

Submitted Electronically

Jan. 7, 2022

Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

RE: Release No. 34-93613; File No. S7-18-21, RIN 3235-AN01

Proposed Rule: Reporting of Securities Loans

Ladies and Gentlemen:

Morningstar welcomes the opportunity to comment on the Securities and Exchange Commission's, or Commission, Proposed Rule on Reporting of Securities Loans, or Proposed Rule.¹ Morningstar's mission is to empower investor success. We collect data from Form N-PX to provide our clients with insight into the securities lending market and its impact on their investments and voting power. Securities lending data that would be collected under Proposed Rule 10c-1, if adopted, could be linked to Form N-PX to support further transparency into securities lending activities and how these activities impact a fiduciary's execution of its stewardship responsibilities when, for instance, securities are lent before a critical proxy.

Executive Summary

Morningstar appreciates and supports the Commission's intention to increase the transparency and available data of securities lending activities in which funds engage. The proposed availability of data-disclosing loans of securities and their negotiated terms, along with Form N-PX voting data, provides investors greater insight into how a fund's use of the securities lending market affects their voice in the corporate governance of fund portfolio companies.

In addition to the Commission's proposal requiring public disclosure of loan characteristics, we recommend the Commission publicly disclose the legal names of the parties to the loan. As noted in Morningstar's comment letter to the Commission's Form N-PX proposal,² transparency regarding a fund's stewardship responsibilities, such as voting proxies, requires tracking shares on loan and disclosing how a fund would have voted if shares were not recalled by the record date. In some instances, borrowers may have voting power if a fund does not recall shares to vote its proxy. By aggregating voting data from Form N-PX and securities lending information reported under Rule 10c-1, shareholders would gain a more comprehensive understanding of the stewardship and governance implications of securities lending activity.

¹ SEC. 2021. Reporting of Securities Loans. <https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf> (Proposed Rule).

² Morningstar. 2021. Form N-PX Comment Letter. <https://www.sec.gov/comments/s7-11-21/s71121-20109508-263896.pdf>.

Knowing the identities of the borrower and the lender allows investors to keep funds accountable for their stewardship promises and stated positions.

I. Morningstar supports the Commission’s proposed disclosure of data elements to the public.

In response to the Commission’s query of whether “all of the data elements in paragraph (b) be made public at the loan-level as proposed,”³ Morningstar answers in the affirmative. The loan-level disclosures will provide investors with a more transparent and complete depiction of a fund’s lending activities.

We support the Commission’s proposal to require loan-level data elements, including the legal name of the security issuer and the Legal Entity Identifier if applicable; the ticker symbol, International Securities Identification Number, Committee on Uniform Securities Identification Procedures, Financial Instrument Global Identifier of the security if assigned; the time and date the loan was effected; and the name of the platform or venue where executed, if applicable. As the Commission has recognized, requiring reporting of these proposed data elements will facilitate transparency in the securities lending market.

Morningstar agrees with the Commission’s proposal to require the negotiated material terms when effecting loans of securities. We believe the amount of securities loaned; the termination date, if applicable; and the borrower type—for example, broker, dealer, bank, customer, clearing agency, or custodian—provide insights to shareholders’ understanding of a fund’s lending activity. The proposed negotiated material terms, combined with Form N-PX voting data, help achieve the goals of the Proposed Rule by enhancing transparency and providing shareholders a broader and more comprehensive depiction of funds’ securities lending activity and the potential impact on their stewardship and governance responsibilities. Specifically, the amount of securities loaned, along with Form N-PX proxy voting data, will convey whether funds are exercising their voting responsibility on matters important to investors.

a. We recommend publicly disclosing the legal name of the parties to the loan to improve transparency of securities lending activity for investors.

The Commission asks whether “borrowers [should] be required to provide 10c-1 information instead of, or in addition to, Lenders providing such information.”⁴ Further, the Commission asks, “what other data elements should be included to increase transparency of securities lending.”⁵

As currently proposed, neither lender nor borrower will be disclosed to the public. Morningstar recommends that lenders be required to disclose the legal names of the parties to the loan as a loan-level data element available to the public. To use Form N-PX filings to determine if the

³ Proposed Rule, P. 69814, Q. 26.

⁴ Proposed Rule, P. 69808, Q. 4.

⁵ Proposed Rule, P. 69814, Q. 24.

lender or borrower voted, the legal name of the parties to the loan must be publicly disclosed. Thus, requiring the legal name of both parties will increase transparency regarding the impact of securities lending on a fund's stewardship responsibilities.

Knowledge of the parties to the loan may be critical for investors to understand securities lending activities. For example, funds may lend shares at the time of a critical proxy vote, denying fund shareholders of their corporate governance rights in the portfolio companies of the fund. Conversely, a borrower could also borrow to gain voting power. For example, a borrower, assuming it has enough scale to put up the collateral, may gain proxy voting power if a fund does not recall its shares at the record date. Generally, borrowers are short-sellers with different incentives than diversified long-term investors, which may cause securities lending to undermine systemic stewardship when lenders do not recall shares and, consequently, borrowers gain voting power. Borrowers may use this voting power to make changes in company management that may not be in the interest of long-term shareholders. Further, there may be instances where borrowers lend shares to others and consequently become lenders. As noted, investors would not have any way of tracking these patterns and consequences without reporting of the legal parties to the transaction.

Morningstar urges the Commission to require public reporting of the legal names to the parties to the loans for investors to properly understand the implications of securities lending. Through a registered national securities association, or RNSA, and the Commission's public reporting of such information, along with information from Form N-PX, investors will understand who is lending and borrowing, how often votes are not voted on by funds, whether votes are made by someone other than the original lending funds, and the implications of lending for stewardship and corporate governance.

Without the identities of lenders and borrowers, the Commission must release sufficient information to investors for determining whether problems exist within their funds' securities lending activities and create some means of holding funds accountable for the stewardship and corporate governance implications affecting investors. If the Commission does not require public disclosure of the legal names to the parties to the loans, then we recommend that detailed information about the fund type and borrower type be provided to the public by the RNSA. Subsequently, the Commission should provide the public with how often votes are not cast or cast by borrowers as a result of securities lending and how corporate governance is impacted generally by securities lending.

II. We support the Commission's proposed scope and timing around reporting of 10c-1 information to an RNSA.

In response to the Commission's question on the scope of persons required to provide securities lending information to an RNSA,⁶ we recommend that all persons who lend should be required to report. As some lenders may not be registrants, the public will not have a comprehensive picture of securities lending transactions if only those registered with the Commission are

⁶ Proposed Rule, P. 69808, Q. 1.

required to report to an RNSA. By requiring all persons who engage in securities lending to report, the public will obtain a well-informed view of the securities lending market from data that the RNSA releases.

We support the Commission's proposal to include all securities in the scope of the Proposed Rule. Including all securities is appropriate as 10c-1 will capture all lending activities, which provides comprehensive data to investors.

The Commission asks whether it should define what it means to "loan a security."⁷ Morningstar recommends that such definition be included. We suggest that, at a minimum, any time the lender loses the right to vote the securities during the time of the loan, the lender has "loaned a security." Additional circumstances may qualify as loans; we leave that to the discretion of the Commission.

a. We support the Commission's proposal to require timely reporting of 10c-1 information to the RNSA and the public.

We support the Commission's proposal to require reporting of loan-level data to the RNSA within 15 minutes after each loan is effected and of the negotiated materials terms to the RNSA by the end of each business day. The Commission's proposal of loan-level information within 15 minutes provides timeliness. As the Commission recognizes, the RNSA's free and unrestricted disclosures to the public increase transparency.

The Commission asks whether it should require a more definitive time frame than "no later than the next business day" for the RNSA to make information provided under paragraph (e) publicly available.⁸ Morningstar agrees with the Commission providing the RNSA a definite time frame. Making the information publicly available by the next business day is an appropriate time frame.

Conclusion

In summary, we support the Commission's intention to make the securities lending market more transparent for investors. We particularly recommend publicly disclosing the legal parties to the loan to make Rule 10c-1 more useful to investors. Requiring the legal name of both parties will increase transparency regarding the impact of securities lending on a fund's stewardship responsibilities. We support the Commission's proposal to require the negotiated material terms when effecting loans of securities. Specifically, the amount of securities loaned, along with Form N-PX proxy voting data, will help convey whether funds are exercising their voting responsibility on matters important to investors.

Regarding the RNSA's public disclosure of data elements under paragraphs (a) through (c), we recommend making the information public in a timely manner, such as by the next business day.

⁷ Proposed Rule, P. 69808, Q. 8.

⁸ Proposed Rule, P. 69813, Q. 23.

We thank the Commission for the opportunity to comment on the Proposed Rule. Should you wish to discuss any of the comments in this letter, please do not hesitate to contact Jasmin Sethi as indicated below:

Jasmin Sethi at [REDACTED] or [REDACTED].

Sincerely,

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