RMA Securities Lending Council

April 11, 2022

Via Electronic Submission

Re: File Number S7-05-22

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Comment Letter on the SEC's Proposed Rule to Shorten the Standard Settlement Cycle for most Broker Dealer Transactions to One Business Day after the Trade Date

Ladies and Gentlemen,

The Securities Lending Council (the "RMA Council") of the Risk Management Association (the "RMA")[1] appreciates the opportunity to submit this letter to the Securities and Exchange Commission (the "Commission" or "SEC") on behalf of the RMA's numerous members that participate in the industry as securities lending agents ("Lending Agents"), including some of the largest U.S. custody banks and asset managers. This letter addresses the Commission's (a) proposed amendment of 17 CFR § 240.15c6-1 ("Rule 15c6-1") to shorten the standard settlement cycle from T+2 to T+1 to promote investor protection, reduce risk and increase operational efficiency; (b) request for comment on the potential impact on compliance with Regulation SHO of a T+1 standard settlement cycle; and (c) request for comment regarding potential pathways to and challenges associated with achieving a T+0 standard settlement cycle (together, the "Proposed Rule").[2]

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1 The RMA Council acts as a liaison for RMA member institutions involved in agency lending functions within the securities lending industry by providing products and services, including hosting several forums, conferences, and training programs annually and sharing aggregate composite securities lending market data free of charge.

2 87 Fed. Reg. 10436 (the "Proposing Release")

General Considerations Related to Agency Securities Lending

Agency securities lending is a well-established, safe and sound activity that supports global capital markets activities and facilitates trade settlement. By effectively increasing the supply of securities available for these and other market activities, securities lending improves market liquidity and enhances price discovery.[3] Securities lenders ("Lenders") largely consist of buy-side entities such as public and private pension funds, mutual funds, ERISA plans, endowment funds of not-for-profit institutions, insurance companies, investment funds and other similar entities or funds into which such entities invest. Borrowers in securities lending transactions largely consist of broker-dealers, banks and other financial institutions.

Lending Agents act as intermediaries in securities lending programs by facilitating loans on behalf of Lenders to qualified borrowers ("Borrowers"). Securities are generally lent pursuant to (i) securities lending authorization agreements between Lenders and Lending Agents, and (ii) securities loan agreements ("SLA") between Borrowers and Lending Agents (acting as agent for Lenders as principals). Under the SLAs, in exchange for the loan of securities, Borrowers provide Lenders (generally, via their Lending Agents) with initial collateral worth more than the loaned securities, typically by 2% to 5%, depending upon the characteristics of the loaned securities, the collateral and other factors. The loaned securities and collateral are then marked-to-market daily to ensure that the collateral consistently meets the requisite value.

The length of the standard settlement cycle becomes an issue in the context of securities lending when a Lender sells a security that is on loan. At that time, the Lender must notify the Lending Agent of the sale so that the Lending Agent can either reallocate the loan to another lender or recall the loaned securities from the Borrower for delivery to the Lender in time to settle the sale. When the Borrower receives a recall notice from the Lending Agent, it will seek to source replacement securities to satisfy the delivery requirement. If the Borrower is unable to borrow the securities, it will be required to buy them in the market. All of this takes time, even in the most automated world, thus we ask that the SEC delay the effective date to late 2024 at the earliest.

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[3] Lenders use agency securities lending services from Lending Agents in order to obtain additional incremental revenues. Agency securities lending activities developed initially as an outgrowth of Lending Agents' custody and related activities, and have long been regulated, examined and treated by regulators as traditional banking services. *See, e.g.*, Securities Lending, Federal Financial Institutions Examination Council, Supervisory Policy (1985) (addressing appropriate regulatory guidelines for the growing securities lending industry); Letter from J. Virgil Mattingly, General Counsel, Board, William F. Kroener, General Counsel, Federal Deposit Insurance Corporation, and Julie L. Williams, General Counsel, Office of the Comptroller of the Currency ("OCC"), to the Securities and Exchange Commission (Dec. 10, 2002) (indicating that interagency guidelines "ensure that banks conduct their securities lending activities in a safe and sound manner and consistent with sound business practices, investor protection considerations and applicable law"); Bank of England, Securities Lending and Repo Committee, Securities Borrowing and Lending Code of Guidance (July 2009) (describing how securities lending transactions are regulated both under UK regulations and EU directives), *available at* http://www.bankofengland.co.uk/markets/Documents/gilts/stockborrowing.pdf; Directive 2004/39/EC, of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments, *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:145:0001:0044:EN:PDF.

The SEC's Proposal for a T+1 Standard Settlement Cycle

For many of the reasons set forth in the Proposing Release, RMA generally supports shortening the standard settlement cycle to T+1. Time to settlement determines a significant portion of a market participant's risk exposure to a given securities transaction, including the time by which it can access its sale proceeds. Accelerating the time to settlement will reduce credit, market, and liquidity risk. It will also serve to decrease the total number and market value of unsettled trades outstanding at any point in time, which should correspond with a reduction in the market participant's overall exposure to risk related to unsettled transactions. We further agree that acceleration of the standard settlement cycle to T+1 could increase the efficiency of capital market transactions and reduce systemic risk.

Along with the September 2017 implementation of the T+2 standard settlement cycle, the Commission asked market participants to continue to identify challenges to implementation of a T+1 settlement cycle. Progress has been made in identifying the technological and operational changes that such an acceleration of timing would require of market participants.

Not to minimize the potential benefits referenced above, in the DTCC White Paper referenced in the Proposing Release, DTCC stated that while accelerating the standard settlement cycle beyond T+2 may bring significant benefits to market participants, it also requires "careful consideration and a balanced approach so that settlement can be achieved as close to the trade as possible without creating capital inefficiencies or introducing new, unintended consequences— such as inadvertently reducing or eliminating the benefits and cost savings provided by multilateral netting.[4]"

Allocation and confirmation of institutional trades, trade documentation, global settlement and FX markets, corporate actions, prime brokerage services, settlement errors and fails, creation and redemption of ETFs, equity and debt offerings and regulatory requirements all factor into this careful, balanced approach generally and specifically, with respect to the securities lending market.

Shortening the standard settlement cycle to T+1 may increase the need for some market participants that engage in cross-border and cross-asset transactions to hedge risks that might arise from mismatched settlement cycles (T+1 in the U.S. and T+2 in Europe, for example). Additionally, because the FX market has a T+2 settlement cycle, those market participants may also be faced with a choice between bearing an additional day of currency risk due to the need to sell Euros as part of the transaction and using the forward or futures markets to hedge away this risk. In each of these examples, the mismatch in settlement cycles among the various jurisdictions results in additional costs to market participants.

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[4] DTCC, Advancing Together: Leading the Industry to Accelerated Settlement, at 2 (Feb. 2021) ("DTCC White Paper"), https://www.dtcc.com/- /media/Files/PDFs/White%20Paper/DTCC-Accelerated-Settle-WP-2021.pdf.

T+1 Impact to Timely Return of Securities on Loan

As far as operations and settlement errors are concerned, RMA agrees with the Commission that though a move to a shorter settlement cycle would likely bring with it a further incentive to automate processing, it may also exacerbate remaining operational risk, because market participants would have less time to resolve errors, particularly on the return leg of securities lending transactions. For example, if there is any error (i.e., incorrect quantity, settlement date or settlement instructions) in processing the return leg of a securities loan, including the sale details between the investment manager and the purchaser of the securities on loan, under a T+1 settlement environment, the parties would have one less day to resolve the error. Under these circumstances, a shorter settlement cycle may increase the probability that the error ultimately results in a settlement fail.

Whether the various participants in the securities lending market, including investment managers, custodians, Lending Agents and Borrowers, are able to efficiently process and communicate executed sale transactions of securities on loan will impact the success of an accelerated standard settlement cycle. Lending Agents depend on receiving prompt notifications from investment managers or custodians of executed sales of securities on loan. Upon receipt of that notice, Lending Agents determine whether they have sufficient supply of the security in their inventory or if they need to recall the security from a Borrower. If the latter, Lending Agents will seek to recall the loaned securities underlying the sale transaction as promptly as possible, in the best case early on the trade date of the sale transaction to minimize the risk of settlement failure on settlement date. To make this process as seamless as possible and to facilitate an accelerated T+1 standard settlement cycle, in addition to receipt of timely communication of the sale transaction, Lending Agents will need to employ automated processes for determining whether a recall is required. Recall notices will also need to be provided to Borrowers promptly, on an automated basis. These automated processes would likely involve enhancements through upgrades developed by vendors, such as Pirum, Loanet and EquiLend. And Borrowers will need to be able to electronically accept recalls and integrate them into their systems in time for the overnight, inventory calculation batch processing to put all parties in the best position for the Borrowers to source the securities and return them on the settlement date to prevent settlement failures.

Though RMA is supportive of moving to a T+1 standard settlement cycle, we want to highlight that, if implemented today, the technology and processes used by securities lending market participants would not be ready to successfully implement this new standard. A target of late 2024 is more realistic but will still be challenging given other competing demands for resources such as Proposed Rule 10c-1, should that be finalized and implemented.

The Impact of T+1 or T+0 on Regulation SHO

Under 17 CFR 242.200(g) ("Rule 200(g)"), a broker-dealer is required to mark all sell orders of any equity security as "long," "short," or "short exempt." Rule 200(g)(1) permits a broker-dealer to only mark a sale as "long" if the seller is "deemed to own" the security being sold under 17 CFR 242.200 (a) through (f) and the security either (i) is in the broker-dealer's physical possession or control; or (ii) is reasonably expected to be in the broker-dealer's possession or control by the settlement date of the security.

When the standard settlement cycle was T+3, the Commission advised that if a beneficial owner of a security that was on loan, was to sell that security and a bona fide recall was given within 2 business days after the trade date of the sale, then that beneficial owner would be "deemed to own" the security for purposes of Rule 200(g)(1), and the sale would not be treated as "short" for purposes of Rule 204. The Commission also stated that a broker-dealer may mark such orders as "long" sales if such marking also complies with Rule 200(c) of Regulation SHO, and the closeout requirements of Rule 204. In the case of a T+2 settlement cycle, Rule 204 would require delivery of the loaned securities into the sale by T+4 (T+2 plus a 2 day settlement cycle) in time to close out any fails on sales marked "long" by the beginning of trading on T+5. In a T+1 environment, such delivery period would be T+3 (T+1 plus a 2 day settlement cycle) to enable the broker-dealer to close out any fails on sales marked "long" by the beginning of trading on T+4.[5]

RMA agrees that if the standard settlement cycle is shortened to T+1, the requirements under Rule 200(g) may result in a change in the timing by which a broker-dealer would need to initiate a bona fide recall of a loaned security to mark the sale of such loaned, but recalled, security "long" for purposes of Rule 200(g)(1). We understand that some broker-dealers may have shortened the previous 3 business day recall period to 2 business days under the T+2 standard settlement cycle to ensure they are able to settle on the proper settlement date. If T+1 is imposed, the recall period would be even shorter (and broker-dealers could choose to further shorten it to one business day) – which may limit securities lending participants' ability to comply with these rules.

Should the implementation of T+1 result in any changes to Reg SHO, RMA recommends that the SEC guidance regarding classification of the sale of a security that is on loan as "long" remain unchanged.

<u>The Effects of Shortening the Settlement Cycle to T+0 on Securities Lending</u>.

RMA appreciates the SEC's thoughtful analysis of the challenges that it has identified as impediments to implementing a T+0 standard settlement cycle and its interest in finding ways to overcome those challenges to improve settlement efficiencies and reduce risks. Moving to a T+0 standard settlement cycle would raise significant challenges; challenges that are far more momentous than those the industry confronted by the move to a T+2 settlement environment or may confront in the move to a T+1 settlement environment. Processes such as trade reconciliations and exception management, and transactions with foreign counterparties (especially where time zones are least aligned) would need to be considered and revised. Payment systems used for final settlement would also require significant modification to enable transactions late in the day, past the close of business. And then, there is the not insignificant issue related to the intraday timing mismatch between the receipt of cash and the receipt of securities, which though present even today would likely be exacerbated by this change.

[5] <u>See</u> Proposing Release, at 99.

Currently available market infrastructure does not support a T+0 environment; the technology needed to upgrade the market infrastructure to provide such support does not exist today.

Set forth below are several of the questions the Commission has asked in Part IV.B.6 of the Proposing Release related to the challenges that might be faced by securities lending market participants in implementing T+0 and RMA's responses.

113. To what extent would shortening the standard settlement cycle to T+0 make it difficult for securities lenders to timely recall securities on loan?

To facilitate a T+0 standard settlement cycle and put all agency securities lending models (custody, third party and in-house lending) on the same footing would require the development and implementation of an infrastructure for real time communication between investment managers and all service providers, including, among others, custodians, fund accountants, and transfer agents. In addition, agency securities lending would benefit from ensuring that Lending Agents receive data on a par with other market participants so that they are able to provide broker-dealers with same day communication and settlement of recalls.

If a T+0 standard settlement cycle refers to instantaneous settlement, rather than same-day settlement, then Lenders would be required to provide third party Lending Agents and third-party advisers with prenotifications of their intent to sell securities that are on loan. Portfolio managers would likely be uncomfortable with providing this information outside of their 4 walls due to the concern that the information could be shared. As a result, it is possible that the availability of any given security would be restricted, reducing liquidity in the market, reducing price discovery and leading to wide fluctuations when there are large trades

If there were to be various settlement cycles for T+0, then the ability of Lending Agents to timely recall securities on loan would depend on the efficiency of the trade allocations and notifications by Lenders to the Lending Agents.

115. Please describe any technology changes that might be necessary to support securities lending operations of market participants if the settlement cycle were shortened to T+0. Please include in any comments descriptions of existing technologies that may help the Commission identify and understand the limitations, if any, of such technologies with respect to a T+0 settlement cycle.

RMA agrees with the SEC that if the settlement cycle was to be further accelerated to T+0, significant, expensive technological and operational changes would be required, including the re-engineering of securities processing, the overall modernization of the current-day clearance and settlement infrastructure, business model changes, revisions to industry-wide regulatory frameworks, and the potential implementation of real-time currency movements.

In addition, substantial improvement of current recall and return communication automation for Lenders and Borrowers facilitated by vendors would be required. Given that under such tight time frames there would likely be little appetite for bilateral recall processing, securities lending operations would require an increased adoption of automated solutions.

Lending Agents would need to be able to obtain, analyze, action, and transmit recall notices in real time, or even in advance of T+0. This would require significant investment by Lending Agents and Lenders. The framework for this improved infrastructure does not exist today; it would need to be completely re-designed not only based on each Lending Agent's systems but also based on necessary wider market infrastructure requirements.

116. With respect to stock loan recalls, are there ways to improve the level of coordination between investment managers and third-party lending agents for underlying funds, and to facilitate partial stock loan recalls from bulk lending positions aggregated from multiple institutional investors?

Whether a Lending Agent needs to issue a recall upon receipt of notice of a Lender's sale of securities on loan is based on whether the Lending Agent has inventory in the particular security. If the Lending Agent is able to reallocate the loan to another client, then the Lending Agent would not need to issue a recall. Partial stock recalls from bulk positions are no different from fully recalled positions. As noted in previous responses, how Lenders execute, allocate, and communicate sales of loaned securities to their Lending Agents is the biggest determinant of how quickly the Lending Agent can recall the security from the Borrower.

In a T+0 environment, wider adoption of standard processes and automated communication methods currently available would be needed by Borrowers, Lending Agents and investment managers. Though incremental improvement of current infrastructure may be sufficient to support a T+1 environment, it would not be sufficient to support T+0. As stated above, the necessary revisions to infrastructure to facilitate a T+0 environment do not even yet exist.

117. To what extent might securities lenders need to rely on predictive analytics to make decisions regarding which securities to recall before lenders can be sure such recalls will be necessary? What additional costs, if any, might be associated with the increased use of predictive analytics?

RMA believes that predictive analytics to determine when a Lender will sell is not appropriate and should not be developed. An asset owner should be very concerned if any third party could predict whatever internal methodologies are used to execute sales. These methodologies are proprietary and reverse engineering them to predict when a Lender is going to sell would be a breach of trust by a Lending Agent.

118. How might shortening the standard settlement cycle to T+0 impact market participants seeking to borrow securities in the U.S. markets? Please include discussion regarding the possible impact on market participants' ability to borrow securities that might be difficult to borrow.

Investment managers who view securities lending as important to their investment process will likely allocate resources to facilitate lending in a T+0 environment. This may result in differences in lending across managers. The securities lending industry would need to see the upstream improvements to the communication process to assess the impact to Lender and Borrower behaviour.

As previously noted, some Lenders might restrict a larger portion of their securities from being available to loan to ensure that they would have sufficient supply in the event they needed to sell. Any such restriction would likely harm liquidity, making more securities harder to borrow and resulting in less market discovery and longer fail periods for less liquid securities.

120. What impact, if any, would shortening the standard settlement cycle to T+0 have on the cost of borrowing securities in the U.S.?

As noted above, shortening the standard settlement cycle to T+0 would result in an increase in the cost to borrow securities in the U.S. as there would be significant infrastructure costs to prepare for such a change. It would not be unexpected for those costs to be shared among market participants, which could cause Lenders to re-think their participation in the purely voluntary securities lending market. Less Lender participation would result in less market liquidity, driving more securities into the "special" or "hard to borrow" categories.

122. To what extent might shortening the standard settlement cycle to T+0 reduce revenue securities lenders generate from loaning securities compared with a T+2 or T+1 settlement cycle?

If a T+0 standard settlement cycle was to be implemented without material changes to the existing communications, technological and operational infrastructures (which changes are not yet available or even in existence today), Lenders would need to be more conservative and implement additional restrictions and limits, resulting in a reduction in the supply of lendable securities, higher costs and lower revenue.

123. What impact, if any, might a T+0 settlement cycle have on overall liquidity in the U.S. markets if such a move were to reduce securities lending activity?

As noted above, implementation of a T+0 standard settlement cycle, without the necessary infrastructure changes may cause an increased risk of settlement failure from participation in securities lending which could have a chilling effect on participation, and, by extension, on liquidity. These factors could drive more securities into the "special" or "hard to borrow" categories.

Conclusion

We appreciate the opportunity to provide these comments and would be happy to engage in a more comprehensive dialogue with the SEC. We agree that shortening the standard settlement cycle to T+1, though challenging in and of itself, will promote investor protection, reduce risk and increase operational efficiency. However, market participants will need to invest in technology enhancements and process changes to avoid an increase in trades failing due to being on loan. Therefore, we urge the SEC to delay the effective date to late 2024 at the earliest. Without such a delay, Lenders may add restrictions or limits to their securities lending programs to avoid trade settlement fails. This in turn would reduce liquidity and lead to further trade settlement failures.

If desired by the SEC, the RMA Council would be pleased to meet with the SEC or its staff to assist the SEC in the development of any of the recommendations discussed in this letter.

Sincerely,

Fran Garritt	*Mark Whipple*
Director	Chairman
Securities Lending & Market Risk	Committee on Securities Lending
Risk Management Association	Risk Management Association