INVESTMENT COMPANY INSTITUTE

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January 7, 2022

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

Re: *Reporting of Securities Loans (File No. S7-18-21)*

Dear Ms. Countryman:

The Investment Company Institute[1] supports the objectives of the SEC's proposal ("Proposal"), which would require reporting of securities loans to the Financial Industry Regulatory Authority (FINRA), to provide investors and other market participants with greater market transparency and to facilitate regulatory oversight.[2] We do not support the Proposal as drafted, however, because it would not result in accurate, useful data that would help achieve the SEC's objectives. Further, the Proposal's impractical reporting obligations would result in increased costs that would undermine the important benefits of securities lending to funds and their shareholders.

As an initial matter, we urge the SEC to extend the comment period for the Proposal.[3] A 30-day comment period is too short for market participants to provide adequate feedback on this complex rulemaking, which would impose an entirely new regulatory framework with significant responsibilities on a range of participants in the securities lending market. We appreciate that the SEC is eager to complete the rulemaking, which was mandated by the Section 984 of the Dodd-Frank Act.[4] However, we strongly believe that, almost ten years after the rulemaking was due to

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[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of $32.3 trillion in the United States, serving more than 100 million US shareholders, and $9.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

[2] *Reporting of Securities Loans*, 86 Fed. Reg. 69802, 69804 (Dec. 8, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf ("Proposing Release").

[3] ICI recently joined other trade associations in requesting an extension of the comment period. *See* Letter to Vanessa Countryman, Secretary, Securities and Exchange Commission, from SIFMA, *et al.*, dated Nov. 23, 2021, *available at* https://www.sec.gov/comments/s7-18-21/s71821-9402961-262828.pdf.

[4] Section 984(b) of the Dodd-Frank Act mandated that the SEC "promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors with respect to the loan or borrowing of securities" within two years of the Act's enactment.

be completed, the SEC has an obligation to take the time necessary to complete the rulemaking in a thoughtful manner that will optimize the benefits of any securities lending reporting regime for market participants and regulators.[5]

In the absence of a longer period to comment, we are limited in our ability to provide detailed recommendations to improve the Proposal. Therefore, we identify below key issues and concerns for the SEC's consideration and provide some broad recommendations. We look forward to the opportunity to continue to engage with the SEC and its staff and provide more specific recommendations regarding these important issues.

I. Introduction

As the SEC recognizes, securities lending is an important tool for registered investment companies, including mutual funds, closed-end funds, and ETFs (collectively, "funds") to generate additional income for funds and add to fund returns, thus directly benefitting fund shareholders.[6] Securities lending also benefits the capital markets more broadly by making markets more liquid, resulting in lower trading costs to market participants, including funds, as a result of reduced bid-ask spreads.

Funds are among the most conservative of securities lenders, operating under strict regulatory limits imposed by the SEC and its staff, including:[7]

- *Express limit on lending.* A fund may not have on loan at any time securities representing more than one-third of the fund's total value.[8]

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[5] The Dodd-Frank Act does not specify the details of the rules that the SEC is directed to promulgate pursuant to Section 984, only that they be "designed to increase the transparency of information available to brokers, dealers, and investors with respect to the loan or borrowing of securities." Thus, the SEC has significant discretion to promulgate a rule that meets Congress' objectives, provides useful information to market participants, and benefits investors, including fund shareholders.

[6] *See, e.g.*, Proposing Release at n.25 and accompanying text; Peter Bassler and Ed Oliver, Securities Lending Best Practices: A Guidance Paper for Institutional Investors (2018), *available at* https://www.eseclending.com/resources/eSecLending-Best-Practices.pdf; ICI Viewpoints, Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: The Basics (2014), *available at* https://www.ici.org/viewpoints/view_14_sec_lending_01 ("ICI Viewpoints on Securities Lending").

[7] For a summary of these restrictions, please see ICI Viewpoints on Securities Lending.

[8] This restriction stems from Section 18 of the Investment Company Act of 1940 ("1940 Act"). We note that certain securities lending arrangements may be deemed to be "similar financing transactions" under rule 18f-4 under the 1940 Act. *See Use of Derivatives by Registered Investment Companies and Business Development Companies*, Release No. IC-34084 (Nov. 2, 2020) ("Rule 18f-4 Adopting Release"), at 223-24, *available at* https://www.sec.gov/rules/final/2020/ic-34084.pdf. Rule 18f-4 permits funds the option to treat similar financing transactions as "derivatives transactions" under the rule subject to additional limitations that address Section 18's asset sufficiency and leverage concerns, rather than including such transactions in the fund's asset coverage calculations. *See, e.g.*, Rule 18f-4 Adopting Release at 213. *See also* rule 18f-4(d) under the 1940 Act.

- *Termination and recall rights.* A fund must be able to terminate a securities loan at any time and recall the loaned securities within the ordinary settlement cycle.
- *Collateralization.* A fund must receive collateral equal to at least 100 percent of the value of the securities on loan. In practice, funds typically require 102 percent collateral for domestic securities and 105 percent for international securities. Because loaned securities must be available for recall on short notice, the collateral that funds can accept from borrowers must be highly liquid, such as cash, government securities, or bank letters of credit.
- *Daily mark-to-market valuation.* The value of the securities on loan must be marked to market every day. Collateral levels are adjusted every day and cash flows between the fund and the borrower to ensure that the 102 percent or 105 percent levels are maintained. Thus, if the value of the securities on loan increases, the borrower must provide additional collateral.
- *Conservative investment of cash collateral.* Cash collateral should be invested in instruments that produce reasonable interest for the loan but also give maximum liquidity to pay back the borrower if and when the loan is terminated. In practice, funds most often invest cash collateral in money market funds.
- *Reasonable return.* A fund must receive a reasonable return on the loan, including any income from the loaned securities, such as dividends.
- *Board oversight.* A fund's board, including its independent directors, must approve the fund's securities lending policies. Board-approved procedures will establish the parameters for the lending program, such as approved borrowers and the terms of lending agent compensation. The board also oversees the securities lending program, periodically reviewing the appropriateness of those policies and the program's performance and costs.
- *Restrictions on the use of affiliated lending agents.* A fund may not use an affiliate as its lending agent without SEC approval, either under a no-action letter or an exemption. This approval, when granted, includes additional conditions to protect fund shareholders.

ICI supports transparency of key data about securities lending activity, which may be useful to market participants and regulators. As the SEC acknowledges, funds already provide extensive reporting and disclosure regarding their securities lending activities. Currently, a fund must:

- Disclose in its registration statement information about the fund's income and fees or compensation related to its securities lending activities, and services provided by securities lending agents, during the fund's most recent fiscal year.[9]
- Identify in the fund's financial statements, which are filed with the SEC and sent to shareholders twice each year, any securities out on loan, investment of cash collateral received, a liability reflecting the obligation to return the cash collateral at the conclusion of the loan, and income earned from securities loans.[10]

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[9] *See, e.g.,* Item 19(i) of Form N-1A. *See also* Item 12 of Form N-CSR (requiring disclosure about securities lending activities by closed-end investment companies).

[10] *See* Rule 6-04 of Regulation S-X; FASB Accounting Standards Codification Topic 860-30-25-6 through 860-30-25-8.

- Report on Form N-PORT, which is filed with the SEC and is publicly available, the fund's securities on loan, collateral received, and the borrowers of those securities.[11]
- Report on Form N-CEN, which is filed with the SEC and is publicly available, the fund's securities lending agents, compensation types paid to securities lending agents, and whether the securities lending agent or another party has agreed to indemnify the fund with respect to securities lending losses.[12]

II. Reporting Party

The Proposal contemplates a single-sided reporting regime in which securities lending agents[13] or broker-dealers that serve as "reporting agents," for purposes of proposed rule 10c-1, would have the primary obligation to report.[14] Beneficial owners that do not employ a lending agent or enter into a written agreement with a reporting agent would be responsible for complying with the requirements of the proposed rule themselves.

Funds, as beneficial owners engaging in securities lending, are likely to use a securities lending agent or, potentially, a reporting agent, to satisfy rule 10c-1's proposed reporting obligation. We therefore agree with the SEC that these entities typically are best positioned to report securities lending data to FINRA.[15] Unlike funds, they have direct access to the underlying data and may already be reporting securities lending data to clients and vendors.[16] If the SEC instead were to impose the reporting obligation directly on the beneficial owners, funds likely would delegate to securities lending agents or reporting agents. It is therefore clearer and more efficient to impose the obligation directly on these entities, when the conditions of the proposed rule are satisfied.[17]

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[11] *See* Items B.4 and C.12 of Form N-PORT. With the exception of certain non-public information reported on Form N-PORT, the information reported on the form for the third month of each fund's fiscal quarter is made publicly available upon filing.

[12] *See* Item C.6 of Form N-CEN.

[13] The proposed rule contemplates securities lending agents that are banks, clearing agencies, or broker-dealers.

[14] To use a reporting agent under the proposed rule, a lender must enter into a written agreement with the reporting agent that includes terms specified in the proposed rule, and provide the reporting agent with timely access to the information required to be reported. The reporting agent would be required to establish, maintain, and enforce written policies and procedures reasonably designed to ensure its compliance with proposed rule 10c-1 and maintain books and records regarding the securities lending information it reports. The reporting agent would be required to provide FINRA with a list of each beneficial owner or lending agent on whose behalf it is reporting securities lending information and update the list by the end of the day when the list changes.

[15] We believe that it is important, however, for the SEC to not lose sight of the equally important role played by the borrower community in the structure and operation of the securities lending market.

[16] We understand, however, that not all securities lending agents have direct connectivity to FINRA. Thus, under the Proposal, these lending agents would either have to update their systems to provide for such connectivity or enter into an agreement with a reporting agent to report the proposed data.

[17] *See supra* note 14.

We urge the SEC, however, to not limit permitted “lending agents” for purposes of the rule to banks, clearing agencies, brokers, or dealers, as proposed, but instead permit any lending agent that acts as an intermediary to a loan of securities to report on behalf of a beneficial owner. Broadening the proposed rule in this manner would more accurately reflect the variety of lending agents that funds use, which are not limited to broker-dealers and banks. As long as a lending agent is able to satisfy the requirements of the proposed rule,[18] we believe there is no reason to limit lending agents to certain entities. Rather, we believe expanding the rule in this manner would facilitate reporting by beneficial owners that prefer to use non-broker-dealer lending agents to report their securities loans.

Furthermore, we strongly support the Proposal’s approach of requiring single-sided reporting, rather than requiring both lenders and borrowers to report on the same transaction. We agree with the Commission that this approach would reduce the potential for double counting of securities lending transactions and limit the burden on lenders. A single-sided reporting regime avoids problems with reconciling reports by each party to a transaction, particularly when the parties’ reports do not match due to reporting differences or errors.

III. <u>Reporting Time Frame</u>

Proposed rule 10c-1 would require the reporting of the material terms of a securities loan to FINRA within 15 minutes of a loan “being effected” or modified. This reporting time frame is not feasible and does not reflect how the securities lending market operates.[19] The SEC bases its proposed reporting regime for securities loans on FINRA’s TRACE reporting regime for corporate fixed-income securities which, similarly, requires reporting to FINRA of transactions within 15 minutes of execution.[20] For the reasons described below, this analogy is misplaced.

The SEC explains that “a loan would be effected when it is agreed to by the parties” and “would be modified when the modification is agreed to by the parties.”[21] Unlike transactions in the cash markets, such as equities and fixed-income securities, securities loans do not involve an outright purchase or sale. Furthermore, the terms of the securities loan are typically negotiated throughout the course of the day and often are not finalized until the end of that day or, potentially, the following business day. Thus, any information reported within 15 minutes would be misleading to investors, as it would not reflect final terms. The securities lending market is not characterized by substantial intraday activity and any intraday modifications to loan terms are unlikely to be

[18] *See* proposed rule 10c-1(a)(i).

[19] The SEC’s understanding of the securities lending market structure also appears to be inaccurate in certain other respects. For example, proposed rule 10c-1 requires, for a cash collateralized loan, reporting of the rebate rate or any other fee or charges. In fact, the relevant data point is the lending spread to the reference rate (most commonly the Overnight Bank Funding Rate), as the rebate rate will change daily based on the current level of the reference rate, even as the negotiated lending spread remains fixed.

[20] *See*, *e.g.*, Proposing Release at 69837 and 69846. FINRA Rule 6730 requires that most fixed income securities be reported to TRACE within 15 minutes of the time of execution.

[21] Proposing Release at 69812.

meaningful to market participants, but instead would result in meaningless "noise" that does not reflect the final terms of a loan. Reporting within 15 minutes also would significantly increase the risk of reporting incomplete data, or data that subsequently may prove to be inaccurate and, in either case, may unnecessarily result in the need to report a modification.[22]

For these reasons, we recommend that the SEC require the reporting of all information required by the rule by the end of the following business day. Reporting on a T+1 basis is consistent with the EU's approach under SFTR,[23] and would result in significantly more accurate and meaningful data. If the SEC nonetheless believes that reporting should take place earlier, it should be no earlier than the end of the business day the securities loan is effected, in which case the SEC should provide clarity regarding the time frame for such reporting, to ensure it is feasible.

IV. Scope and Applicability of Rule

A. Scope of Reporting

The proposed rule would require reporting of loans with respect to all securities.[24] The reporting obligation would appear to apply potentially to all types of securities lending arrangements, not limited to traditional securities loans.[25]

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[22] We acknowledge that some data vendors make certain information about securities loans available in 15 minute increments. This is not a basis to require reporting to FINRA within 15 minutes, however. First, reporting to data vendors takes place on a voluntary basis and includes limited data elements. Second, this data is not made publicly available, but is only made available to those who subscribe to receive this data. And third, and most importantly, it is well understood by market participants who subscribe to these data services that intraday data may be incomplete and is subject to change.

[23] SFTR requires reporting to trade repositories or, where a trade repository is unavailable, to the European Securities and Markets Authority (ESMA). SFTR does not require that the data be reported publicly, although it does require managers of investment funds including UCITS and AIFs to report to investors on their use of securities financing transactions (SFTs) and total return swaps in disclosure documents and certain periodic reports. *See* Sections A and B of Annex to SFTR. The UK adopted its version of SFTR that has applied since the end of the Brexit transition period that is similar to the EU's SFTR, but the UK decided not to impose reporting obligations on non-financial counterparties (NFCs) which had been due to apply from January 2021. The UK did not require NFCs to report on the basis that systemically important NFC trading activity is captured sufficiently through the other reporting obligations that apply to financial counterparties. *See* Financial Conduct Authority, UK Securities Financing Transactions Regulation (UK SFTR), *available at* https://www.fca.org.uk/markets/sftr; Written Statement by Rishi Sunak, UK Chancellor of the Exchequer, Financial Services Updated made on 23 June 2020, *available at* https://questions-statements.parliament.uk/written-statements/detail/2020-06-23/HCWS309.

[24] Proposing Release at 69808.

[25] Proposing Release at 69810, 69846. We note that traditional securities loans include, but are not limited to, those made pursuant to industry-standard documentation, such as the Master Securities Loan Agreement (MSLA). The MSLA governs traditional securities loans against a transfer of collateral. *See* Master Securities Loan Agreement, *available at* https://www.sifma.org/wp-content/uploads/2017/06/MSLA_Master-Securities-Loan-Agreement-2017-Version.pdf (2017 version).

First, we urge the Commission to limit the initial rollout of any final rule to loans of US-listed equity securities, and evaluate whether to expand the reporting obligation to additional asset classes, as appropriate. Implementing the Commission's securities loan reporting regime will be a tremendous undertaking, both for FINRA and for market participants. Similar to the approach taken in the context of other substantial new reporting obligations, the SEC should begin by requiring reporting of loans with respect to a subset of securities. Once market participants and FINRA have gained experience with this reporting, the SEC could consider expanding reporting obligations to additional asset classes, as appropriate. This approach is consistent with FINRA's historic approach to TRACE reporting.[26]

Second, we recommend the SEC make explicit within any final rule the types of securities loans to which rule 10c-1 applies so that market participants have clarity as to which types of securities loans must be reported. Our understanding from the Proposal is that the SEC is primarily interested in greater transparency of data about traditional securities loans. Requiring data to be reported about lending arrangements that have very different characteristics may not result in useful information to regulators or market participants, to the extent it would add unhelpful "noise" to the data reported.

B. Clarify Cross-Border Implications of Proposal

We encourage the SEC to analyze and clarify the cross-border implications of any final rule. Based on the legislative history of Section 984 of the Dodd-Frank Act[27] and the Commission's statements in the Proposal,[28] the intent of proposed rule 10c-1 appears to be to increase transparency of securities lending information with respect to the *US markets* for the benefit of *US brokers, dealers, and investors*. This is not clear from the Proposal, however, which appears to have a broad reach, as it would define "lender" as "[a]ny person that loans a security on behalf of itself or another person . . ." The Commission explains that it intends this definition to include all lenders, including entities not subject to SEC oversight.

Based on the Commission's broad approach, it is unclear whether the proposed rule potentially could apply to non-US entities, including UCITS and similar funds that are subject to reporting of their securities lending transactions under SFTR.[29] To ensure that the rule does not have

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[26] *See, e.g., Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change Relating to TRACE Reporting and Dissemination of CMO Transactions,* Release No. 34-78925 (Sept. 23, 2016), *available at* https://www.sec.gov/rules/sro/finra/2016/34-78925.pdf.

[27] *See e.g*., 155 Cong.Rec.H. 14418, 14420 (daily ed. Dec. 9, 2009) (Congressman Kanjorski, chairman of the Capital Markets Subcommittee, noted that "the Investor Protection Act of 2009-a key part of H.R. 4173- contains more than six dozen provisions aimed at strengthening the oversight of *U.S. securities markets* and closing regulatory loopholes.") (emphasis added).

[28] *See, e.g.,* Proposing Release at 69803 ("The value of securities on loan in the *United States* as of September 30, 2020, was estimated at almost $1.5 trillion. Yet, despite its size, the securities lending market in the *United States* has a general lack of information available to *its market participants, the public and regulators*.") (emphasis added and internal citations omitted); *id.* at 69830 (discussing securities lending practices in the United States).

[29] As noted above, however, SFTR does not require public reporting. *See supra* note 23.

inappropriate extraterritorial reach, the Commission should explicitly clarify the cross-border application of any final rule.

C. Clarify Reporting Obligations

More generally, the Commission must ensure that any final reporting regime provides the clarity and certainty that market participants will need to comply and report accurately. Under proposed rule 10c-1, the SEC would establish the basic parameters of the proposed securities lending reporting regime and FINRA would engage in a separate rulemaking regarding its administration of the collection of data required by the rule. Certain aspects of the Proposal, however, are vague or unclear. For example, there is a lack of clarity in the Proposal regarding the concepts of "lender," "beneficial owner," "lending agent," and "reporting agent." Given that, in most instances, the reporting obligation will be on the lending agent or reporting agent, the Commission should ensure that these terms are defined and used clearly in any final rule to avoid suggesting regulatory obligations where they do not exist. It is important for the SEC or FINRA, in its rulemaking, to address these and other issues in advance of finalizing a securities lending reporting regime to avoid ambiguity that may result in disparate reporting.

V. <u>Securities Available to Lend</u>

The Commission should modify the proposed rule's requirement to report, as of the end of the day, the "total amount of each security that is not subject to legal or other restrictions that prevent it from being lent ('available to lend') . . ."[30] The Commission proposes that this information be publicly reported, in conjunction with the total number of shares on loan, to allow market participants to calculate a "utilization rate" for each security that could help evaluate whether the security will be difficult or costly to borrow.[31] We are deeply concerned, however, that reporting based on the Commission's proposed definition of "available to lend" does not reflect the regulatory restrictions to which funds are subject under the 1940 Act[32] and would result in an inflated estimate of supply.[33] Reporting this information would be misleading to market participants and could discourage beneficial owners from lending due to an inaccurate perception of the supply of securities "available to lend."

[30] Rule 10c-1(e), as proposed.

[31] Proposing Release at 69817.

[32] Because of the restrictions under Section 18 of the 1940 Act, a fund may not have out on loan at any time securities representing more than one-third of the fund's total value. *See supra* note 8.

[33] The utilization rate would be calculated by dividing the total number of shares on loan by the total number of shares available for loan. The Commission acknowledges that some securities lending programs may be subject to overall portfolio restrictions but because those restrictions apply to the overall portfolio but not the specific securities held in those portfolios, those securities would be available to lend unless the securities are themselves subject to restrictions that prevent them from being lent. Proposing Release at 69817. As explained above, we are concerned this definition would result in an inflated number of securities available to lend in the market.

For these reasons, we recommend that the Commission not require reporting of securities "available to lend." This measure is overinflated and, as such, could be misinterpreted by market participants. If the Commission nonetheless believes this is necessary information for FINRA to have in connection with its regulatory oversight role, we urge the Commission to require that securities "available to lend" be reported only to FINRA and that FINRA would not make the information public, similar to the proposed rule's approach with respect to certain other data elements.

VI. Cost-Benefit Considerations

While we appreciate that the SEC is promulgating proposed rule 10c-1 pursuant to the requirements of the Dodd-Frank Act,[34] it is unclear whether or to what extent any final rule would provide the benefits the SEC cites. We believe a proposed rule of this magnitude should be based on a firmer analytical foundation and, critically, must take into consideration the considerable costs to fund shareholders.

The SEC states that it:

> . . . preliminarily believes that the data collected and made available by the proposed Rule would improve price discovery in the securities lending market and lead to a reduction of the information asymmetry faced by end borrowers and beneficial owners in the securities lending market. The Commission preliminarily believes the proposed Rule would close securities lending data gaps, would also increase market efficiency, and lead to increased competition among providers of securities lending analytics services and to reduced administrative costs for broker-dealers and lending programs.[35]

The Commission further states that disclosing the material terms of securities loans:

> . . . might improve the efficiency and resiliency of the securities market by reducing frictions in the cost of borrowing securities, which may also have positive effects on the markets for the securities themselves. Additional benefits from increased transparency could include increased savings and profits for investors, improved terms for beneficial owners participating in lending programs, and improved competitiveness in the lending agent and broker-dealer businesses.[36]

The potential benefits the SEC identifies appear to be speculative, at best, and it is fundamentally unclear from the Commission's analysis who, other than FINRA and the SEC, will clearly benefit from reporting of this data.[37]

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[34] *See supra* notes 4-5.

[35] Proposing Release at 69804; *see id.* at 69830.

[36] *Id.* at 69804; *see id.* at 69838.

[37] *Id.* at 69840.

The SEC notes the direct costs of rule 10c-1 to FINRA, as well as direct compliance costs for entities to report to FINRA, including the reporting fees that FINRA will impose. The SEC acknowledges that these compliance costs may be passed on to end customers in the form of increased fees for broker-dealer or lending program services.[38] We believe this analysis is incomplete.

Nowhere does the Commission consider that fund shareholders will absorb part of the substantial costs of rule 10c-1. This outcome should be a key consideration in the Commission's analysis. Securities lending is an important and beneficial source of income to fund shareholders. The rule would require FINRA to develop, build, and oversee a complex new reporting system for securities loans. The considerable costs of building and operating this reporting system can be expected to be passed on to entities required to report under rule 10c-1.[39] Furthermore, lending agents and reporting agents undoubtedly will incur substantial costs to build out the reporting systems and connectivity necessary to provide the many data elements envisioned in the Proposal, enter into or amend agreements with beneficial owners, vendors or others, and develop compliance and risk oversight. Lending agents and reporting agents can be expected to pass such costs on to their customers. As a result, these costs ultimately will come directly out of the pockets of beneficial owners, including funds and their shareholders, to the detriment of their long term interests. Such costs may result in higher costs to administer a securities lending program or the potential decision by a fund that it no longer is economically worthwhile to operate a securities lending program, in either case lowering fund returns for shareholders. The Commission should explicitly account for these costs in its economic analysis.

VII. <u>Confidentiality Concerns</u>

As proposed, lenders would be required to report most of the data elements required by rule 10c-1 to FINRA within 15 minutes of a securities loan being effected or the terms of the loan being modified.[40] FINRA would then make this information public as soon as practicable. Lenders

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[38] *Id.* at 69830.

[39] Given that the proposed reporting system is intended to benefit borrowers, as well as lenders and other market participants, we urge the SEC to require FINRA to impose the costs of building and operating the reporting system equally on lenders and borrowers, instead of solely on lenders.

[40] Terms that would be reported for a securities loan include:

- Legal name of the issuer of the securities to be borrowed and the LEI, if any;
- The ticker symbol, ISIN, CUSIP, or FIGI of the security, if assigned, or other identifier;
- Time and date of the loan;
- Name of the platform or venue, if one is used;
- Amount of securities loaned;
- Rates, fees, charges and rebates for the loan as applicable;
- Type of collateral used to secure the loan and the percentage of the collateral provided to the value of the loaned securities;
- Termination date of the loan, if applicable; and
- Borrower type, e.g., broker, dealer, bank, customer, clearing agency, custodian.

would report additional loan terms, including the identities of the parties to the loan, to FINRA, but FINRA would not make this information public. The proposed rule also would require that, by the end of each business day, a lender report detailed information to FINRA about its total amount of securities on loan or available to loan. Due to the sensitivity of this information, we support the proposed requirement that FINRA make this information publicly available only on an aggregated basis, and that FINRA would keep confidential, subject to applicable law, identifying information about lending agents, reporting agents, and other persons using reporting agents.

A. Public Availability of Individual Transaction Information

If the SEC does not accept our recommendation to report on a T+1 basis, it is critical that the Commission require FINRA to make public only on an aggregated basis the data that would be required to be reported within 15 minutes. Further, the SEC should strongly consider the approach taken by FINRA with respect to TRACE of not publicly disseminating trading data for a newly reported asset class until FINRA and market participants have had an opportunity to gain experience with reporting data for that asset class.[41]

Given the granularity of the proposed data elements, making the data public on a loan-level basis throughout the day risks revealing sensitive information about funds' operations and their trading strategies. For large fund lenders, this information may be enough for a market participant to identify the lender and seek to front run its trades or engage in other predatory trading practices, harming the fund and its shareholders. For the reasons explained above, this intra-day data would not provide useful information to regulators or market participants and, thus, making it public intra-day raises significant risks and costs to funds and their shareholders, while providing little benefit.

B. Confidentiality Obligation

To protect the confidential securities lending information that would be reported to FINRA under proposed rule 10c-1, the SEC should impose explicit confidentiality obligations on FINRA. The SEC also should ensure that FINRA implements adequate data security measures, given that FINRA will serve as a repository of a large amount of sensitive and non-public securities lending data.

Under the proposed rule, lending agents and reporting agents would report a large amount of sensitive and non-public data to FINRA on a daily basis. It is critical that this information be subject to explicit confidentiality obligations to protect funds and their shareholders from the harm that would result from non-public data inadvertently becoming public or sensitive data being prematurely disseminated to the market. As described above, release of this data may allow market participants to identify lenders and seek to front run their trades or engage in other predatory trading practices, harming the fund and its shareholders.

[41] *See supra* note 26.

We also urge the SEC to ensure that FINRA has appropriate cybersecurity measures to protect the enormous volume of sensitive and confidential data that will be reported to it under the proposed rule. FINRA's collection of this valuable fund data will create a vast, unique, trove of sensitive data and a potential single point of failure would undoubtedly attract the attention of cybercriminals. A hack of FINRA's securities lending database could expose the universe of funds that engage in securities lending to the types of predatory trading practices described above—all at the expense of fund shareholders. In addressing this concern, the SEC should consider lessons learned regarding information security protection in analogous situations, including the SEC's fund reporting obligations under Form N-PORT[42] and implementation of the consolidated audit trail (CAT).[43]

VIII. Implementation Considerations

Implementing rule 10c-1 will be an enormous and costly operational effort for FINRA and market participants. Market participants will need significant time to create or modify reporting systems, identify data sources and create connectivity among systems, enter into or amend agreements with beneficial owners, vendors, or others regarding reporting, and develop appropriate compliance and risk oversight. The complexity of creating or modifying systems will be greater to the extent the rule requires reporting on a 15-minute time frame. The SEC and FINRA therefore must provide a sufficiently long implementation period for beneficial owners, lending agents, and reporting agents to take the myriad steps that will be necessary to comply with any final rules, including implementing rules promulgated by FINRA. Implementation should provide for phase in of reporting requirements by reporting party[44] and by asset class. Because beneficial owners will not have the infrastructure to report, any direct reporting by beneficial owners should be phased in after the implementation date for reporting by reporting agents and lending agents.

Further, as recommended above, we urge the SEC to tailor the final rule to initially apply only to loans of US-listed equity securities, and only consider expanding the scope of securities subject to the rule once FINRA and market participants have an adequate opportunity to establish reporting systems, gain familiarity with the reporting obligation, and determine whether

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[42] *See Investment Company Modernization*, 82 Fed. Reg. 58731 (Dec. 14, 2017), *available at* https://www.govinfo.gov/content/pkg/FR-2017-12-14/pdf/2017-26922.pdf.

[43] The SEC has proposed additional steps to increase the security and confidentiality of CAT data, including enhanced information security requirements that apply to FINRA as the CAT plan processor. *See Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail to Enhance Data Security*, 85 Fed. Reg. 65990 (Oct. 16, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-10-16/pdf/2020-18801.pdf.

[44] We note that the EU similarly took a phased-in approach to implementation under SFTR, based on reporting party. Reporting was introduced in four phases over a period of nine months (which was subject to delays), with entities such as credit institutions and investment firms in the initial phase, CCPs and CSDs in the second phase, funds and insurers in the third phase, and NFCs in the final phase. See Article 33 of SFTR, *available at* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R2365.

adjustments may be necessary. In addition, we recommend that the SEC or FINRA provide clarity regarding applicability of any final rule to securities loans that are outstanding on the rule's implementation date.[45]

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[45] This was a significant "day one" issue with respect to implementation of SFTR. SFTR required covered counterparties to "backload" outstanding SFTs concluded before the applicable phase-in date where those SFTs either (i) have a remaining maturity exceeding 180 days as at the relevant phase-in date or (ii) have an open maturity and remain outstanding 180 days after the relevant phase-in date. See Article 4 of SFTR, *available at* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32015R2365. Given the difficulties the EU faced with this issue, we urge the SEC to provide clarity regarding its approach to reporting of securities loans that are outstanding when rule 10c-1's reporting obligations commence.

Thank you for the opportunity to provide comments on the Proposal. If you have any questions on our comment letter, please feel free to contact Susan Olson at [redacted] or Sarah Bessin at [redacted].

Sincerely,

/s/ Susan Olson

Susan Olson
General Counsel

/s/ Sarah A. Bessin

Sarah A. Bessin
Associate General Counsel

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee
The Honorable Caroline Crenshaw

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