May 15, 2023

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

Re: Release No. 34-93613; File No. S7–18–21 Reporting of Securities Loans

Ms. Countryman:

The Securities Industry and Financial Markets Association ("SIFMA")[1] submits this additional comment letter to supplement our earlier comment letters[2] on the proposal by the Securities and Exchange Commission (the "SEC") to adopt Rule 10c-1 ("Proposed Rule 10c-1") under the Securities Exchange Act of 1934 ("Exchange Act").

Proposed Rule 10c-1 would for the first time implement a regime requiring the reporting of identifying data and material negotiated terms of securities lending transactions, as well as other securities lending market information, to a registered national securities association ("RNSA"), and the subsequent public dissemination by the RNSA of select securities lending transaction terms and market information.[3] We reiterate the recommendations we made in our prior comment letters, including our firmly held view that the SEC should not depart from its long standing practice of distinguishing short positions from securities loans for regulatory purposes. Instead, to avoid potential confusion and uncertainty, the SEC should make clear in any final rulemaking that short positions are not, and therefore should not be reportable as, securities lending transactions.

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] See (https://www.sec.gov/comments/s7-18-21/s71821-20111680-265019.pdf) and (https://www.sec.gov/comments/s7-18-21/s71821-20122364-278394.pdf).

[3] See Exchange Act Release No. 93613 (Nov. 18, 2021), 86 FR 69802 (Dec. 8, 2021).

As described in more detail below, we continue to strongly believe that the SEC should define what it means to "loan a security" under the Proposed Rule 10c-1 to be to "enter into a transaction in which one person, on behalf of itself or another person (the lender or the lending agent), will temporarily lend to a counterparty (the borrower) certain securities (i) pursuant to a written securities lending agreement, (ii) against a transfer of collateral, and (iii) documented as a securities loan on the lender's books and records."

<u>Shorts are not Carried on Broker-Dealer Books and Records as Securities Loans and have Different Economic Characteristics from Securities Lending Transactions</u>

Consistent with longstanding practice designed to comply with various important regulatory requirements, short sales settled by a broker-dealer are not documented or booked as a securities loan between the parties, and thus they should not be included as part of any securities lending reporting under Proposed Rule 10c-1. The terms governing short positions are determined by a brokerage account agreement as opposed to being governed by or subject to a written securities lending agreement, and are treated completely differently under the U.S. margin rules and customer asset protection rules. Further, short positions are neither carried on a firm's books and records as securities loans, nor treated as securities loans for financial reporting purposes or any other regulation applicable to securities loans (as further elaborated below).

Importantly, we further note that the pricing of securities lending transactions and customer short positions differ to such an extent that any reporting that includes both will prove unwieldy, inconsistent, unreliable, and potentially destabilizing. In longstanding industry practice, individual securities loans are generally negotiated and priced at rates that change over time as driven by supply and demand in the agent lender and broker dealer securities lending market. Conversely, broker-dealer short rates may reflect a pre-negotiated rate (for general collateral securities) or a transaction-specific rate (for non-GC securities). Importantly, these rates are based on a number of factors including that client's risk profile, credit worthiness, portfolio composition, and anticipated usage of resources including but not limited to, balance sheet and capital. In other words, client short rates are not necessarily tied to prevailing securities lending market rates and any effort to report them as similar or equal will pollute the data and confuse market participants.

<u>Current Regulation and Law Clearly Distinguishes between Securities Lending Transactions and Short Positions</u>

There have been long established distinctions under various regulatory regimes between securities loans and customer short positions held by a broker-dealer and governed by a broker's account agreement— including under the Dodd-Frank Act itself. For example, Dodd-Frank has separate provisions for short sale reforms and securities loan reporting (Section 929X [Short Sale Reforms] and Section 984 covering securities loan reporting.) Importantly, the SEC itself has recognized this distinction by proposing a separate disclosure regime for short positions under the authority of Section 929X (Proposed Rule 13f-2).

Additionally, short sales and short positions historically have been governed by regulations such as Regulation T, Regulation SHO, FINRA 4210 (Margin Requirements), FINRA Rule 4320 (Short Sale Delivery Requirements), and FINRA Rule 4560 (Short-Interest Reporting), whereas securities lending transactions have historically been governed by regulations such as FINRA Rule 4314 (Securities Loans and Borrowings) and FINRA Rule 4330 (Customer Protection—Permissible Use of Customers' Securities). Moreover, SEC Rule 15c3-3 (Customer Protection—Reserves and Custody of Securities) bifurcates the treatment of short positions and securities loans: for example, Rule 15c3-3(b)(1) and Exhibit A thereto (customer reserve formula) address the ability of a broker-dealer to deliver customers' "margin securities" (as defined in Rule 15c3-3(a)(4)) for settlement of a short sale, whereas securities lending transactions of "fully paid securities" (as defined in Rule 15c3-3(a)(3)) (as well as "excess margin securities," as defined in Rule 15c3- 3(a)(5)) are governed, separately, by Rule 15c3-3(b)(3) ().

In each of the regulatory regimes cited above, the differing treatment between securities loans and short positions is intentional given the uniquely different product characteristics, uses, markets, legal form, and market participants. Importantly, these clearly distinct markets, along with incompatible regulatory requirements would lead to very different types of answers to some items proposed to be reported under Proposed Rule 10c-1, and in some cases make it very difficult, if not impossible, for broker-dealers to supply information that is not misleading when combined as if they were the same product. Collateralization levels are the most obvious example of this: the securities lending market is almost universally collateralized at either 102% or 105%, while short positions are subject to Regulation T and FINRA Rule 4210, which impose far higher collateralization requirements.

<u>Failure to Distinguish between Securities Lending Transactions and Short Positions will Lead to Double Counting and an Inconsistent Gross Distortion of the Data Available to the Public</u>

If the short positions of a broker-dealer's customers were to be included as "stock loans," publication of collected transaction data under the Proposed Rule 10c-1 would essentially result in almost all external borrows by broker-dealers (from agent lenders or other broker-dealers) being "double counted" (i.e., the agent lender would be required to report the securities loan to the broker-dealer, and then the broker-dealer would also be required to report a "stock loan" to its customer who has a short position). Indeed, such double counting and possible inconsistent reporting would lead to publication of grossly distorted purported securities lending data, due largely to the long-standing common understanding of the distinctions described above. This would fundamentally mislead the public and the regulators about the securities lending market.

Specifically, Proposed Rule 10c-1 will result in a material miscounting of securities on loan. In the normal course of business, brokers can choose to internalize (the process by which one client's margin, or the broker's own, long position covers another client's short position) their customer shorts or choose to borrow externally from a lender. Normally, there is a combination of both, with overall levels of internalization varying materially among broker-

dealers and across individual securities. Proposed Rule 10c-1 ignores this common practice and will introduce significant confusion in the market.

For example, if a broker-dealer has a client that is short 100 shares of security XYZ, the proposal appears to contemplate that the firm report the 100 shares as a securities loan. If that broker-dealer chose to borrow shares from a lender to settle that customer short, the lender will also report a securities loan of 100 shares of XYZ. Alternatively, if the broker-dealer had partially internalized its customer short, it would still report 100 shares of XYZ as a loan, but the lender(s) would also report an amount somewhere between 1 and 99 shares, depending on how much the broker internalized. The consumer of this information will be left guessing which part of the reported numbers corresponds to an actual securities loan or a customer short, and consumers of the information, and in particular retail customers, may draw erroneous misleading conclusions. The proposal could result in duplicate, sometimes multiple loans being reported for the same shares. In other words, the proposal could lead to there being no reliable gauge, or even rule of thumb, to guide the public on the true securities lending volume. Rather, it will be pure guess work. The only way to avoid such confusion and to provide an accurate view of the securities lending market, and short sale volumes, is to follow Congress's legislative intent and report securities loans and customer shorts separately, as provided for under the Dodd-Frank Act.

Many of the Specific Reportable Elements are not Applicable to Short Positions and Further Distort the Data

As mentioned in our previous comment letters, the SEC's goal of increasing transparency in the securities lending market would not be achieved by reporting data that commingles (i) individual stock loans by agent lenders and inter-broker-dealers, where essentially all of the data elements proposed to be disclosed are individually negotiated, and (ii) customer short positions, where margin levels, rates, and other key elements are interdependent with multiple factors not feasibly captured in the data. Indeed, certain of the proposed data fields are simply incompatible with short position reporting. For example, the collateral amount and type for short positions will be a commingled pool of collateral supporting the aggregate extension of credit in the customer's account by the broker-dealer, inclusive of the client's other positions, rather than calculated solely on the customer's short positions, let alone on a single short position. Thus, treating short positions as being in the same data pool as securities lending transactions could lead to significant confusion and misinterpretation by the public. Additionally, as noted above, financing rates, including short position rates, are a primary way in which prime brokers charge clients for the overall suite of services they provide (e.g., clearing, settlement, custody, asset servicing, and financing) and do not reflect just the cost of the borrow. Short position rates also can vary based on credit counterparty risk assessments of the customer. These differences would make it extremely difficult for an end consumer to normalize the data.

Many of the granular reporting elements for securities loan transactions proposed by the SEC are not applicable to short positions, or do not apply to short positions in the same way as they apply to securities loans, and would necessarily lead to incomplete, inaccurate, and misleading data (e.g., percentage of collateral to value of loaned securities required to secure the

loan, type of collateral, and lending fee/rebate rate). As mentioned in our prior comment letters, short positions are fundamentally unsuited to a trade-by-trade reporting regime, and SIFMA's strong view is that incorporating short positions in the reporting regime with traditional securities loans would not only be inappropriate from a technical standpoint but also create confusion in the market given the many critical differences between short positions and securities lending transactions.

Unlike a securities loan, a customer short position is not a *transaction* entered into by two parties at a specific time. Instead, a customer short position is a *position* recorded in a customer margin account indicating the securities a customer is obligated to deliver to a broker-dealer when and if the broker-dealer were to demand such delivery. In essence, a customer short position is a *residual* balance calculated at a point in time that may have resulted from multiple transactions a client had conducted in its margin account (*e.g.* short sales; buy-to-cover trades; asset servicing/corporate actions events; and long and short position transfers in and out of the account).

Because of the nature of customer short positions being residual balances in a margin account, on an intra-day basis customer short positions are often incomplete, provisionally calculated, and not yet sufficiently finalized by the broker-dealer for short charges until the end of day on settlement date. Customers that trade short (*e.g.* hedge funds) often execute with brokers other than their prime brokers. Accordingly, the prime brokers often depend on their customers and third-party executing brokers to send information about already executed trades. The prime brokers then take in this information, record it in the customers' margin account and, when calculating the end of day settlement date position relevant for calculating short charges, add it to, or net it against, any start of day long or short settlement date positions in such account, any position transfers that day, and the processing of any relevant asset servicing events for that day. Under FINRA's current short position reporting rules carrying broker-dealers have multiple days after the reporting date to report aggregate short positions to allow sufficient time for the position data to be reasonably accurate and complete.

Consistent with the above description, this comment letter supplements our prior comment letters by illustrating in the chart below why many of the granular reporting elements for securities loan transactions proposed by the SEC are not applicable to short positions, or do not apply to short positions in the same way as they apply to securities loans, and would necessarily lead to incomplete, inaccurate, and misleading data.

Proposed Transaction Data Element	**Customer Short Position in a Brokerage Account**
Date loan effected	Not an insightful data element because short settlement date positions can go up and down day over day based on a myriad of transactions booked to the customer's account, some of which have offsetting impacts.

	Misleading data element because customers regularly transfer short positions across their carrying brokers for various reasons, but the client's overall short position across all brokers remains unchanged.
Time loan effected	Not meaningful data. Time of day would often not be knowable or meaningful to a carrying/clearing firm with respect to establishment of a customer short position, given that the carrying/clearing firm often first calculates a short settlement date position for rate purposes as of the evening of that settlement date after having recorded the effect of customers' trades, corporate action and transfer activities given up for the carrying firm to settle that day.
Platform or venue where effected if applicable	Not relevant. A short position is not effected on a venue; it is created in the carrying broker's books
Fee rate if not cash collateralized	Data not comparable. Rates are often agreed with client as "bundled rates" that are not bespoke to a single short position nor that distinguish between securities versus cash collateral.
Type of collateral	Not meaningful data. Collateral consists of an ever-changing pool of securities positions and/or cash balances in a client's account that securitizes the client's long and short side financing obligations and collateral is not separately identified as belonging to particular short positions or even to short positions in general.
Rebate if cash collateralized	Same as above for non-cash collateral line item
Margin percentage	Not meaningful data. Unlike the common 100, 102 or 105 margin %s for securities loans, margin % for short positions vary substantially across a broker-dealer's margin platforms (e.g., Reg T or Portfolio Margin accounts, arranged financing arrangements); and are often portfolio-based (*e.g.,* Portfolio Margin accounts) rather than position-based (*e.g.* Reg T). In addition, any transaction level reporting would be potentially misleading as it might not take into account, for example, portfolio level add-ons
Term date	Misleading data. Would reflect different information as compared to stock loan market. Term can mean different things in certain circumstances and forced standardization for reporting could lead to misleading and confusing data to the market.

We believe that this chart illustrates that many of the proposed data fields are simply incompatible with short position reporting. Thus, the proposed data elements in Proposed Rule 10c-1 do not make sense in the context of short positions and including them in the same data pool as securities lending transactions could lead to significant confusion and misinterpretation by the public.

To Avoid Adverse Unintended Consequences to Investors and the Markets, the SEC Should First Familiarize Itself with Data received by the RNSA During an Initial Phase of Reporting to Determine what Aggregated Data Should be Made Publicly Available in a Second Phase of Reporting.

We further note that recent market events, particularly with respect to meme stocks, have greatly heightened our concerns with the Commission's proposal to require the public dissemination of each securities lending transaction. Such information could be misinterpreted by investors and fuel speculative or baseless market sentiment that could lead to significant market disruptions and instability. For example, the disclosure of elevated increased securities lending transactions activity in the shares of a company under the proposal could lead individual investors to mistakenly assume that such company is in financial distress, creating a negative feedback loop amplified through social media. While our members remain concerned that in some situations the information could reveal unwanted information about proprietary trading strategies, they are also concerned that in other situations there is a real risk that investors will mistakenly misinterpret the data as revealing a trading sentiment that did not actually exist. False narratives spread through social media could impact markets based on erroneous assumptions about the data. Such a scenario is not outside the realm of possibility given individual investors' belief, as reflected in their comments on the proposal, that such disclosure reflects short activity in the company's stock, when in fact the securities loans could be occurring for a variety of reasons including borrowing to cure a broker's segregation deficiency in the security, satisfy delivery obligations, or support existing short positions previously supported by customer margin stock. The Commission can mitigate these risks and continue to satisfy its mandate under Section 984(b) of the Dodd-Frank Act by ensuring that, if any information that is provided publicly by the RNSA (after an initial phase-in which the SEC and FINRA gain familiarity with reported data) be limited to only aggregated securities lending data, including, among other things, a volume-weighted average borrowing fee aggregated across all firms for each security loaned. In its current form, the Commission's approach under the proposal could lead to unnecessary and potentially systemic market instability.

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SIFMA appreciates the opportunity to further expand upon the comments and recommendations made in our prior comment letters regarding Proposed Rule 10c-1. SIFMA thanks the Commission Staff for its consideration of our recommendations and would welcome

the opportunity to meet with the Commission Staff again to discuss our recommendations and any other aspects of Proposed Rule 10c-1. If you have any questions or require additional information, please do not hesitate to contact us by calling Rob Toomey at [redacted] or Joe Corcoran at [redacted].

Sincerely,

Robert Toomey
Head of Capital Markets
Managing Director & Associate General Counsel

Cc: The Hon. Gary Gensler, Chair
The Hon. Hester M. Peirce, Commissioner
The Hon. Caroline A. Crenshaw, Commissioner
The Hon. Mark T. Uyeda, Commissioner
The Hon. Jaime Lizarraga, Commissioner
Mr. Haoxiang Zhu, Director, Division of Trading and Markets