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Securities and Exchange Commission
100 F St. NW
Washington, DC 20549-9303
Rule-comments@sec.gov

Re: Reporting of Securities Loans

File No. S7-18-21, SR-NSCC-2021-803

Dear SEC:

In summary:

[1] All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. I am very grateful to Georgetown University for financial support. Over the years I have served as a Visiting Academic Fellow at the NASD (predecessor to FINRA), served on the boards of the EDGX and EDGA stock exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, other self-regulatory organizations, market makers, industry associations, and law firms. I am the academic director for the FINRA Certified Regulatory and Compliance Professional (CRCP®) program at Georgetown University. I've also visited over 75 stock and derivative exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest and well-diversified holdings in most public companies, including brokers, asset managers, market makers, and exchanges.

RIGHT ON!!!!!!!!!!!!!!!!!!

Introduction

The SEC is proposing to create a ticker tape for securities lending transactions to be run by FINRA.[2] With only a 15-minute delay, the general public would be able to see free information about the terms and conditions of securities transactions such as ticker, rate, term, etc. This would cover all securities, including not just NMS equities, but also OTC equities, and fixed income, along with all the bright shiny crypto thingies that the SEC thinks are securities. At the end of each day, information about total supply of lendable securities will also be collected. FINRA will collect additional information that it and the SEC can use for surveillance purposes. The SEC estimates initial setup cost for the industry alone at $375 million.

I strongly support this proposal for all of the reasons expressed in the proposing release. As has been seen in other markets, such as fixed income after the introduction of TRACE, increasing transparency in the securities lending market will reduce the price dispersion seen in the market. Better information about the price and availability of securities lending will allow asset owners (including the funds working for Mr. and Mrs. 401-k) to make sure that they are getting proper value for their securities lending. At the same time, it will be easier for borrowers to assure that they are getting a good price. It will also shed more light on the degree of short selling in the market.

<u>This proposal will help retail investors.</u>

I am a retail investor who sometimes engages in short selling, usually to hedge another position such as in a merger arbitrage or pairs trading transaction. The securities lending market is opaque to me, and it is difficult for me to obtain good information as to the cost of borrowing. I know what my broker is charging me, but I have no way of determining whether those fees are in line with the market or not. Is my broker getting best execution for me on stock loan? Sometimes I have serious doubts. Is 439.18% per year a reasonable fee rate for borrowing Pacific Gas and Electric Class A Preferred?[3] Without a way to cross-check what brokers are charging us, it is easy to assume the worst and believe conspiracy theories. Having freely available data, while it will be far from perfect, will be extremely helpful.

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[2] https://www.sec.gov/rules/proposed/2021/34-93613.pdf

[3] That is what my broker was quoting as of the first draft of this comment letter. It has since mysteriously dropped to a rate of 0.25% per year, which is my broker's standard fee for general collateral borrowing.

I also participate in my broker's fully-paid securities lending program. Again, it is next to impossible to judge whether my broker is doing a good job or not. Is my broker doing a good job of making my shares available? Are the returns I am getting reasonable? Again, having easy access to securities lending data will make it much easier to assess the quality of the services I am getting from my broker.

Another area of concern is the risk of being bought in involuntarily. Been there, done that, and have the tax loss to show for it. Public display of the aggregated once-daily data on inventory and utilization will help retail investors come to a better understanding of the risk of involuntary buy-ins.

This data will also be useful to investors who have no intention of ever shorting shares. Information about the cost of borrowing shares, like information about total short interest, can be useful in predicting future returns on securities. Large institutions can get this information for a price, but it is not available on reasonable terms to us little people.

Furthermore, the information will be useful to investors who may be interested in purchase-to-lend strategies. I note that some perfectly reasonable ETFs have rather high borrowing fee rates. For example, the Invesco FTSE RAFI 1000 US (PRF) has a fee of 23.77% as of this writing. An investor whose broker offers fully-paid lending may well want to consider the expected revenues from securities lending when selecting investments.

The information will help the beneficial owners of assets evaluate their stock lending programs.

As pointed out in the proposing release, some information about securities lending is available from data vendors – for a price. While some industry participants may claim that such data are readily available, there are gaps in the data. Not all institutional owners of securities are large enough to afford paying extra for data on sec lending, or expensive consultants to evaluate their sec lending programs. By making standardized data available for free, it will be much easier for asset owners, such as small institutions, to evaluate their stock lending programs.

Many things are unclear in the proposal.

My operations friends have pointed out many areas in which the proposal is not clear or problematic.[4] I suspect they will send in their own comment letters to which you should pay close attention. However, they may not have time due to the short comment period over the holidays and the large number of other rule proposals that are out for comment at this time. Thirty days (over the holidays) is really not enough

[4] I wish to think panel discussants at an event hosted by Georgetown University's Center for Financial Markets and Policy, for many of these ideas. The event is available at https://finpolicy.georgetown.edu/virtual-fmq-series-the-secs-proposal-for-securities-lending/. As always, my remarks, are my own and don't necessarily reflect those of the panelists or anyone else.

time for this proposal, especially since the SEC only took 11 years after its Dodd-Frank mandate to get this far, despite the two-year deadline in Dodd Frank.

For example, when and how are loans from customer margin accounts to be reported? It is not clear at all when such loans actually occur. A retail customer puts in an order to short a stock on date T for a stock on the easy to borrow list. The order is executed an hour later. A brokerage firm identifies a need to borrow on T+2, and notices that it has many shares available for lending from its customers' margin accounts. The shares are in "fungible bulk" and the broker makes delivery at DTC to settle its net delivery obligation. The firm may not even have identified which customer's shares are being loaned out when it makes its delivery. How should the broker report the lender of the shares to FINRA? Forcing firms to allocate stock loans in real time to customer margin accounts on a customer by customer basis could require costly system changes in many firms.

It could be that the brokerage firm may be a net recipient of shares on the settlement date due to the netting that takes place in the CNS system. If a broker's customers purchased in total more shares than they sold, then the broker will stand to receive shares at DTC on settlement date. Yet, some of the broker's customers may have gone short and the broker needs to borrow on their behalf. Assuming that the broker has shares available for lending from its customer margin accounts, it does not need to go out and borrow any more shares. When should such a loan be reported, if at all? When final settlement occurs? When netting occurs? Some other time? Some clarity with respect to when and how to report is essential.

Another example of lack of clarity is in the total supply of available shares. Many institutions participate in securities lending programs, but have limits on the total lending they can do. For example, the SEC staff prohibits mutual funds from lending out more than 1/3 of their total assets.[5] As long as their total

[5] The "rule" that a mutual fund may only lend out securities up to one-third of its net assets stems from a series of staff no-action letters going back to the 1970s. https://www.sec.gov/divisions/investment/securities-lending-open-closed-end-investment-companies.htm For example, see https://www.sec.gov/divisions/investment/noaction/1975/salomonbrothers040475.pdf and https://www.sec.gov/divisions/investment/noaction/1997/brinsonfunds112597.pdf. The one-third limit is totally arbitrary and makes no economic sense. As long as the securities can be recalled at any time from a credit-worthy counterparty, there is no reason that a fund should not lend out up to 100% of its securities. The one-third limit stems from an extreme interpretation of Section 18(f) of the Investment Company Act that generally restricts leverage in investment companies. The ancient staff interpretation was that the requirement to return collateral at the termination of the stock loan was in fact a loan to the fund and thus subject to the 300 percent asset coverage requirement in the Act. That is an extreme interpretation, as securities lending is very different from borrowing money to leverage up a portfolio. Even if such collateral were technically a loan, the SEC should use its broad exemptive powers to exempt securities lending from the limit. Fortunately, the one-third limit is not binding on most funds as there is generally an oversupply of securities to lend. It is mostly an unnecessary yet costly compliance burden with one more box to check for compliance. This limitation harms the shareholders of the fund by depriving them of the ability to earn additional sec lending revenue, while needlessly increasing compliance costs borne by the beneficial owners of the fund.

assets lent are under the limit, 100% of their shares in any particular stock are available for lending. Should the fund report 100% of that particular stock as available, or only 33%?

Rule 10c-1(d)(2) is vague in that the phrase "securities inventory" is not clearly defined. [6] Does that refer to securities owned by the broker-dealer as part of its proprietary trading, or securities owned by the broker-dealer's customers? Again, is a mutual fund's inventory 100% of available shares or 33%?

Provide clarity on crypto, OTC, 144A, munis, and other securities.

The proposed rules seem to provide for reporting on all securities. This presumably applies to so-called "digital asset" securities such as various crypto tokens. Such tokens generally don't have CUSIP numbers. How should securities without standard identifiers be reported?

Indeed, the crypto world is evolving financial products that provide many of the financial services provided by the traditional finance, or "tradfi" institutions. The "decentralized finance" or "defi" platforms are a prime example. If one "stakes" a security token in a defi platform, is that a reportable security loan? Clarity is needed, as it is in most of the crypto world.

The crypto world should NOT be exempted, but the rules should be applied in an appropriate way that does not provide an undue burden. However, please don't spend another decade of regulatory navel gazing in order to attempt to arrive at a perfect solution.

More clarity on types of loans would be helpful.

One of the major differences between sec lending and regular transactions is that securities lending is really a lending relationship with a strong credit component. Different lenders may command different terms at exactly the same time for what looks like the same loan, but could be very different. For example, one may see two demand loans on the same stock at the same time, meaning they can be recalled at any time. However, one is done by a market maker with a volatile inventory who may need to recall the stock quickly, which the other is from a stable index fund that is unlikely to recall the shares. Such differences in the probability of a recall can rightfully lead to differences in the prices borrowers are willing to pay to borrow the shares. However, these differences would not necessarily be reflected in the data proposed to be captured. Perhaps flags for the type of lender and type of borrower would make the data less vulnerable to misinterpretation.

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[6] Proposed 10c-1(d)(2) requires the reporting of "If the person lending securities is a broker or dealer and the borrower is its customer, whether the security is loaned from a broker's or dealer's securities inventory to a customer of such broker or dealer;"

Let non-FINRA members report without joining FINRA.

The SEC proposes that all reporting be done through FINRA members. The advantage of this is that it effectively delegates enforcement to FINRA and thus spares SEC's scarce resources. However, it is time consuming and expensive to become a member of FINRA. Furthermore, FINRA's primary regulatory focus is on brokers and dealers, and many FINRA rules are totally irrelevant to the firms that may be submitters to the reporting facility. It makes no sense to force non-FINRA members to put in a compliance infrastructure to document compliance with rules that don't apply to them. For example, non-FINRA submitters are not selling securities to the public and thus the communications with the public rules don't apply to them. The FINRA examiners may not be familiar with how the submitters are different from typical FINRA members. The submitters would have an unneeded compliance burden dealing with such exams and repeatedly educating each vintage of FINRA examiners on why most FINRA rules don't apply to them.

There is clearly an enforcement issue as to how to monitor reporting quality from non-FINRA submitters. FINRA can easily deal with enforcement issues through the contract that submitters would have to sign. The submitters would agree in the contract to have documented and enforced policies and procedures in order to submit accurate information in a timely manner, and to cooperate with FINRA in auditing the submitted data. FINRA would then submit evidence of violations to the SEC.

Let OCC and DTCC and other platforms be reporting agents.

As mentioned in the proposing release, the OCC operates two stock lending platforms. DTCC is launching its new Securities Financing Transaction (SFT) Clearing service. Platforms such as these could provide low-cost reporting solutions to market participants. The SEC should work closely with these institutions to determine whether the final rules could be done so that these institutions can do much of the reporting and thus reduce costs. [7]

Don't let repo be a loophole.

The proposal explicitly exempts repurchase (repo) agreements, which are very similar to securities lending transactions. Repurchase agreements are generally used to borrow or lend money for short periods of time. They are structured as a sale of a security with an agreement to repurchase the security at a slightly higher the price. The difference in price between the sale and the repurchase is the interest on the loan.

This is very similar to securities lending, in which the borrower of the security puts up cash collateral to the lender of the security. The lender of the security then does what they want with the cash collateral and typically rebates a portion of the interest earned to the borrower. In both sec lending and repo, there

[7] SR-NSCC-2021-803. I support the DTCC (NSCC) proposal and it should be approved without further delay.

is an exchange of cash for the security that is later reversed. The lender of cash in a repurchase transaction can do whatever it wants to with the collateral, including using it to settle a short sale, as long as it returns the collateral at the appropriate time.

The major difference between repo and sec lending is that repo deals are structured as purchase and repurchase transactions and not as loans and repayments. The intent is usually quite different: In sec lending, the focus is on obtaining a particular security such as borrowing to settle a short sale. In repo, the focus is on borrowing or lending cash. My understanding is that most repo collateral is general collateral; securities on “special” command a higher rate and are too valuable to use in generic repo transactions.

Despite these differences, one could easily dress up a sec lending deal as a repo in order to avoid reporting the terms of the transaction. This is a potential loophole that needs to be addressed. The final rule needs to define securities lending in such a way that it deters such evasion, while not ensnaring normal repo in the reporting requirements. I suggest a principles-based approach that would define any transaction for which the security involved would be used to settle a short sale or further loaned or repoed as a securities lending transaction, regardless of its repurchase classification.

Don’t micromanage the contract terms.

The proposing release asks about the details of the contractual terms between reporting agents and FINRA. PLEASE keep the final release more principles-based and let FINRA work out the details. FINRA has the experience, the resources, and the capability to do a good job, along with the flexibility to update the terms when needed based on experience. They can be trusted. The SEC has better things to do than micromanage the contract terms.

Data should be available indefinitely, or at least 10 years.

The proposing release does not clarify how long the data will be made available for free to the public. As this data will be useful for academic as well as practical use, ideally it should be made available indefinitely. At the very least, the final rule should specify a minimum length of time the data should be available for free on the web of at least 10 years. Ten years should be long enough to cover a complete market cycle along with some extreme events.

Redundant record keeping is unneeded.

FINRA already has the data. Why should the rules require that the reporting agent has to retain the data as well? This it totally redundant and unnecessary.

<u>Don’t require all borrowers to get an LEI. Retail doesn’t need them.</u>

Question 42 asks whether borrows without a Legal Entity Identifier (LEI) should be required to have one. NO. Most retails investors do not have an LEI, nor should we be required to get one. Regulators can easily identify who we are by going to our brokers.

<u>Please be more concise in rule proposals and adoptions.</u>

In recent years, SEC rule proposals and final adoptions have gotten longer and longer. In general, this is because they have been getting more and more repetitive, repeating the same things over and over again. As discussed above in the previous sentence, SEC rule proposals have been getting more and more repetitive, repeating the same things over and over again. Such unnecessary verbosity increases the burdens on all who read these things, including the staff who write and proofread and the Commissioners themselves.

This proposing release mentions the word “discussed” 67 times, usually in reference to something that has already been said or will be said. How can we get the SEC the bigger budget it so desperately needs when so much effort is squandered in such unnecessary redundancy?

Here are some examples:

as **discussed** more fully below. Private data vendors have attempted to address the opacity

As **discussed** above, certain institutional investors, including pension funds (which provide retirement benefits)

As **discussed** below, the existing data are not comprehensive or centralized, and there are

as **discussed** below61 in the format and manner required by the rules of the

As **discussed** further in Part VI, the securities lending market lacks public information regarding

as **discussed** in greater detail in Part VI.C.2, proposed Rule 10c-1

as **discussed** below in Part III.A.2.a), would relieve these smaller lending

as **discussed** below,75 the proposal would allow Lenders, including lending agents, who are

as **discussed** in Part VI below, the Commission could require that Lenders provide 10c-

As **discussed** throughout this release, the Commission preliminarily believes that FINRA is well-positioned

As **discussed** in supra Part II.A, certain digital platforms provide electronic trading in

as **discussed** below) from the RNSA, which would aid the Commission with its oversight

As **discussed** above, proposed Rule 10c-1(a)(1)(i)(B) and (a)(

As **discussed** throughout this release, to increase the transparency of information available to market

As **discussed** in detail below, paragraph (c) would only require that information about

As **discussed** below, proposed Rule 10c-1(d) requires the provision of certain data

As **discussed** in Part VI, the Commission preliminarily believes that the requirement to provide

as **discussed** in Part VI, the Commission also preliminarily believes that the requirement to

As **discussed** below, the Commission is not specifying the parameters of "the amount

Perhaps this is some lawyerly attempt to convince the courts that the SEC is actually checking all of the boxes in the Administrative Procedures Act needed to promulgate a rule. Are you that scared of the DC Circuit? Even if you are, do you think repeating the same thing 67 times will convince them? They aren't that stupid. My view of their decisions is that if the rules pass a common sense test, the court will keep them, and if not, hundreds of pages of duplicative repetition won't save them.

<u>Be reasonable on the time frame, but don't let the industry slow-walk this.</u>

As discussed above <SMILE>, there is a lot that is unclear with this proposal. I am sure that other commenters will raise many additional items that need clarification. The SEC should listen carefully to the industry comments in working out a reasonable time frame for implementation.

Despite my love for this proposal, I don't expect the industry to love it. The cost is large, and there is no upside in terms of revenue. The industry will rightly view this as a compliance tax. They will approach it with all of the eagerness of teenagers asked to clean up their room. As we have seen with TRACE and CAT, the industry will be in no hurry. They will raise delaying objections, some reasonable and some not so reasonable. I would do the same thing if I were in their shoes. Just delaying this a year or ten will have a measurable impact on this year's P&L.

It may be hard for regulators to discern which objections are reasonable and which are not. One reasonable concern is the limited technology bandwidth available in this time of skilled labor shortages and pandemic disruptions. Would you rather have the operations people involved concentrate on T+1, the interface with DTCC's new SFT, onboard multiple market data consolidators, or this? There are a finite number of trained operations people expert in these areas.

Phase the implementation to speed up implementation while reducing compliance costs.

The SEC should be reasonable on the time frame but not let this take another decade to put into action. One way to speed up implementation while dealing with the technology bandwidth issue is to phase the implementation in over time in three dimensions:

1. The first dimension is who reports, with larger market participants required to go sooner. I suspect that it will be fairly straightforward for OCC and DTCC to report more quickly than other entities. We users of the data will gain a lot of benefit quickly even if we only see a subset of the data. We learned in Stat 101 that one can get a good estimate of a parameter with only a statistically relevant sample of the data.
2. The second dimension is what is reported, as it may take longer to build systems to report certain data elements. Again, having even partial and messy data available will be a huge improvement over what we have (or more precisely, don't have) now. Different asset classes could be phased in at different times. Even though crypto should not be exempted, it would make sense to phase them in later while US regulators figure out how to regulate them.
3. The third dimension is on enforcement. There should be an explicit "no-action" policy with no fines for errors and omissions for several years for firms that are making a good-faith effort to comply and who self-report errors and omissions when they find them. This should result in less industry pushback as there will be less industry fear of big fines for honest mistakes.

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Respectfully submitted,

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