COMMITTEE ON SECURITIES LENDING

March 28, 2016

Via Electronic Submission
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Use of Derivatives by Registered Investment Companies and Business Development Companies
File Number S7-24-15

Ladies and Gentlemen:

The Committee on Securities Lending of the Risk Management Association (the "RMA")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on its behalf and on behalf of numerous of its members, including The Bank of New York Mellon, Brown Brothers Harriman, Deutsche Bank, Goldman Sachs, JP Morgan Chase, State Street Corporation, The Northern Trust Company and other financial institutions that participate in the securities lending industry as securities lending agents ("Agent Banks") on behalf of their clients. This letter addresses the Commission's proposed new rule (the "New Rule") addressing the use by registered investment companies (hereinafter referred to as "funds") of derivative transactions and financial commitment transactions (each as defined in the proposed rule), specifically with regard to its application to securities lending transactions. We recognize the benefits of the Commission's efforts to provide a more comprehensive and updated approach to the regulation of funds' use of derivatives, and we generally support the Commission's efforts to increase the protections to investors that undergird Section

[1] The RMA Committee acts as a liaison for RMA member institutions involved in agent lending functions within the securities lending industry by providing products and services, including hosting several forums, conferences and training programs annually and sharing aggregate composite securities lending market data free of charge.

18 of the Investment Company Act of 1940 (the "Act"). However, we believe that with regard to securities lending activities, funds' investors are adequately protected by the well-developed line of no-action guidance that has been promulgated by the Commission over the past 40 years. We further believe that to subject securities lending transactions to the New Rule would limit what is currently a well understood source of additional return to fund investors, reduce the liquidity that securities lending provides to the market, while at the same time not provide protection to funds that is not already available under current guidance from the Commission.

Securities Lending and Proposed Exposure or Risk Based Limits

The Commission asks if securities lending transactions should be subject to the same exposure limits as derivative transactions. If this were to be the case, then a fund seeking to engage in securities lending would need to include its obligation to return collateral when calculating the new exposure or risk-based limits set forth in the New Rule. Given that securities lending collateral is comprised of only assets permitted by the Commission which are highly liquid, and given further that lending collateral may not be rehypothecated (in the case of non-cash collateral) or may only be invested in conservatively managed cash vehicles (in the case of cash collateral), including obligations to return collateral in exposure limits would not seem necessary to effect the Commission's goals of protecting funds from leverage risk inherent in other types of derivative transactions. Furthermore, the existing limits restricting funds from lending only one-third of their total assets practically constrains the amount of collateral a fund can receive, and thus limits the corresponding obligation to return the collateral to the borrower.

Securities Lending as Financial Commitment Transactions

Under the New Rule, financial commitment transactions, including short sales and reverse repurchase agreements, would be permitted subject to asset segregation rules, in order to protect funds from the risk that a fund might be required to liquidate assets in order to meet its obligations to a counterparty under a financial commitment transaction. The Commission asks if securities lending should be included as a financial commitment transaction, and the RMA strongly believes that this should not be the case. In the case of a securities loan, the exposure which would cause the Commission concern is a fund's obligation to return collateral to a borrower upon termination of a loan. However, under existing guidance from the Commission, collateral for securities loans is invested in highly liquid investments, is marked to market daily, and is segregated from the assets of the fund and cannot be rehypothecated. As such, it is readily available to return to a borrower and poses little risk of creating an additional obligation on the fund.

In addition, if securities lending were to be considered a financial commitment transaction, the requirement to segregate assets to cover the obligation to return collateral could potentially disincentivize funds from seeking more collateral from a borrower. Given that over-collateralization is one of the primary tools in protecting against borrower default, requiring asset coverage for obligations to return collateral would increase costs to the fund and make it less attractive for a fund to request a higher level of collateral from a borrower in order to protect the fund. This is particularly true when considering the securities lending marketplace; while borrowers have many reasons why they may default, including a failure to return a security or insolvency, lending funds do not rehypothecate collateral and are not generally subject to the same insolvency risks as borrowers. As such, any rules governing securities lending should consider the allocation of risks between these parties and consider first protection of lending funds by, among other things, creating incentives to ensure sufficient collateralization.

Securities Lending and Current Guidance

Finally, the Commission asks whether its current approach to securities lending, under which funds do not have on loan at any given time more than one-third of the fund's total assets, together with other guidance from the Commissions' Staff concerning securities lending, effectively deals with the concerns that are being addressed with regard to other derivatives transactions by the New Rule. The RMA strongly believes this to be the case, and further believes that subjecting securities lending transactions to the New Rule could both increase risk to the funds while at the same time potentially reduce performance available to the funds and their underlying investors.

As noted above, under current guidance from the Commission, funds lending securities are limited in the amount they lend to one-third of a fund's total assets. For those funds that do lend securities, Commission guidance requires a number of protections, including the right to terminate a loan at any time for return within the standard market settlement cycle, receipt of highly liquid collateral worth no less than the amount of securities loaned and daily mark to market valuation of the securities on loan. Any collateral received by a lending fund must be invested in conservative cash collateral vehicles, and the fund must receive a reasonable return for any securities lending that it performs. Finally, any fund's securities lending program is subject to board oversight to ensure compliance with these rules as well as the performance and costs of the lending program.

Based on this guidance from the Commission, funds have been able to access the securities lending market for many years, enjoying strong protections while being able to provide investors with additional returns generated from the securities lending. If the Commission were to change the characterization of securities lending such that it would be subject to the restrictions set forth in the New Rule, funds and their investors could see a potential decrease in income from lending activity, while not benefiting from protections any more extensive than those articulated under the well-developed guidance from the Commission over the past forty years. In addition, their inclusion under the New Rule would require systems and operational changes across the industry in order to comply with the new standards, which could again introduce the possibility of risk while decreasing income for fund investors and market liquidity brought about by securities lending activities.

Conclusion

We appreciate the opportunity to file this letter with the Commission and we encourage the Commission to consider the comments and recommendations set forth herein. We believe that the Commission has provided strong guidance to funds that addresses the risks inherent in securities lending while ensuring access to lending income, and we believe that this should be preserved for the benefit of the funds and their investors. If desired by the Commission, the RMA would be pleased to discuss our comments in further detail and to assist the Commission in any way.

Sincerely,

Francis Garritt

Fran Garitt

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