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THE RISK MANAGEMENT ASSOCIATION
Serving the Financial Services Industry

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September 24, 2008

Erik R. Sirri
Director, Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Impact of Rule 204T on the Securities Lending Industry

Dear Mr. Sirri

We are writing on behalf of the Risk Management Association's Committee on Securities Lending to alert you to a significant issue that, to our knowledge, has not been brought to the attention of the Staff. Founded in 1914, The Risk Management Association (RMA) is a not-for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk principles in the financial services industry. RMA has over 2,700 institutional members that include banks of all sizes as well as nonbank financial institutions throughout North America, Europe, and Asia/Pacific. RMA's Committee on Securities Lending was formed in 1983. The objective of the committee is to promote sound securities lending practices within its members and the industry.

Specifically, RMA is concerned about the impact of Rule 204T's close-out requirement on the securities lending market. Despite the Commission's efforts to provide additional time for clearing firms to close out long sale fails, we understand that some clearing firms will not be relying on Rule 204T(a)(1) due to the CNS netting process (*i.e.,* the difficulty that clearing firms face in determining how to allocate their settlement obligation between and among short and long sales) and the severe consequences of being in the "penalty box." These clearing firms have indicated that they intend to execute a close out on T+4 (not T+6) if a customer has failed to deliver securities sold long to the clearing firm by settlement date, including in situations in which the customer has loaned the securities out and is in the process of recalling the loan.

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To ensure that securities can be delivered by settlement date, and to avoid the potential cost that would result from an automatic buy-in on T+4, we understand that certain major institutional investors are contemplating recalling their outstanding securities loans.[1]

This could have at least two substantial, harmful and unintended effects on capital markets. First, a reduction in available securities for lending would interfere with one of the cornerstones of the SEC recent emergency actions, which anticipate that securities will be available for lending to clearing firms seeking to satisfy their delivery obligations and to support short selling and other market activities that are critical to maintaining liquidity in the cash and derivatives markets. Second, a recall of any size would precipitate an unwind of securities loans, requiring that cash collateral delivered by borrowers and invested in short-term reinvestment funds (including money market funds) be redeemed from those funds. This would put further pressure on the liquidity of these cash management vehicles, particularly as the securities lending market is estimated to be a $10 to $15 trillion dollar market.

We believe that the Staff could help mitigate these pressures by issuing an additional FAQ that provides guidance regarding how a clearing firm can "demonstrate on its books and records that [a] fail to deliver resulted from a long sale." For example, the Staff could provide assurances that a clearing firm will be in compliance with Rule 204T if it has a reasonable methodology for assigning close-outs among short and long sellers and, in the case of a long sale fail, obtains reasonable assurances from the customer or its agent that it owns the securities, that it is in the process of attempting to recall a securities loan, and that it intends to deliver the securities to the clearing firm as soon as reasonably practicable.

RMA would welcome the opportunity to discuss the points raised in this letter. If you have any comments or questions regarding the foregoing, please do not hesitate to contact Brandon Becker at (202) 663-6979 or Elizabeth Seidel at (617) 772-6146.

Sincerely,

Michael P. McAuley
Chair, RMA Committee on Securities Lending

Cc: Christopher Cox, Chairman
Luis A. Aguilar, Commissioner
Kathleen L. Casey, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
Robert L.D. Colby, Deputy Director, Division of Trading and Markets

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1 These lending arrangements involve the lending of long security positions under terms that provide for return of loaned securities on notice equal to the three day settlement period for such securities. Due to the mechanics of the notification process, the instruction to recall the loaned securities may be received by the settlement agent after the close of business on trade date, with the result that securities have a return date after T+ 3 but prior to T + 6. This arrangement poses no difficulty under the letter of Rule 204T, which does not necessitate a close-out of long positions until T+6 .

Daniel M. Gallagher, Deputy Director, Division of Trading and Markets
James Brigagliano, Associate Director, Division of Trading and Markets
Michael P. McAuley, Chair, RMA Committee on Securities Lending and Senior Managing Director, State Street Corporation
Curtis Knight, RMA Director of Securities Lending/Market Risk
Elizabeth A. Seidel, Executive Committee, RMA Committee on Securities Lending and Senior Vice President, Brown Brothers Harriman & Co.