰ See colloquy between Senators Dodd and Boxer, 156 Cong. Rec. S5904 (daily ed. July 15, 2010); colloquy between Representatives Frank and Himes, 156 Cong. Rec. H5226 (daily ed. June 30, 2010) (“**Mr. Himes**. . . . Because the [Volcker Rule] uses the very broad Investment Company Act approach to define private equity and hedge funds, it could technically apply to lots of corporate structures, and not just the hedge funds and private equity funds. I want to confirm that when firms own or control subsidiaries or joint ventures that are used to hold other investments, that the Volcker Rule won’t deem those things to be private equity or hedge funds and disrupt the way the firms structure their normal investment holdings. **Mr. Frank**. . . . The point the gentleman makes is absolutely correct. We do not want these overdone. We don’t want there to be excessive regulation. And the distinction the gentleman draws is very much in this bill, and we are confident that the regulators will appreciate that distinction, maintain it, and we will be there to make sure that they do.”)(emphasis added).

do not exhibit the characteristics of hedge funds or private equity funds,” the FSOC Study recommended that the “Agencies carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in section 3(c)(1) or 3(c)(7) and consider whether it is appropriate to narrow the statutory definition by rule in some cases.”¹¹ The FSOC Study also identified a number of characteristics of traditional hedge funds or private equity funds, including those relating to “compensation structure . . . trading/investment strategy . . . use of leverage . . . [and] investor composition.”¹² It also recommended that the Agencies limit any similar funds designations to funds that are similar to traditional hedge funds or private equity funds.¹³

Instead of giving effect to the clear intent of Congress and the FSOC’s recommendations to narrow the scope of the “hedge fund and private equity fund” definition, the Proposed Rules significantly expand the types of entities that would be “covered funds” by designating two broad groups of legal entities as “similar funds.”¹⁴

(a) Designating all commodity pools as “covered funds”

Section __.10(b)(1)(ii) of the Proposed Rules includes as a covered fund any “commodity pool, as defined in section 1a(10) of the Commodity Exchange Act.” The Commodity Exchange Act broadly defines commodity pool as “any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests,” without regard to the level of trading in such interests. “Commodity interests,” in turn, cover a broad range of instruments including contracts of sale of a commodity for future delivery, options on such contracts, security futures, swaps (including options on foreign currencies and non-exempted foreign currency swaps), leverage contracts and foreign exchange contracts on physical commodities.¹⁵ Not all entities falling within the broad definition of commodity pool in the Commodity Exchange Act possess the characteristics of hedge funds or private equity funds. In fact, the commodity pool aspect of the “covered fund” definition would even capture SEC-registered investment companies that trade “commodity interests.” The Volcker Rule was

¹¹ See FSOC Study at 61-62 and n. 54.

¹² See FSOC Study at 62-63.

¹³ See FSOC Study at 62.

¹⁴ SSgA strongly supports industry recommendations that the Agencies define “covered fund” in a way that focuses on the attributes of traditional hedge funds and private equity funds. We generally support the attributes-based approach proposed by other trade associations, specifically including the hedge fund and private equity fund characteristics identified in the Trade Association Letters.

¹⁵ See Commodity Exchange Act § 1a(10).

clearly not intended to prohibit banking entities from investing in or sponsoring U.S. mutual funds.

SSgA requests that the Agencies reconsider the necessity of including all commodity pools within the scope of the Volcker Rule. The Agencies should, at a minimum, refine the definition to capture only those “commodity pools” that resemble traditional hedge funds (based on characteristics such as the use of significant leverage on a total fund basis) and that are primarily engaged in trading commodity interests.

(b) Designating virtually all foreign funds as “covered funds”

Section __.10(b)(1)(iii) of the Proposed Rules includes as a covered fund any issuer organized or offered outside the United States that would be a commodity pool or an investment company but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act “were it organized or offered under the laws, or offered to one or more residents, of the United States or of one or more States.” This aspect of the “covered fund” definition would capture virtually all foreign funds because Sections 3(c)(1) and 3(c)(7) of the Investment Company Act are the primary exemptions that foreign funds rely on to offer their interests to U.S. residents. For example, it would capture a number of publicly offered and substantively regulated funds, such as an Undertaking for Collective Investment in Transferable Securities (“UCITS”), which is offered to the public and subject to substantive regulation under the European UCITS Directive and the fund’s home jurisdiction.¹⁶

The preamble to the Proposed Rules does not explain why the Agencies have determined that so many foreign funds are “similar” to traditional hedge funds or private equity funds. Moreover, nothing in the legislative history of the Volcker Rule suggests that Congress intended or contemplated that substantially all foreign funds would be swept into the Volcker Rule’s prohibitions.

SSgA appreciates the need to prevent certain banking entities from evading the Volcker Rule by investing in or sponsoring non-U.S. funds that are equivalent to traditional U.S. hedge funds and private equity funds. However, the Agencies should not address the risk of evasion by designating as “covered funds” substantially all foreign funds regardless of their characteristics. Instead, the Agencies should consider addressing evasion directly through the supervisory and enforcement processes. In this respect, we note that Section 13(e) of the Bank Holding Company Act grants the Agencies broad powers to respond to specific instances of evasive behavior.

¹⁶ The foreign fund aspect of the proposed definition does not take into account the manner of offering, investment or operational characteristics of foreign funds.

2. **Adverse consequences of overly broad definition of “covered fund”**

Currently, SSgA manages more than 371 funds with more than \$153 billion in total assets¹⁷ organized in jurisdictions other than the U.S. The very significant majority of these funds are the equivalent of index funds, enhanced index funds, money funds and government bond funds for which SSgA earns very modest fees as manager or investment adviser. Some are offered publicly, such as our UCITS fund ranges in EU and others are offered privately to institutional investors, such as our managed pension funds scheme in the UK. These funds are, in short, the farthest thing from traditional hedge or private equity funds imaginable.

SSgA and the non-U.S. funds that it advises and manages would be significantly and negatively impacted by the current overly broad definition of “covered fund.” As currently constructed and without interpretive or other relief from the prohibitions of Super 23A, SSgA’s affiliated custodian, State Street Bank and Trust Company (“SSBT”) could be forced to discontinue certain custody services to our non-U.S. Funds. SSgA believes that our clients derive very significant benefits from our ability to use SSBT, one of the world’s largest and most highly rated custodian banks and administrators. Given the size of SSgA’s non-U.S. fund business, the process of converting the custody accounts for those funds from SSBT would take several years and result in significant costs to the funds and their investors.

These costs must be weighed against any benefit that might be derived from the breadth of the “covered fund” definition. On the benefit side of the equation, SSgA would argue strongly that forcing our non-U.S. funds to secure alternate custodians would do nothing to enhance the systemic stability of the global financial system or the safety and soundness of SSBT. In fact, we believe it could have the opposite effect by increasing the risk of settlement and other operational failings which could add costs and friction to the smooth functioning of financial markets.

In addition to the difficulties the current “covered fund” definition poses for the custodial operations of the SSgA non-U.S. funds, SSgA will need to satisfy the onerous requirements of the asset management exemption¹⁸ to the hedge fund and private equity provisions of the Volcker Rule in order to continue to offer asset management services to these funds. Because the asset management exemption was not designed with foreign funds in mind, it may not be possible for some foreign funds to satisfy the requirements in those provisions. For example, the asset management exemption requires that a covered fund owned or

¹⁷ As of December 31, 2011.

¹⁸ BHC Act § 13(d)(1)(G); Sections __.11 and __.12 of the Proposal.

sponsored by the banking entity not share the same name as the banking entity. This requirement is incompatible with laws in certain jurisdictions that require a fund's name to have a direct connection to its sponsor.¹⁹ Moreover, because this prohibition would not apply to registered investment companies (unless they constitute commodity pools under the Proposed Rules), it should not apply to similar foreign funds.

The individual and aggregate ownership limits contained in the asset management exemption would also be problematic if applied to publicly offered foreign funds. For example, SSgA would need to closely monitor its investments in such covered funds on a continuous basis because many of them provide daily liquidity to public investors. SSgA could also be forced to divest its ownership interests in such a covered fund whenever the three percent individual ownership limit is exceeded because of redemption by other investors. However, certain foreign regulatory regimes may require a fund manager or adviser to have measurable "skin in the game" that exceeds the three percent limit.²⁰

These conflicts between the Proposal and foreign regulatory requirements would be significantly mitigated by a more tailored definition of "covered fund."

3. Definition of "covered fund" and proposal for a safe harbor

As noted above SSgA strongly supports industry recommendations that the Agencies define "covered fund" in a way that focuses on the attributes of traditional hedge funds and private equity funds. We generally support the attributes-based approach proposed by the SIFMA, including the hedge fund and private equity fund characteristics identified in SIFMA's comment letter. An attributes-based approach to defining "covered fund" gives effect to Congressional intent and the recommendations in the FSOC Study. SSgA believes the Agencies have legal authority to adopt such an approach. Specifically, Section 13 of the BHC Act broadly authorizes the Agencies to "adopt rules to carry out this section."²¹ This general and broad grant of

¹⁹ In certain instances, the Financial Services Authority ("FSA") has taken the position under Section 6.9.6 of the Collective Investment Schemes Information Guide that the authorized fund must have a name representative of the authorized investment manager to avoid misleading fund investors. See FSA Handbook, Collective Investment Schemes, available at <http://fsahandbook.info/FSA/html/handbook/COLL/6/9>.

²⁰ See Article 9, Initial Capital and Own Funds under DIRECTIVE 2011/61/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF> (requiring alternative investment fund managers to have minimum investments in funds they manage).

²¹ BHC Act § 13(b)(2).

rulemaking authority allows the Agencies to issue regulations and interpret terms in Section 13 that give effect to the “goals” of the Volcker Rule.²²

SSgA notes, however, that multiple non-U.S. jurisdictions authorize fund structures which might not benefit from the exclusions suggested in the industry letters but that are by regulation, contract or otherwise, subject to investment limitations of the sort imposed on SEC-registered funds.²³ Accordingly, SSgA also recommends that the Agencies establish a non-exclusive safe harbor within the definition of “covered fund” for non-U.S. investment funds that are the “foreign equivalents” of U.S. mutual funds. A foreign issuer that satisfies either condition in the safe harbor would not be a “covered fund.”

Specifically, the safe harbor should provide as follows:

Any issuer that is organized or offered outside the United States would not be a “covered fund” if it is:

(A) subject to substantive regulation of its investment objectives, policies and strategies by an authority in the jurisdiction in which it is organized or offered; or

(B) subject to contractual or other restrictions that effectively limit its investment objectives, policies and strategies to those objectives, policies and strategies that would be permitted for registered investment companies under the Investment Company Act of 1940.

This safe harbor is consistent with the goals of the Volcker Rule. The Volcker Rule was not intended to bring SEC-registered investment companies within the definition of hedge fund and private equity fund, in part because SEC-registered investment companies operate within a regulatory structure that places

²² 76 Fed. Reg. at 68,928 (“In implementing the covered funds provisions of section 13 of the BHC Act, the Agencies have proposed to define and interpret several terms used in implementing these provisions and the goals of section 13.”).

The Agencies’ concern with the goals of the Volcker Rule is also evident in their numerous requests for comment. In fact, approximately one in ten of the 383 questions in the Proposed Rules ask whether a proposed approach, or some alternative, would be consistent with or effective in light of both the “language and purpose of section 13 of the BHC Act.” These questions include, among others: Question 5; Question 9; Question 14; Question 15; Question 25; Question 28; Question 46; Question 52; Question 76; Question 84; Question 106; Question 114; Question 115; Question 116; Question 124; Question 131; Question 215; Question 217; Question 218; Question 221; Question 225;226; Question 230; Question 234; Question 237; Question 243; Question 266; Question 283; Question 290; Question 342; Question 345; Question 350; and Question 375.

²³ For example, UK Managed Pension Funds and Authorized Unit Trusts, Irish Qualified Investor Funds.

effective limits on the use of leverage and other types of investment strategies typically employed by hedge funds. In fact, the statutory definition's focus on the exemptions from the investment company definition ensures that entities that *are* investment companies are outside the scope of the Volcker Rule.²⁴ By parity of reason, the Volcker Rule should not capture the foreign equivalents of U.S. mutual funds, whose investment strategies do not implicate the types of risks that the Volcker Rule was intended to address.

In proposing this non-exclusive safe harbor, SSgA believes that it is appropriate to focus only on those sections of the Investment Company Act that relate to a fund's investment objectives, policies and strategies.²⁵ Much of the Investment Company Act and the SEC's rules and interpretations thereunder are investor protection provisions addressing issues of fund governance, conflicts of interest of the adviser and its affiliates, and fund distribution limitations and requirements. SSgA does not believe those sections of the Investment Company Act implicate the systemic risk concerns of the Volcker Rule and, in some cases, may be inconsistent with foreign regulations governing non-US funds.

The Agencies have the legal authority to create such a safe harbor because the designation of certain foreign funds as similar funds is discretionary and not mandatory,²⁶ which means the Agencies could define similar funds as narrowly as they deem appropriate in light of the purposes of the Volcker Rule. As noted above, a key Congressional goal behind the Volcker Rule is to avoid the "excessive regulation" that would result from a mechanical implementation of the "very broad Investment Company Act approach to defin[ing] private equity and hedge funds."²⁷ Instead, Congress intended and expected the Agencies to use their rulemaking authority to implement the Volcker Rule in a way that focuses its prohibitions and restrictions on traditional hedge funds and private equity funds.²⁸ Section 13(b)(2) of the BHC Act authorizes the Agencies to adopt a definition of "covered fund" that "carri[es] out" this Congressional intention and expectation.²⁹

²⁴ This is the case except, as discussed above, to the extent that the registered investment company is deemed a "commodity pool" captured by the "covered fund" definition.

²⁵ E.g., Investment Company Act, Section 18 addressing the capital structure of registered investment companies which places limits on borrowing and the issuance of senior securities.

²⁶ BHC Act § 13(h)(2) ("The terms "hedge fund" and "private equity fund" mean . . . such similar funds as the [Agencies] may, by rule, as provided in subsection (b)(2), determine.").

²⁷ Colloquy between Representatives Frank and Himes, 156 Cong. Rec. H5226 (daily ed. June 30, 2010).

²⁸ *Id.*

²⁹ Our recommended approach to defining "covered fund" is also consistent with the findings and recommendations of the FSOC study, which the Agencies are required to consider in implementing the Volcker Rule. See BHC Act § 13(b)(2).

In addition, because such funds are similar to U.S. registered investment companies, it would be reasonable for the Agencies to exclude such funds from the definition of “banking entity,” in the same manner as has been requested for SEC-registered funds.³⁰ In the absence of such an exclusion, any such fund that is “controlled” by a banking entity would be prohibited from normal course business activities due to the Volcker Rule’s prohibition on proprietary trading and funds investment. This would be a particularly odd result, given that such funds are subject to legal restrictions that are intended to maximize their safety and soundness.

IV. The Agencies should confirm that the definition of “banking entity” does not include registered investment companies or collective investment funds that are exempt from the Investment Company Act of 1940 under sections 3(c)(3) and 3(c)(11) to enable those funds to continue to engage in their businesses.³¹

The statutory Volcker Rule defines the term “banking entity” to include all *affiliates* and *subsidiaries* of a depository institution holding company, an insured depository institution, or a foreign banking organization treated as a bank holding company.³² The terms “affiliate” and “subsidiary” are defined by reference to Section 2 of the Bank Holding Company Act of 1956, as amended (the “**BHC Act**”). Section 2 of the BHC Act defines “affiliate” to mean “any company which controls, is controlled by, or is under common control with another company.” It defines “subsidiary” to mean any company that is directly or indirectly controlled by another company, which includes the company having a controlling influence over the subsidiary.

Under Federal Reserve regulations and interpretive guidance, the company acting as trustee for a fund, or that owns or controls 25% or more of any class of voting securities of the fund, may frequently be deemed to control that fund.³³ Accordingly, when SSgA acts as trustee for a fund exempt from the Investment Company Act of 1940 (“**1940 Act**”) under 3(c)(3) or (3)(c)(11), the fund may

³⁰ See discussion in Part IV, *infra*.

³¹ We believe this section is responsive to Question 6 in the Proposal.

³² 12 U.S.C. § 1851(h)(1).

³³ The release accompanying the Proposal indicates the “concept of control” throughout the Proposal “is as defined in section 2 of the BHC Act and as implemented by the Board.” 76 Fed. Reg. at 68,855 n.79. Section 2, in turn, defines control to mean (1) ownership or control of 25% or more of any class of voting securities of the company; (2) control over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the company; or (3) having a controlling influence over the management or policies of the company. See 12 U.S.C. § 1841(a)(2); 12 C.F.R. § 225.2(e).

well be deemed to be controlled by SSgA and therefore a banking entity subject to the Volcker Rule's prohibition on proprietary trading. With respect to registered investment companies, the more relevant test for this analysis centers on equity ownership of the fund. Particularly during a registered fund's initial period of operation (which can last a number of years), the adviser can own a majority of the fund's outstanding shares. Should the investment advisor own sufficient shares of common stock of the registered investment company, it could be deemed to control the fund for purposes of the BHC Act and therefore the fund would be deemed a "banking entity" for purposes of the Proposal (subjecting it to the prohibitions on proprietary trading and sponsoring and investing in covered funds). SSgA believes this is a result that Congress could not have intended.³⁴

Funds exempt from the 1940 Act under sections 3(c)(3) or 3(c)(11) are known as "collective investment funds." A 3(c)(3) fund is a common trust maintained by a bank for the collective investment of money contributed by the bank in its capacity as a trustee, executor, administrator, or guardian. A 3(c)(11) fund is also a collective trust fund, but it consists solely of assets of governmental plans or of an employee's stock bonus, pensions, or profit-sharing trusts that meet certain Internal Revenue Code requirements.³⁵ It is noteworthy that Congress did not include these funds – just as it did not include SEC-registered mutual funds – in the statutory definition of those terms in the Volcker Rule.

SSgA believes it would be inconsistent with the purpose and intent of the statute for Section 3(c)(3) and 3(c)(11) funds, as well as SEC-registered mutual funds, to be considered "banking entities," as subjecting such funds to the Volcker Rule's prohibitions would prevent them from investing in or sponsoring hedge funds or private equity funds, and could have the unintended result that such ordinary course investment programs constitute proprietary trading under the Proposal. Moreover, because SEC-registered mutual funds, 3(c)(3) funds and 3(c)(11) funds are *not* "private equity funds" or "hedge funds" within the meaning of the statute, they cannot qualify for the current exemption from the definition of banking entity for private equity or hedge funds sponsored under the permitted activity of asset management. Congress' intent could not have been that funds that Congress deemed to pose fewer safety and soundness concerns would be more restricted in their ordinary course business than the very funds that Congress sought to limit.

The Agencies themselves were cognizant of the unintended consequences that would arise from an overly broad definition of "banking entity." For this reason, the Proposal excludes a "covered fund" held pursuant to the asset

³⁴ See, e.g., *Public Citizen v. Dep't of Justice*, 491 U.S. 440, 454 (1989).

³⁵ COLLECTIVE INVESTMENT FUNDS, COMPTROLLER'S HANDBOOK 53 (Oct. 2005).

management permitted activity from the definition of banking entity.³⁶ The Agencies note in the Preamble that they excluded covered funds “in order to avoid application of section 13 of the BHC Act in a way that appears unintended by the statute and would create internal inconsistencies in the statutory scheme.”³⁷ They explain further:

“If such a covered fund were considered a ‘banking entity’ for purposes of the proposed rule, the fund itself would become subject to all of the restrictions and limitations of section 13 of the BHC Act and the proposed rule, which would be inconsistent with the purpose and intent of the statute. For example, such a covered fund would then generally be prohibited from investing in other covered funds”³⁸

As noted above, the same rationale supports strongly excluding SEC-registered mutual funds, as well as 3(c)(3) and 3(c)(11) funds – traditional bank fiduciary funds – from the definition of banking entity. Accordingly, SSgA believes the Agencies should revise the rule to explicitly exclude SEC-registered mutual funds, 3(c)(3) and 3(c)(11) funds from the definition of “banking entity.”³⁹

V. The Agencies should provide an exemption from the “Super 23A” restrictions for traditional custody services.

The “Super 23A” provisions of the Volcker Rule prohibit “sponsors” or “advisors” of “covered funds” from engaging in transactions with the fund that “would be a covered transaction, as defined in Section 23A of the Federal Reserve Act.” While we understand that Congress intended this provision to eliminate the potential risk of “bailouts” of hedge funds and private equity funds by banks, we are concerned that the Proposed Rule takes too narrow an approach, and could be interpreted to prohibit banks from providing “covered funds” traditional custody and other banking services which present none of the risks Congress intended to address. For example, custodians typically provide provisional credit for funds expected to settle on a specific day, contractual settlement, and contractual income payments to funds. Custodians also offer indemnified securities lending to funds. None of these activities create the potential for “bailouts” of funds, and all are conducted under well established and regulated banking practices. Including such activities within the “Super 23A” provision could require SSgA to

³⁶ Proposal § __.2(e).

³⁷ Proposal at 68,855.

³⁸ Proposal at 68,855–56.

³⁹ See the Trade Associations Letters.

seek an alternative custodian, or seek alternative providers of the prohibited services. Making such changes requires a significant effort by an asset manager, would introduce transition costs and disruption, and could reduce the efficiency of our securities settlement and similar processes ---- with no reduction in risk for SSgA, our affiliated custodial bank, SSBT, our investors, or the system overall. We urge the Agencies to provide an exemption from “Super 23A” for such activities.⁴⁰

VI. The Agencies should revise the attribution rules in § __.12 of the Proposal so that they do not prohibit banking entity affiliate-sponsored funds from investing in third-party funds.

The statutory Volcker Rule allows a banking entity to make a *de minimis* co-investment of up to 3% in a covered fund that the banking entity organizes and offers, or sponsors, under the asset management permitted activity.⁴¹ Section __.12 of the Proposal then contains attribution rules that govern how to calculate a banking entity’s ownership interest in order to measure compliance with the 3% limitation. SSgA believes these attribution rules would lead to unintended consequences, create internal inconsistencies within the statutory scheme, and impede the ability of its sponsored funds to invest in third-party funds for the benefit of clients.⁴²

SSgA offers customers the ability to invest in feeder funds or funds of funds, which are very common structures in the asset management business. For example, the 3(c)(3) and 3(c)(11) funds that SSgA sponsors may invest in third-party funds. Nothing in the statutory text of the Volcker Rule suggests Congress intended to restrict the ability of asset managers like SSgA to provide these investment options. In fact, Congress and the Agencies have indicated an intent to permit just this activity. As we discuss above, the Proposal excludes covered funds that fall within the asset management permitted activity and the entities they control from the definition of banking entity to ensure covered funds like funds of funds are not subject to the Volcker Rule’s prohibition on proprietary trading. That is, through this exclusion, the Proposal clearly contemplates that a sponsored covered fund can make controlling investments in third-party funds without complying with the conditions of the asset management permitted activity.⁴³

⁴⁰ For more detailed discussion of these issues, see joint comments filed by State Street, Northern Trust, and BNY Mellon, dated February 13, 2012.

⁴¹ 12 U.S.C. § 1851(d)(4)(B)(ii).

⁴² For a fuller discussion of anomalous results caused by the attribution rules, see the Trade Association Letters.

⁴³ *Cf.* 12 U.S.C. § 1851(f).

The attribution rules, however, could be read to prohibit or severely limit the ability of funds sponsored by banking entities – including 3(c)(3) and 3(c)(11) funds – to invest in third-party funds, thereby nullifying the Agencies’ attempt to ensure these kinds of investments are permitted. In particular, SSgA is concerned about the attribution provision regarding controlled investments, which states:

“The amount and value of a banking entity’s permitted investment in any single covered fund shall include: (A) Controlled investments. Any ownership interest held under § __.12 by any entity that is controlled, directly or indirectly, by the covered banking entity for purposes of this part.”

Because the term “control” is defined broadly in the BHC Act, this provision could be read to prohibit a feeder fund or fund of funds sponsored by a banking entity like SSgA (“**Fund 1**”) from investing in a third-party fund (“**Fund 2**”). The provision does this by attributing to the banking entity 100% of Fund 1’s investment in Fund 2 for purposes of determining compliance with the 3% investment limit.

SSgA therefore agrees with other comment letters proposing that the Agencies revise the attribution provisions to remedy these defects, which would allow SSgA to use feeder fund and fund of funds structures to invest in third-party funds.⁴⁴ In particular, SSgA would like the Agencies to clarify that the attribution rule for controlled investments applies only to investments controlled by subsidiaries or affiliates included in the term “banking entity.” This attribution provision should not apply to covered funds organized and offered or sponsored under the asset management permitted activity. It also should not apply to 3(c)(3) and 3(c)(11) funds which, as explained above, SSgA believes should be similarly excluded from the definition of “banking entity,” or for that matter banking entity-sponsored mutual funds that, for whatever reason, are deemed to be “controlled” by a banking entity.

VII. The Agencies should implement a process designed to grant banking entities a two-year extension for *bona fide* purposes of seeding an investment strategy that will ultimately be offered to clients once a track record is established.

As part of its business, and consistent with industry market practice, SSgA invests its own moneys in order to create new investment strategies, test their viability and create track records for its fiduciary clients. SSgA’s clients and prospective investors often require a long term, funded and proven investment track record to validate the investment thesis of new strategies. These “seed”

⁴⁴ See the Trade Association Letters.

portfolios are commonly invested for periods of three-plus years so that investors can better understand the risks, trading approach, and other portfolio characteristics through time and prior to initial investment.

The statutory Volcker Rule permits banking entities to invest in covered funds under certain conditions. Initially, a banking entity may furnish one-hundred percent of the seed investment in a covered fund, but subsequently must reduce and maintain such investment to not more than three percent of the total ownership of the covered fund within one year after its establishment. The statutory Volcker Rule places a limitation on aggregate seed investments across all banking entity seeded covered funds not to exceed three percent of the banking entity's Tier 1 capital. The banking entity may apply to the Federal Reserve Board for up to three 1-year extensions if the Federal Reserve Board determines an extension is "consistent with safety and soundness and in the public interest."

SSgA is concerned that the extension framework, as currently contemplated by the Proposal, is an inefficient process that will severely inhibit a banking entity's ability to create and bring to market innovative and diversified investment products. A one year seeding time frame simply does not provide for the requisite duration to establish performance of a new strategy. "Paper portfolios" are not a practical substitute as clients generally demand actual investment performance prior to investing. It should be noted that any gains realized by the strategy are entirely ancillary to the focus of the seeding activity, which is directly connected to the traditional bank fiduciary activity of asset management.

The ability to offer investors a diversified product suite is essential to constructing an appropriate and sound investment program. Ultimately, investors are better served when in receipt of all the facts pertinent to an investment strategy, to wit, new products must be tested and incubated over time in a manner that illustrates performance, whether positive or negative. Investors are reticent to invest in a strategy that hasn't been managed for at least three years as they believe it to be untested. Accordingly, we believe that certainty in the ability for a banking entity to seed a strategy for a period of three years will better serve the investor community and therefore join other commenters in recommending that the Agencies consider creating a program that would allow for an automatic two-year extension for *bona fide* seeding programs.⁴⁵

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⁴⁵ See specifically the AII comment letter on Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds (RIN 3235-AL07) (File Number S7-41-11).

SSgA appreciates the opportunity to provide the foregoing comments and recommendations regarding the Proposal.

Respectfully submitted,



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