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Chairman Kohl, Ranking Member Corker and Members of the Special Committee: Thank you for the opportunity to appear before you today. My name is Steven Meier and I am the Chief Investment Officer, Global Cash Management, for State Street Global Advisors ("SSgA"), the investment management business of State Street Corporation ("State Street"). The Committee has asked me to address the practice of securities lending by employee retirement plans such as 401(k) plans and I hope my testimony will assist you with your important work. Our interests at State Street are aligned with those of our securities lending clients, who are generally long-standing clients for whom securities lending is one of many services State Street provides. We have managed the cash collateral pools and the lending program in a prudent manner, consistent with our fiduciary duties.

At State Street, we believe that securities lending can play a role in the development of a balanced investment program for professionally managed retirement plans. As you know, employee retirement plans typically earn dividends and interest from the plan's investment portfolio. However, if participants choose to invest in a plan option that engages in securities lending, the investment portfolio can earn additional incremental income. While the amount of this incremental income varies by portfolio and depends upon a number of factors such as prevailing interest rates and spreads between Federal funds and other credits, this incremental income can be significant. The plan can use this income either to offset ongoing expenses that would otherwise have been paid by the plan participants, such as custodial or administration fees, or to supplement the plan's investment return for participants. Whatever the use, the incremental

income derived from securities lending activity directly benefits the millions of American workers that rely on their employee retirement plans.

BACKGROUND AND EXPERIENCE

Let me begin with a brief description of my background and experience. I have more than twenty-seven years' experience in financial services, with a focus on traditional money markets, fixed income, global cash, and financing. I began my career working as a securities lending management trainee at the Irving Trust Company in 1984. I worked there for approximately two years before leaving for graduate school. During my time at Irving, I was able to learn the securities lending and cash collateral investment business in its early years. Today I am an Executive Vice President, and my primary responsibility as Chief Investment Officer of the cash asset class is to manage global cash activities, including money market funds and other cash management products such as the collateral investment vehicles for SSgA-managed funds that participate in securities lending. I am a member of SSgA's Executive Management Group, as well as its Senior Management Group and Investment Committee.

State Street is one of the world's leading providers of financial services to institutional investors, with nearly $22 trillion in assets under custody and administration, and almost $2 trillion under management. SSgA is the investment management business of State Street and manages traditional cash, money market funds, and other investment programs, including separate accounts and commingled cash collateral vehicles used by participants in State Street's securities lending program. In 2009 and 2010, SSgA was named the "World's Best Bank" in the Asset Management category by *Global Finance Magazine*.

THE SECURITIES LENDING INDUSTRY

Securities lending is a means by which institutional clients who hold and plan to retain long securities positions can earn incremental income. The asset owner, generally with the

assistance of a securities lending agent, lends a security it holds as a long position to a borrower who needs the security to facilitate settlement of a securities transaction, often in connection with a short sale. The borrower has an obligation to return the borrowed security and provides collateral to secure that obligation. This collateral is typically worth between 102 – 105% of the market value of the borrowed security, and can be either cash, which is most common, or securities. During the course of the loan, as the market value of the security on loan varies, the lender either collects more collateral from the borrower (if the value of the security has gone up) or returns some collateral to the borrower (if the value of the security has gone down).

If the lender has received cash collateral, it reinvests the collateral and when the loan terminates, it pays the broker-dealer a negotiated "rebate rate" on the cash pledged to secure the loan, and shares the remaining reinvestment income with the securities lending agent. The lending agent's "split" of the proceeds is its compensation for its services administering the program, such as matching lenders to borrowers, re-assigning loans when a lender divests an asset, marking to market the value of securities on loan daily, and either collecting additional collateral from borrowers, or returning a portion of collateral to them, depending on the loan. These administrative services play an important role in maximizing the return that a plan can achieve from participating in a lending program. The lending agent's split is also compensation for the risks it takes by indemnifying lenders against the failure of a borrower, such as Lehman, to return a security. This indemnity substantially reduces the risk to a plan of participating in a lending program by shifting the risk of the failure of a borrower to return securities if the borrower enters bankruptcy or otherwise defaults on its obligations; such indemnity correspondingly exposes the lending agent to increased risks.

STATE STREET'S SECURITIES LENDING PROGRAM

Institutional clients can choose to participate in securities lending at State Street in two ways. A client can appoint State Street as its "lending agent" and directly lend its securities to borrowers. Plans that choose to directly lend their securities in this way negotiate how much they will compensate State Street for its services as lending agent and choose whether to accept cash collateral and which investment vehicle to use for cash collateral reinvestment (e.g., a separately managed account or a choice of several commingled collateral pools).

Second, an institutional investor such as a 401(k) plan may participate in securities lending by investing in State Street's bank-maintained collective and common trust funds that, in turn, lend securities and invest cash collateral in collateral vehicles managed by SSgA. I will refer to those bank-maintained collective and common trust funds as "Lending Funds." In general, the plan sponsors that choose to offer Lending Funds also have the option of offering a non-lending version of the same fund, and the Lending Fund version includes the phrase "Lending Fund" in its name for the sake of clarity. When a Lending Fund loans securities and receives cash collateral, it agrees to pay a rebate to the borrower in an amount that reflects current market rates and is intended to compensate the borrower for the interest it could have otherwise received on that cash. The remaining income from reinvestment of the cash collateral is split between the Lending Fund investor and State Street as lending agent.

State Street's split is its sole compensation for its work as lending agent, which is done by State Street's Securities Finance division, not SSgA. The split is not tied to any compensation SSgA receives for its management of the collateral pools. For unrelated services, such as custody and administration, State Street will also receive compensation from the client.

IMPACT OF THE FINANCIAL CRISIS ON CASH COLLATERAL REINVESTMENT

As this Committee is aware, the events of the recent global financial crisis that began in 2007 and worsened in 2008 were unprecedented. Our nation experienced a liquidity crisis in the fixed income sector as the secondary market for such securities essentially ceased functioning. Within the span of a few days in September 2008, we witnessed the failure of long-standing financial institutions and a large SEC-registered money market fund. The value of equity and non-Treasury debt securities plunged along with investor confidence.

These events impacted lenders of securities in several ways, including a significant drain of liquidity from their cash collateral investment pools. Specifically, as the market value of certain securities declined, lenders marked down the value of their securities on loan and had to return large amounts of cash collateral to borrowers. At the same time, borrowers de-leveraged their businesses, returning many of the securities they had borrowed without borrowing new securities. Again, this resulted in the return of significant amounts of cash collateral. Finally, lenders themselves reacted to the market by making changes to their portfolios, selling securities to raise cash or alter their asset allocation. When lenders sold securities that had been out on loan and the loans could not be re-assigned, the loans of those securities terminated and the lenders returned the cash collateral to the borrowers. In fact, during the period from June 2008 to December 2008, State Street managed a nearly 50% decline in outstanding loan balances without any 401(k) plan investor invested in a Lending Fund realizing a loss due to a lack of cash collateral pool liquidity.

However, this series of events caused significant impacts on cash collateral vehicles. Depending on their risk profiles and return objectives, collateral vehicles own assets of varying levels of liquidity, ranging from short-term cash and cash equivalents to high quality medium-

and long-term assets such as asset-backed securities and unsecured debt. If redemptions from a cash collateral vehicle (due to ongoing legal obligations to borrowers under the securities lending arrangement) exceed the vehicle's cash and cash equivalents and additional liquidity is required to meet its participants' obligations, the manager of the cash collateral vehicle will be forced to sell medium- and long-term assets to raise liquidity. In the market environment of 2008, such an imbalance made it virtually impossible to sell these assets, and if sales were possible, would have caused managers to sell assets at a substantial loss that did not reflect the intrinsic value of those securities, but rather reflected short-term illiquidity and unprecedented spread volatility in the markets.

State Street acted cautiously and thoughtfully to protect the interests of all of our securities lending clients. As a result, our Lending Fund investors did not incur any realized losses in connection with cash collateral reinvestment, unless they chose to take an in-kind distribution of securities and sell them at a loss. We are particularly proud of the way State Street has managed its securities lending program during the financial crisis over the last several years:

- We maintained 401(k) plan participants' full, unrestricted rights to make withdrawals from their retirement savings invested in Lending Funds.

- Due to our prudent management, none of the cash collateral pools realized material credit losses. As Chief Investment Officer, Global Cash management, I am particularly proud of this fact. We avoided the sale of strong credits into a distressed market and reinvested cash flow in highly liquid, short-term securities for a period of approximately one year before Lehman's default, building up the short-term liquidity in our cash collateral vehicles and managing the vehicles in an increasingly conservative manner.

- State Street restricted certain withdrawals from the Lending Funds at the plan sponsor level for a period of time after the Lehman bankruptcy, to ensure consistent access among retirement plans to the available liquidity in our common and collective trust funds. We lifted those restrictions in August 2010 after we voluntarily contributed $330 million to the collateral pools, in light of the market's continued discounting of certain asset-backed securities held by the collateral pools – a discount that resulted from continued liquidity challenges and wider credit spreads, not the credit quality of the assets.
- Retirement plans, including 401(k) plans, that appointed State Street as securities lending agent and directly lend the securities in their portfolio and reinvest the cash collateral in SSgA-managed cash collateral pools have remained able to access the liquidity they needed to support normal investment activity.
- We, like many securities lending agents, indemnified our clients when Lehman Brothers defaulted upon its obligations as a borrower. Because we agree to hold retirement plans harmless in the event that the financial institutions to which they have lent securities default on their obligations, when Lehman Brothers declared bankruptcy, the risks of that default rested with State Street and not our lending clients.

We believe State Street's actions exhibited its commitment to maintaining safety of principal, adequate liquidity and strong consistent returns for all Lending Fund investors while managing the impact and risks inherent in this difficult market cycle. State Street believed, and continues to believe, that it acted in the best interests of all investors in the common and collective trust funds managed by SSgA that engaged in securities lending.

DISCLOSURES REGARDING SECURITIES LENDING

We understand that the Committee is also interested in how much plan sponsors and plan participants knew about and understood the risks of cash collateral reinvestment. State Street has

followed the model established by federal banking regulations, which primarily required us to make information available to our institutional investors. Throughout the financial crisis, State Street also undertook to distribute additional securities lending disclosures through a number of channels to institutions invested in Lending Funds. State Street has always adhered to industry best practices regarding disclosure, and we continue to be fully committed to appropriate levels of transparency.

As proud as we are of these steps, we are challenged by an issue that we believe affects many providers of lending services to direct contribution plans: State Street, acting in a capacity of investment manager to a plan sponsor (or a service provider of the plan sponsor, such as a recordkeeper) often does not have sufficient information about the individual 401(k) participants in its Lending Funds to communicate with them directly. We welcome discussion and collaboration with the Committee and other stakeholders about how else the industry can improve its disclosures to retirement investors given the limited ability of asset managers and lending agents like State Street to convey information directly to individual participants in retirement plans.

Thank you again for the opportunity to be here today to speak on this subject. I would be pleased to answer the Committee's questions.