



NEWS RELEASE

CALLAN ASSOCIATES SURVEY REVEALS CURRENT STATE AND FUTURE PLANS OF INSTITUTIONAL INVESTORS' SECURITIES LENDING PROGRAMS

Comprehensive report finds cash collateral reinvestment losses prevalent across fund types

SAN FRANCISCO, July 21, 2009 — Securities lending virtually ground to a halt in 2008 as a result of the deepening credit crisis and extreme market volatility that swept over the capital markets. In May 2009, Callan Associates' Senior Vice President of the Master Trust, Global Custody and Securities Lending Group, Virgilio "Bo" Abesamis, surveyed 72 fund and plan sponsor organizations to determine how their securities lending programs were faring individually and collectively and to discover their future plans.

The participants, comprised of clients and non-clients and collectively representing approximately \$1 trillion in assets, provided detailed information about their securities lending programs in the survey and to Abesamis in follow-up discussions. According to Abesamis, the granular level of detail shared and the related findings are remarkable.

"I have covered securities lending for 22 years, but the high participation rate among survey respondents truly allowed us to capture the collective pulse of the industry and confirms my suspicions about the extent of the wreckage facing fund sponsors," said Abesamis. "Institutional investors are keeping a long-term focus, seeking strategies to manage their predicament and are more willing to better define their risk appetite since they met their threshold of pain."

The Callan 2009 Securities Lending Survey Universe:

Public and corporate funds, at 42% and 38% respectively, comprise the majority of survey participants. More than half — 54% — are mid-sized funds that hold from \$1 to \$9 billion in fund assets; 19% are small funds that have less than \$1 billion. The remaining assets are split between mega funds (13%) and large funds (14%) which hold more than \$25 billion and \$10 to \$24 billion, respectively.

Key Findings and Concerns:

According to Callan's *2009 Securities Lending Survey*, cash collateral reinvestment losses, both realized and unrealized, were common across all direct and indirect fund and plan types and sizes and was the leading concern among 76% of the organizations surveyed.

Approximately 48% of respondent firms with securities lending programs are undergoing a controlled withdrawal to reduce the risk profile of the program and minimize current and future losses. The controlled unwind is the most common strategy within "work out" solutions and firms are using it for rebalancing and to raise cash for liquidity. Nearly all are utilizing their current custodian or securities lending provider for the unwind and most believe it will take one to three years to complete.

Disclosure regarding risk profile and program structure — along with redemption issues and exit strategies from both direct and indirect lending — ranked highly with nearly four out of five respondents.

Securities lending income is most often utilized to offset costs — including custody and investment management fees and/or internal administration costs. By contrast, one-fifth of participants use securities lending income to enhance performance.

Fund and plan sponsors are also reviewing their investment policies and guidelines with a clear resolve to manage risk, understand the attribution of earnings, tighten compliance, seek better transparency and disclosure and finally, strengthen accountability. Additionally, less than half of those surveyed are concerned about litigation.

"Collectively, the majority of plan sponsors have placed a high priority on revamping their current securities lending programs," said Abesamis. "Pursuing litigation at this point would stop that process dead in its tracks until any legal issues were resolved."

Expected Changes and Considerations

Due to a variety of factors, only 44% of respondents are pondering changes to their securities lending programs. However, among firms that are considering changes, fine-tuning cash collateral reinvestment guidelines ranks the highest — with mega and large funds the most interested at 67%.

The survey shows that 27% of respondents want to participate in funds that do not lend out their assets (indirect lending) and nearly 20% indicate they may cap the program at a more manageable level.

Sixty-four percent of defined contributions plans are contemplating moving or replacing indirect lending funds with non-lending funds and nearly 25% of all participants may terminate their securities lending program altogether.

The Ideal Securities Lending Program – Future Trends

Callan asked fund and plan sponsors if given the opportunity to design a program from scratch, how interested would they be — on a scale from one to four¹ — in implementing intrinsic value-oriented approaches.

Surprisingly, the results were tight between the three strategies offered, but results appeared contingent on the size, type and risk profile of the plan. Results were highest at 3.1 for demand and general collateral lending spreads, but only if full repurchase agreements (REPO) and cash reinvestment risk indemnifications are provided. A close second at 2.9 would implement a pure demand lending spread using overnight REPO reinvestment guidelines. Applying a pure demand lending spread, but using money market SEC Rule 2a-7 cash reinvestment guidelines, came in third around 2.8 out of a possible 4.

“While the results are closer than we anticipated, the survey confirms that investors are not migrating blindly to 2a-7 programs, but are gravitating to less risky alternatives² as we enter a rising interest rate environment over the short and medium term,” says Abesamis.

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About Callan Associates

Founded in 1973, Callan Associates is one of the largest independently-owned investment consulting firms in the country. Headquartered in San Francisco, Calif., the firm provides research, education, decision support and advice to a broad array of institutional investors through five distinct lines of business: Fund Sponsor Consulting, Independent Adviser Group, Institutional Consulting Group, Callan Investments Institute and the Trust Advisory Group. Since its inception in 1991, Callan’s Master Trust, Global Custody and Securities Lending group has lead the institutional investment consulting industry in providing dedicated resources and consulting services to clients interested in trust, custody, securities lending and transition management issues. For more information, visit www.callan.com.

¹ The likelihood of implementation: one equals least likely and four equals most likely.

²The application of SEC Rule 2a-7 guidelines should not increase the underlying risk profile of the asset class, portfolios or securities that are out on loan. In a rapidly rising interest rate environment, SEC Rule 2a-7 guidelines may not be immune to losses due to the gap between the loan and the reinvestment. Since current interest rates are near zero, there is a high probability that a rapid rising interest rate environment can materialize over the next few years. If this happens the securities lending program would be subjected to interest rate risk which could lead to losses.