Introduction

- Good afternoon, my name is Mark Faulkner. I am the Founder and Head of Innovation of Data Explorers. We welcome the initiative the SEC is showing in hosting these roundtables. I would like to thank the Chairman for the opportunity to address you today and I look forward to answering any questions that you and colleagues may have.

- Data Explorers has built a unique and independent global database of OTC stock-loan data over 7 years, gathered daily from over 125 global custodians and 32 prime brokers, and comprises $11 trillion dollars of lendable assets held in 22,000 funds. We estimate that this data represents approximately 85% of the global stock-lending market, and believe because of the size and also quality of our database that our data is therefore the closest proxy to short interest available. There is more transparency available today than some may think.

- Our clients span the financial sector from Issuers, Institutional Investors, Banks, Brokers and Hedge Funds. We serve their needs from offices in New York, London and Edinburgh.

- Our corporate objective is "to be the industry's most complete source of data, analysis and insight into short selling and securities financing".

Scale

- Securities Lending plays a pivotal role providing the liquidity that the global capital markets need to operate efficiently. Without which prices would be wider and positions less liquid to the detriment of investors.

- Securities lending balances on loan today are in excess of 2 trillion usd. The industry generates more than 15 billion usd per annum in income on behalf of more than 25,000 individual funds on a global basis. This figure does not include the income generated by intermediaries.

- The securities lending balances today are at least 50% below their peak, reached in May 2008 – We believe that it might take 3-5 years to reach such levels again.

- We would encourage caution about over-regulating an activity that has self-adjusted in scale so dramatically to world economic events – it might just be the right size.

- Recent history shows us that regulation made in haste, based on limited empirical evidence, is often regretted and can have unintended consequences that harm market efficiency and investors as ex-SEC Chairman Cox knew when noting the "greatest regret" of his tenure.

- With justification the US Government is now the largest player in the securities lending markets. When and how the Fed "withdraw" from this position to a more sustainable long term level may have a major bearing upon the repo and lending markets.

Information value

- The securities lending market can be an excellent proxy for short side activity but securities lending is **not** short selling and short selling is **not** securities lending. There might be no need to regulate both activities, one of them or neither of them more in the future.

- Investors benefit from making well informed decisions and short side intelligence is an excellent source of information. Some see the informed decisions made by those active in the short side of the market e.g. hedge funds as being the "canary in the coalmine" – offering early warnings and valuable insights at time of duress.

- Regulators too can benefit from understanding the short side of the market as argued by Anthony Bolton, President, Investments at Fidelity International in a 15th July 2009 Financial Times article – "that regulators should recognise the skill with which some hedge funds read the approaching disaster and try to learn something from them. The best hedge funds represent a body of well-informed investors who have done extensive work on the risks of both individual companies and the financial system as a whole."

Lessons Learned

- In light of recent events the securities lending business of the future will be more risk sensitive – focussing upon risk-adjusted returns not returns in isolation. Clients will demand this.

- Regulators should encourage investors and participants to share risk and return information and to quantify and understand risk positions better. Reporting needs to improve.

- Recent realised and unrealised losses have predominantly come from cash re-investment NOT securities lending.

- Securities lending is a term sometimes unintentionally used as a collective noun. "securities lending" is one transaction and "cash re-investment" is another – it is important not to combine two distinctly different activities under one banner.

- In Europe, Canada and elsewhere much of the securities lending market does not involve cash collateral or cash re-investment at all – thereby avoiding investor losses.

- Counterpart risk, as the Lehman Brothers default demonstrated, has typically been well managed by the securities lending industry using legal agreements, positive margins, tri-party services, collateral diversification, independent mark-to-markets etc. It is important to consider this risk in its proper context. It is possible that it is being overemphasised.

- An open mindedness from the regulators towards collateral flexibility might help the US market avoid past expensive mistakes.

- By encouraging cash as collateral the US regulators have inadvertently encouraged many practitioners to build cash balances which in turn have driven earnings in the "good times" and losses in the "bad times".

- This "encouragement" has distorted behaviour to the potential detriment of investors – many of whom unfortunately failed to understand the risks being taken in their name.

- Lending cross subsidisation between investors (intra and inter fund family) has crept into many business models and become almost unavoidable. "Volume lending" has lead in some circumstance to an inefficient allocation of business/balances/cash/risk and return.

- The securities lending industry, in common with many other areas of the financial markets, has historically exhibited too much dependency upon the rating agencies. We welcome your interest in the ratings agencies and expect new business models to develop over time.

Diversification

- The juxtapositioning of many bundled services within "super banks" e.g. custody, clearance, tri-party, collateral management, securities lending, prime brokerage, repo, cash management and execution has created a few organisations that are potentially "too big to fail" BUT they have also access to information that almost ensures that they do not - there are significant conflict of interest issues at stake here.

- In the future a potentially greater role for independent utilities and exchanges may need to be encouraged to ensure efficient markets can be maintained at times of increased stress.

- With the above in mind, more diversification of counterparts and independent collateral processors and providers rather than a concentration of services by a limited number of “super banks” might be a preferable future outcome.

Summary

- Securities lending is an integral part of the capital markets and not just about the support of short selling.

- There is a significant amount of transparency already available to investors, practitioners and regulators regarding securities lending and short selling.

- If there is one area that requires focus from all participants including the regulators – it is cash collateral and the subsequent cash re-investment. This is where the risk in the securities lending industry really lies and has manifested itself.

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