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**VIA ELECTRONIC TRANSMISSION**

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: U.S. Securities and Exchange Commission's Securities Lending and Short Sale Roundtable, September 29-30, 2009

Dear Ms. Murphy:

This letter is in response to the request for comments on issues discussed at the subject Roundtable, and specifically, the topic of investment of cash collateral received by mutual funds in connection with securities lending. The mutual fund industry would benefit from additional guidance from the U.S. Securities and Exchange Commission (the "SEC") regarding the amount of flexibility a lending fund has with respect to the types of investments in which cash collateral from securities lending may be invested. While the SEC staff has at various times mentioned that collateral could be invested in various specified ways,[1] the only definitive statement is that the type of investments for cash collateral is a decision for directors of the fund.[2] The mutual fund industry has assumed, however, that the SEC requires that cash collateral must be invested in highly conservative liquid investments, such as money market type funds and short-term fixed income instruments.

Although liquidity is a clear requirement for the investment of collateral that may have to be returned on short notice, there are circumstances where a fund should not be limited to

1 *See, e.g., Chase Manhattan Bank*, SEC No-Action Letter (July 24, 2001) (investment in joint accounts that, in turn, would invest in fully collateralized repurchase agreements, commercial paper, and other Rule 2a-7 eligible securities); *State Street Bank and Trust Co.*, SEC No-Action Letter (Sept. 29, 1972) (investment in high yielding short-term investments which give maximum liquidity to pay back the borrower when the securities are returned).

2 *State Street Bank and Trust Co.*, SEC No-Action Letter (Sept. 29, 1972).

such conservative investments. Rather, where consistent with the fund's investment objective and strategies, greater flexibility may be appropriate when such flexibility is adequately disclosed, and when that flexibility will provide the potential for either higher returns or cost savings for shareholders.

For example, a fund that employs a leveraged long/short equity strategy could provide possible cost savings to shareholders if the fund was permitted to obtain its additional long exposure by investing the cash collateral it receives from securities lending in equity securities. In employing a leveraged long/short equity strategy, the investment adviser for the fund buys securities "long" for the fund's portfolio that it believes are underpriced and will increase in value, and sells securities "short" that it believes are overpriced and will decline in value. A fund using this strategy may maintain long positions in equity securities equal to 120% to 140% of the value of its assets, short positions in equity securities equal to 20% to 40% of the value of its assets, and cash positions equal to 0% to 10% of the value of its assets.

Currently, a fund uses the proceeds it receives from engaging in short sales to purchase the additional long positions necessary for the fund to implement its investment strategy of holding more than 100% of its assets in long positions. The equity securities purchased with the short sale proceeds and any additional collateral required with respect to the short sales is held at the fund's custodian pursuant to a tri-party custody agreement among the fund, the fund's custodian, and the prime broker. The fund pays additional financing fees to the prime broker above those charged in typical short sales transactions to be able to use the proceeds from the shorts sales to purchase equity securities and hold those securities in an account at the fund's custodian.

If a fund was permitted to invest the cash collateral that it receives from securities lending in equity securities to achieve the fund's desired long position target, the cash proceeds from the fund's short sales could be held at the fund's prime broker, which would eliminate the additional financing costs the fund currently incurs to obtain its additional long exposure. Under this scenario, the fund could utilize a securities lending program operated by an affiliated bank of the fund's prime broker (the "securities lending agent"), which would enter into a sub-custodian arrangement with the fund's custodian. Under the securities lending program, the securities lending agent would lend a basket of securities to an institutional counterparty. The fund would in return receive cash collateral that it would invest in equity securities to obtain the long exposure necessary to implement its leveraged long/short equity strategy.

With respect to a fund that employs a leveraged long/short equity strategy, the ability to invest securities lending cash collateral in equity securities may provide the fund with a more cost efficient means to execute its strategy and would be consistent with the disclosed risk profile of the fund. Additional guidance from the SEC regarding the parameters for the investment of securities lending cash collateral would provide a fund that has a unique strategy, such as a fund employing a leveraged long/short equity strategy, with the guidance necessary to make a determination that it has the flexibility to invest its cash collateral from securities lending in equity securities, a type of investment that generally has not been purchased with securities lending cash collateral.

Sincerely,

Jana L. Cresswell

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