



COMMITTEE ON SECURITIES LENDING

COMMITTEE MEMBERS

Chairman
Michael P. McAuley
State Street

Patrick M. Avitabile
Citi

David DiNardo
The Bank of New York Mellon

Christopher R. Kunkle
Wachovia Global Sec. Lending

Sandra L. Linn
The Northern Trust Co.

Elizabeth Seidel
Brown Brothers Harriman & Co.

Jason P. Strofs
Barclays Global Investors

Ex-Officio
W Tredick. McIntire
Goldman Sachs Agency Lending

RMA Staff

Curtis Knight
Director
215-446-4082

Francis Garritt
Manager, Market Risk

Loretta Spingler
Adm. Support
215-446-4081

Kimberly Gordon
Adm. Support
215-446-4021

June 12, 2009

To the editor:

The Risk Management Association's Committee on Securities Lending believes it important to respond on behalf of our members to the May 30th article "Is Your Fund Pawning Shares at Your Expense?" Our response is intended to provide additional information that we believe is necessary for a more balanced understanding of the aspects of securities lending that were discussed in this article.

We are encouraged that the Wall Street Journal recognizes the value of securities lending in providing incremental returns to investors. However, without some additional information, the RMA is concerned that portions of the article could be misinterpreted to imply that there is something inappropriate occurring in these regulated securities lending programs.

We at The Risk Management Association (RMA) know that the *Wall Street Journal* is committed to balanced reporting and that it would be interested in the information we are providing with respect to the matters discussed in the article.

RMA's Committee on Securities Lending

RMA is a member-driven professional association whose sole purpose is to advance the use of sound risk principles in the financial services industry. The objective of its Committee on Securities Lending is to promote sound securities lending practices among its member firms and the broader industry. In this regard the RMA strongly supports transparent disclosure of all fees and risks in securities lending.

The committee represents over 25 institutional agent, direct and third-party lenders.

Fund Managers and Lending Fees

The article implies that there are no regulatory constraints on fund managers who act as lending agents or the compensation that they receive from lending the securities of their funds. The RMA would like to point out that through a series of exemptive orders and No-Action Letters, the Securities and Exchange Commission has developed strict requirements governing the operation of securities lending programs by registered mutual funds. These guidelines address both compensation and the situation where a fund manager or any other affiliate of a fund acts as the lending agent on behalf of a fund.

In addition, the board of a mutual fund is responsible for the review of all of the fund's arrangements, including securities lending arrangements and the related fees and compensation.

In order for a fund manager or any affiliate of a mutual fund to act as lending agent, such activity must be in conformity with long-established regulatory relief granted by the Securities and Exchange Commission in the form of no-action letters or exemptive orders. This relief sets forth detailed conditions and requirements with respect to the conduct of the lending program, shareholder disclosure, board oversight and the compensation of the affiliate. The relief also typically requires ongoing compliance certifications and detailed reporting to the fund board. Specifically, with respect to the compensation of the fund manager or other affiliate for conducting the lending program, the relief typically requires conditions regarding the compensation arrangement, and includes a requirement that, among others, addresses the structure of the fee arrangements and requires that any compensation paid to an affiliate is fair and reasonable in comparison to what the fund would be required to pay to receive equivalent services in the marketplace from unaffiliated agent lenders.

In general, securities lending agents are compensated by sharing in the revenue generated by lending the fund's securities. The fees earned by the lending agents are reflective of the human and technology resources required to run lending programs that are generally transaction-intensive. In addition, lending agents may provide their clients with indemnification against borrower default. This type of indemnity ensures that their client will receive its securities back if the borrower defaults. Defaults typically occur when a borrower of securities becomes bankrupt. Part of the lending fee is to compensate the lending agent for taking on this risk and for the capital that it must reserve to support this indemnification.

Cash Collateral Management Fees

The portion of the article that discusses fees for the management of cash collateral could be misconstrued to imply that there is something unusual about an affiliated manager charging a management fee for cash collateral or that the fund is somehow being charged twice for managing the same assets.

A fund manager or other affiliate acting as securities lending agent for their funds and who wishes to invest cash collateral in an affiliated money market fund, whether registered or unregistered, would generally be required to comply with conditions imposed by exemptive relief granted by the Securities and Exchange Commission or the recently adopted Cash Sweep Rule (1940 Act Rule 12d1-1). The Cash Sweep Rule specifically authorizes funds to invest cash balances (whether uninvested cash or securities lending collateral) in other investment companies, including affiliated funds. The exemptive order and the Cash Sweep Rule address the various concerns around duplicative advisory fees through disclosure, and require the advisor to reimburse a fund to the extent it invests cash in a fund with sales charges or service fees. This limitation on the imposition of such service fees and sales charges may be among the reasons that the fees associated with securities lending oriented institutional vehicles can be significantly lower than management fees for typical money market investment. For example, iMoney.net quotes a weighted average institutional fee of 33 basis points for general money market funds.

In general, a securities lender that accepts cash collateral will reinvest the cash to generate additional return. Lenders who prefer to receive cash collateral and reinvest the cash must find an entity to manage

the cash investment. Indeed, such collateral comprises additional assets of the fund. As an example, if a fund has \$100 million of assets invested in equities, and \$20 million of those equities are on loan, the fund effectively has \$120 million of gross assets to manage. Moreover, the expertise of the equity manager is different from the expertise of the cash manager

Investment Losses

With respect to the article's discussion of investment losses, it should be noted that over the last eighteen months, we have experienced extraordinary turmoil in the financial markets, including the money markets. These conditions were in no way confined to investments of cash collateral generated by securities lending. In fact, both registered and unregistered money market funds, corporate balance sheets and other cash investors were impacted by investments in structured investment vehicles, asset-backed securities and paper issued by financial services firms.

Securities Lending

It is well documented that securities lending is critical to the efficiency and liquidity of the financial markets. Lending securities provides a means of generating incremental revenue for long investors (both retail and institutional), while providing supply for the markets which is necessary to ensure liquidity and efficient pricing

Sincerely,

The RMA Committee on Securities Lending