

STATE STREET'S FINANCIAL DIGEST OF SECURITIES LENDING AN INTRODUCTION

Our primary reason for publishing *State Street's Financial Digest of Securities Lending* is to raise the level of discussion around risk and return and enable participants to make more informed decisions concerning these issues.

As securities lending continues to be increasingly viewed within the mainstream of investment management, the industry has been actively trying to find a means of evaluating performance and improving the decision-making process. However, subtle differences exist between core investment management activities and securities lending, making it difficult to directly apply standard investment management metrics.

While the perception of securities lending within the industry is changing, participants cognitively view risk and return in securities lending through a different prism than their core investment activities. Many plan sponsors continue to view securities lending as an adjunct activity, to which limited time and analytical resources are dedicated. Since broadly applicable benchmarks do not exist, participants find it difficult to evaluate competing claims.

In reality, a participant must make complex decisions between offsetting risks and opportunities. In employing any one of a number of distinct strategies, it is important to understand the risk and return potential over the long term for any of these strategies. An agent lender cannot maximize utilization, spread, and return while simultaneously minimizing all forms of risk. As such, a participant must make an educated decision regarding the appropriate levels and forms of risk that one is willing to take, while at the same time setting rational expectations for future utilization rates and returns given these risk parameters.

As the industry continues to become more introspective, it is becoming increasingly clear that securities lending is a complex process requiring ever-increasing expertise and experience. The aim of State Street's Financial Digest of Securities Lending is to foster intellectual inquisitiveness by industry participants in an effort to raise the level of risk and return discussion and enable more informed risk-taking decisions.

The authors hope you find the Digest articles to be thought provoking and that they will enable you to better frame your risk tolerances and return expectations as a securities lending program participant.

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