BROWN BROTHERS HARRIMAN

October 30, 2009

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

Re: File No. 4-590 (Securities Lending and Short Sale Roundtable)

Dear Ms. Murphy:

Brown Brothers Harriman & Co. is submitting this comment letter in connection with the roundtable that the Securities and Exchange Commission ("Commission") hosted on the topic of securities lending on September 29, 2009. Brown Brothers Harriman is a private banking partnership established in 1818 and serves clients globally though three businesses: Investor Services & Markets, Investment Management, and Banking & Advisory. Our firm was founded and has operated on the principle of protecting the long term best interests of our clients. This letter follows on my remarks as a member of the Securities Lending and Short Sale Roundtable.

We commend and thank the Commission for examining the topic of transparency and the securities lending industry in the context of its place in the capital markets and with a view toward long-term stewardship. In particular, given recent market developments, we understand the Commission's desire to review whether the existing regulatory framework for securities lending is adequate, and we commend the Commission for its efforts to solicit a broad range of views to ensure that there is a balanced discussion about this important topic. Based on our broad experience as an agent lender serving some of the largest global asset managers, we do not believe that there is any need for imposing a centralized risk management process. For the reasons discussed below, we believe that the unique attributes of the securities lending market have been well served by the existing framework based on bilateral contracts. In our view, the strength of the current market structure can further benefit from enhanced transparency by way of additional information and education that may be provided by agent lenders to beneficial owners in respect of securities lending revenue and risks.

As noted by other commentators in respect of the Roundtable, the securities lending market is a developed market that operates on a well-established base of legal principles and standardized operating procedures. A plethora of regulatory requirements and industry protocols apply to this market. ERISA, the Investment Company Act of 1940, SEC Rule 15c3-3, Federal Reserve Board Reg T, Reg SHO and Rule 204 under the Securities Exchange Act, along with the capital framework recommended by the Basel Committee and the Agency Lending Disclosure taskforce are a few examples of regulations and industry efforts that ensure appropriate transparency and integrity to loan participants and to regulators.

Much of the recent discussion about securities lending has centered on the relative merits of using a central counterparty ("CCP") in lending transactions. Central Counterparties serve an important function in counterpart risk management in the clearance of standardized and irrevocable contracts involving securities or commodities. However, we believe that the CCP structure is less effective in addressing issues beyond those related to clearance and settlement of transactions.

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Unlike the clearance of exchange-traded securities or commodity contracts, a securities loan is not a discrete transaction; instead it involves a continuing commercial relationship between borrower and lender that is terminable at any time by either party. The ability to effectively manage a loan as a set of ongoing obligations between a borrower and lender is critical to ensuring the interests of beneficial owners are protected and that the overall integrity of the loan market is preserved.

We believe that one of the lessons of the last 18 months of nearly unprecedented market conditions is that treating loans as fungible commodities comes at the expense of appropriate loan administration. Lending relationships can be effectively managed by a bilateral relationship between lender and borrower, entailing sufficient end-to-end transparency to allow for individual attention to origination, collateralization and liquidation on default.

The interposition of a CCP could change an identifiable bilateral obligation into a new species of derivative, dependent on a limited number of market makers for performance, and under-girded by guaranty funds already committed to other purposes. Furthermore, beneficial owners would lose the ability to customize and manage securities lending risks via the CCP model. Many beneficial owners actively manage securities lending program parameters such as counterpart selection, credit and diversification limits by counterpart, and eligible collateral. Additionally, many beneficial owners conduct daily oversight and due diligence on counterpart exposure to better manage complex-wide counterpart exposure.

Nor would a CCP model provide the necessary transparency beneficial owners and lending agents seek regarding the ultimate counterpart in the lending transaction. We believe this lack of transparency may create the condition for greater systemic risk by preventing beneficial owners from actively managing portfolio and complex-wide counterparty risk.

The only aspect of lending that is asserted to be more transparent under the CCP proposals is loan pricing. We should not confuse "price publicity" with transactional transparency when assessing CCP models. Because of the nature of a lending transaction, we believe that transparency needs of beneficial owners and lending agents, including execution and performance measurement, should be construed broadly to reflect the overall objectives and management of a lending program. Monitoring objectives should include financial performance, but of equal importance is the management of program risks including:

1) counterpart performance and credit risk;
2) operating risk;
3) collateral and collateral reinvestment risk; and
4) legal, tax, and regulatory risk.

Therefore, "best execution" judgments cannot be reduced solely to consideration of a loan fee or spread negotiated on the day of execution. Securities lending transactions involve continuous and multi-faceted relationships. Monitoring and assessment of a loan program should include the assessment of program risks in addition to loan fee/spread/income generation. This will foster a balanced performance measurement methodology that will emphasize risk adjusted returns rather than absolute dollars. It will also encourage lending agents to properly disclose and discuss program risks and structure a lending program tailored to the risk tolerance of the beneficial owner rather than focusing primarily on revenue generation and economic performance.

Importantly, the losses experienced by lenders of securities over the last 20 years have not been the direct result of counterpart failure. Collateralization and contractual provisions for the cure of loan defaults have operated largely as designed. Losses experienced by lenders have, instead, been the direct result of losses attendant to the investment of cash collateral. And it's important to note that not all beneficial owners participating in lending programs experienced cash reinvestment losses or impaired liquidity. Loan program models vary, ranging from programs that rely heavily on cash management to programs that have no cash collateral investment component and that rely on lending premiums for income and collateral in kind for securing counterpart performance. Many beneficial owners guided by an investment management discipline have effectively structured their securities lending programs to minimize securities lending risk, and to specifically minimize cash and collateral investment risk and counterpart risk.

If there is a need for enhanced transparency, it is transparency between agent lenders and beneficial owners as to: (i) the source of compensation for securities loans, and particularly whether this compensation entails cash investment and its attendant risk; (ii) further education and communication between lending agents and beneficial owners regarding the risks and nuances of securities lending to allow a lender to ensure that their securities lending program will not impede or detract from their investment policy or objectives; and (iii) the unbundling of pricing structures that include custody, securities lending, and cash management.

We would urge the Commission to proceed with caution before altering the operating structure of an industry that has operated efficiently over a 20 year period, even in the face of broker-dealer bankruptcies, currency crises and, most recently, the events of 2008. We would support a requirement for greater transparency and disclosure between lending agents and beneficial owners with regard to sources of securities lending revenue and risks.

Sincerely,

Christine Donovan
Managing Director
Brown Brothers Harriman & Co.

cc: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen Casey, Commissioner
The Hon. Troy Paredes, Commissioner
The Hon. Luis Aguilar, Commissioner