SECURITIES LENDING COUNCIL

January 7, 2022

Via Electronic Submission

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Comment Letter on the SEC's Proposed Rule to Provide Transparency in the Securities Lending Market

Dear Sir or Madam:

The Securities Lending Council (the "RMA Council") of the Risk Management Association (the "RMA")[1] appreciates the opportunity to submit this letter to the Securities and Exchange Commission (the "Commission" or "SEC") on behalf of the RMA's numerous members that participate in the industry as securities lending agents ("Lending Agents"), including some of the largest U.S. custody banks and asset managers. This letter addresses the SEC's proposed Rule 10c-1 (the "Proposed Rule") under the Securities Exchange Act of 1934 (the "Exchange Act") (17 CFR § 240.10c-1) regarding transparency in the securities lending market.[2]

The Proposed Rule implements Section 984(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which directs the SEC to promulgate rules "designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities."[3] Section 984(a) of the Dodd-Frank Act in turn provides the SEC enforcement authority with respect to the Proposed Rule by adding a new paragraph (c) to Section 10 of the Exchange Act, which makes it unlawful for any person, directly or indirectly, by use of

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

[2] 86 Fed. Reg. 69802 (the "Proposing Release").

[3] Pub. L. 111-203.

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any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect, accept or facilitate a transaction involving the loan or borrowing of securities in contravention of rules and regulations promulgated by the SEC thereunder.[4] The Proposed Rule impacts Lending Agents because it would require beneficial owners of securities and/or their agents to provide certain terms of their securities lending transactions to a registered national securities association ("RNSA"), such as the Financial Industry Regulatory Authority ("FINRA"), which then would publicly disclose the terms of such transactions other than the identities of the parties and whether they are being used to close out a fail to deliver pursuant to Regulation SHO.

The RMA Council supports the Commission's efforts to increase market efficiency and provide for enhanced regulatory monitoring that may improve market integrity. We also appreciate the Commission's desire to move this proposal promptly forward and avoid undue delay. However, as the Commission acknowledges in the 97 questions it poses in the Proposed Rule, there are many important elements meriting due consideration prior to finalizing these rules and implementing a securities loan reporting regime. As we wrote on November 23rd, given the scope, significance and breadth of the Proposed Rule, the length of the comment period is inconsistent with the spirit of the Administrative Procedure Act. Our members are concerned that they do not have adequate time for substantial data gathering or analysis to provide the Commission with meaningful, well-considered feedback under the 30-day comment period, which coincided with year-end and the holiday season. As further discussed below, we also believe that significant elements of the proposal should be further developed to address various issues relating to scope. We therefore strongly urge the Commission to consider reproposing the Proposed Rule based on the comments received to allow a more appropriate period of time to consider and respond to the Commission's questions and the various substantive issues raised by the Proposed Rule. We respectfully submit that the brief delay that such an approach would require will be outweighed by the more informed content that the Commission will receive from the public to aid it in finalizing these rules.

Due to the time limitations noted above, we have not attempted an in-depth technical analysis of the specific data elements in the proposal or to answer many of the 97 questions posed by the Commission in its proposal. This letter discusses issues identified in the limited time provided and includes certain recommendations to address practical barriers to implementation, clarify scope, address areas of over-breadth and bring the burdens imposed by the Proposed Rule closer in line with the benefits that Congress sought to achieve in adopting Section 984(b). With greater time or the benefit of an additional comment period in connection with a reproposal, the RMA Council would consider collecting empirical data to examine the costs, benefits and economic impact that the Proposed Rule will have on the market.

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[4] 15 U.S.C. § 78j(c)(1).

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Executive Summary

The Proposed Rule is unduly broad and unclear in scope. Certain proposed reporting elements would be unavailable or operationally impracticable to gather and report within the proposed timeframes, or would impose burdens unnecessary to achieve pricing transparency or meaningful regulatory oversight.

To address these concerns, the following clarifications and changes should be made:

- The SEC should amend the 15-minute reporting requirement in favor of end-of-day reporting on a next day (T + 1) basis because the nature of the market makes 15-minute reporting impractical for several reasons, while a T + 1 standard addresses the SEC's transparency concerns, reduces implementation costs and aligns with the existing SFTR securities loan reporting regime.

- The SEC should not include a requirement to report securities available to loan (as determined by regulation) because such data provides an inherently inaccurate picture of the market and may act as a deterrent to lending that could reduce liquidity.

- The SEC should modify the rule to require reporting by SEC-registered broker-dealers only, whether acting as borrower or lender acting in a principal or agency capacity, as such an approach would substantially reduce overall implementation costs, would not impose costs on a single side of the market and would still provide for sufficient market data.

- To enhance certainty and promote reporting comparability and consistency, the SEC should clarify the scope of the transaction reporting requirement in several ways consistent with a staged approach to implementation:

    - The SEC should provide a specific definition of a "securities loan" covered by the rule, which should be a functional definition based on the purpose of a loan. To the extent reporting remains a lender[5] requirement, such a definition should look to the intent of the beneficial owner. The SEC should also provide flexibility to the RNSA to exclude intra-affiliate and other non-arm's-length transactions from public dissemination.

    - Initially, reporting should be mandated for more liquid securities before expanding to other security types to provide the SEC with the opportunity to assess the value and integrity of data provided while minimizing potential market confusion and disruption. The initial stage of reporting should consist of regulatory reporting (only) of equity securities listed or traded on a U.S.

[5] The lending obligation in the Proposed Rule can apply to the beneficial owner acting alone or its Lending Agent acting on its behalf. As such, in some cases, we use the term "lender" to refer to either a beneficial owner or Lending Agent.

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exchange. Reporting of other U.S. equity securities or debt securities should only be adopted after further study.

    - The SEC should defer public dissemination of data to a later stage in the program implementation to allow the SEC to gain experience with the data and ensure that the program is designed effectively.

    - The SEC should provide explicit guidelines on the cross-border application of the rule that provide clarity, promote competitive equity and that rely on standards and data categories currently in use in the securities industry. This will maximize consistency and integrity of data collection and avoid undue expense and delay stemming from additional industry documentation and operational implementation exercises.

- Once public dissemination of transaction data is implemented, the SEC should provide for the RNSA to publish aggregate pricing and volume data rather than transaction-by-transaction data in order to provide a more comprehensive and accurate view of the market.

- The rule should provide flexibility in the production of Unique Transaction Identifiers ("Transaction Identifiers"), so that they may be produced by reporting parties, as well as the RNSA, provided that the reporting parties are capable of producing such Transaction Identifiers.

- The SEC should clarify that where applicable, pricing data may be reported as a spread to a benchmark rate, and that such pricing does not need to be updated for changes in the value of the benchmark rate.

In the next section, we offer some targeted observations, and in the section that follows, we discuss the recommendations outlined above in greater detail.

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I. **Background and General Considerations**

A. Agency Securities Lending

Agency securities lending is a well-established, safe and sound activity that supports global capital markets activities and facilitates trade settlement. By effectively increasing the supply of securities available for these and other market activities, securities lending improves market liquidity and enhances price discovery.[6] Securities lenders largely consist of buy-side entities such as public and private pension funds, mutual funds, ERISA plans, endowment funds of not-for-profit institutions, insurance companies, investment funds and other similar entities or funds into which such entities invest. Borrowers in securities lending transactions largely consist of broker-dealers, banks and other financial institutions.

Lending Agents act as intermediaries in securities lending programs by facilitating loans on behalf of beneficial owners to qualified borrowers. Securities are generally lent pursuant to a (i) securities lending authorization agreement between the beneficial owners and the Lending Agents, and (ii) securities borrowing agreement between the borrower and the Lending Agents (acting in an agency capacity on behalf of the beneficial owners as principal). Under these agreements, the borrower provides initial collateral to the beneficial owners (generally, via its Lending Agent) in excess of the value of the loaned securities, usually by 2% to 5% depending upon the characteristics of the loaned securities and the collateral. The loaned securities and collateral are then marked-to-market daily to ensure that the collateral consistently meets the requisite value. As the Proposing Release notes, the margins for securities lending transactions are typically low. Because agency lending typically involves a Lending Agent guaranty against borrower credit risk, agency lending by capital-regulated banks is also somewhat capital intensive. Accordingly, securities lending generally requires economies of scale to be profitable, and even marginal increases in cost may drive supply-side liquidity out of the market unless it can be offset with increased fees.

As agents for their clients, Lending Agents use their expertise in the lending market to obtain competitive pricing for their clients. Clients frequently ask for, and Lending Agents provide, benchmark reports based on the market data they have obtained from various sources.

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

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While the Proposing Release repeatedly asserts that information asymmetries exist between those "in the center" of the lending markets and beneficial owners and borrowers on the "periphery," in point of fact beneficial owners currently benefit from substantial information obtained by Lending Agents acting on their behalf and pricing remains highly competitive. At the same time, borrowers in the "wholesale" market are predominantly broker-dealers and large hedge funds with independent resources to access market data, while the "retail" market is primarily a separately priced market segment within which regulated broker-dealers provide short positions to customers in margin accounts subject to Federal Reserve Board and FINRA margin rules.

As of the second quarter of 2021, RMA data showed approximately $2 trillion of loaned securities globally. RMA composite figures, compiled using responses of 13 member institutions, reflected approximately $20 trillion of U.S. lendable assets and $9 trillion of non-U.S. lendable assets in the securities lending market for the second quarter of 2021. Of those assets, over $700 billion of U.S. securities and $125 billion of non-U.S. securities were on loan against cash collateral.

B. Price Formation in Securities Lending

Unlike cash market sales of securities, securities lending transactions are open or term-based credit exposures that are generally negotiated and managed as part of broader credit relationships between parties documented under master agreements. In substantial part, the pricing for these transactions depends on a number of party-specific, contract-specific and other idiosyncratic factors that are not directly dependent on the market price or general availability of the security being loaned, including:

- the credit of the counterparty,
- the type and amount of collateral provided,
- the ability to profitably deploy cash collateral,
- the negotiated terms regarding the volume and the credit relationship broadly (*e.g.*, inclusion of "pay to hold" arrangements and/or borrower volume commitments) and
- other factors idiosyncratic to the parties, such as capital and opportunity costs.[7]

Moreover, pricing is also a function of general interest and credit rates and does not move with the same rapidity as pricing for individual securities, which is highly sensitive to issuer-specific market news and other new information. Accordingly, the pricing for two separate loans of the same security occurring at roughly the same time can vary substantially based on the various factors described above. Unlike in the cash markets for securities, borrowers and lenders do not obtain a picture of the market price from last transaction data as there is no reason to

[7] This specific list includes characteristics typically relevant to Lending Agents. Additional considerations may be relevant to other types of lenders.

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believe that securities lending transactions are fully fungible or that pricing can be represented in a single "spot" market price.

The SEC acknowledges this difficulty in the Proposing Release when it states:

> "The Commission recognizes that these benefits [of the proposed reporting system] are somewhat limited because the data will not contain all information necessary to perfectly compare the fees on different loans…. While recognizing this limitation, the Commission does not believe this limitation could be solved by adding information on counterparty risk. In particular, the Commission is unaware of reliable measures for counterparty risk that would be informative when attached to transaction information."[8]

This observation highlights that data reporting and publication in the securities lending market should not simply follow the models that have been developed for the securities trading markets. While the SEC may look to a number of existing reporting regimes as references for the newly proposed reporting system, the RMA Council submits that the differences between the way that prices are formed in the cash markets for securities and the market for securities lending transactions logically dictates a different approach to reporting.[9]

C. Cost-Benefit Considerations

While the Proposed Rule would fulfill a Congressional mandate, as written, its justification in cost/benefit terms appears to be highly uncertain. Further, it would impose direct costs exclusively on the lender side of the market while primarily benefitting borrowers. In the Proposing Release, the Proposed Rule is estimated to be costly in absolute terms, with an initial implementation cost estimated at $371,000,000 for just 409 market participants and annual direct compliance costs estimated to be $140,000,000 thereafter.[10] These costs are expected to be offset with unquantified benefits in improved regulatory supervision and increased market efficiency while also contributing to "small" increases to capital formation. In light of this trade-off, factors that may contribute to excessive and/or unanticipated costs could materially change the net benefit of any rulemaking or even cause a net loss of welfare. We therefore believe it highly significant that certain assumptions relied upon by the SEC to estimate the cost of the rule appear to be unrealistic if the Proposed Rule is adopted in its current form.[11]

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[8] 86 Fed. Reg. at 69839.

[9] Id. at n. 73 (referencing the Alternative Display Facility, OTC Transparency, OTC Reporting Facility, Trade Reporting and Compliance Engine and the Trade Reporting Facility).

[10] These estimated costs are understood to be incomplete. The SEC also projects unquantified indirect costs through exit by smaller securities lenders and broker-dealers but does not attempt to quantify these costs. Similarly, the SEC anticipates that an RNSA may charge fees to recover its own costs.

[11] The SEC's hour estimates for initial implementation appear to be low based on anecdotal data and we do not believe that assumptions on how the rule would be implemented are realistic. In particular, the SEC projects significant cost savings through the use of "reporting agents" as it estimates that lenders that use such reporting agents will realize a 50% cost savings relative to lenders that report data directly to an RNSA. While that 50% reduction itself is questionable, in our view, any such reduction is unlikely to be realized in full or in substantial part, because Lending Agents and many beneficial owners are unlikely to provide the extensive and

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Furthermore, we submit that imposing the direct costs of the reporting system almost entirely on the lender side of the market (primarily Lending Agents, mutual funds and benefit plans) creates asymmetries that will magnify the indirect costs of transaction reporting. Besides burdening primarily lenders, the proposed requirement to publicly report available inventory arguably creates an information asymmetry in favor of the borrower side of the market (primarily hedge funds). This allocation of costs and benefits creates a high risk of a material negative impact on liquidity. As the Commission acknowledges in the Proposing Release, securities lending in the United States is already a low-margin business, and this is true in particular for Lending Agents who are subject to bank capital requirements and typically guaranty beneficial owners against borrower defaults. For structural reasons, Lending Agents are also unlikely to be able to fully pass on the costs of implementation to borrowers or to capture the benefit of increasing lending fees, which are primarily passed on to beneficial owners through long-term service contracts that include negotiated revenue splits. Accordingly, the RMA Council has substantial concerns that the imposition of material additional regulatory costs on lenders as a result of the Proposed Rule could make agency lending unprofitable in some cases, causing beneficial owners to exit from markets with particularly thin spreads and causing smaller Lending Agents to exit the market entirely.

While not captured by the Commission's analysis, the Proposed Rule would also potentially impose opportunity costs on the market by crowding out other initiatives. Parties in this space are consistently innovating to create a more liquid and efficient securities lending market. Projects that are in planning stages include technology improvements to provide for readiness to manage a T + 1 settlement regime across the product chain and integration of financial technologies like blockchain that could ultimately obviate the need for special transaction reporting systems and make transactions viewable on their native ledgers. Resources dedicated to implementing these other projects may need to be diverted to focus on building for the proposed reporting regime.

In light of these considerations, we are concerned that the Proposed Rule could have a material, negative impact on both beneficial owners and the marketplace as a whole. Conversely, while the SEC does cite to a single study suggesting that increased transparency with respect to executed loan pricing may decrease prices, the existing data is extremely limited.[12]

high-sensitive portfolio data that would be required under proposed 10c-1(e) to a broker-dealer. Solely by eliminating that assumption, the estimated direct costs of the rule increase by about $100,000,000 in year 1 and $38,000,000 in subsequent years or about 28%. The SEC also appears to estimate that reporting agents that must provide reporting functionality to their customers as well as develop the capacity to submit reports to an RNSA would bear roughly the same costs as a market participant that reports for exclusively itself, which also appears to be unrealistic.

[12] *See* Fábio Cereda, Fernando Chague, Rodrigo De-Losso, Alan Genaro, and Bruno Giovannetti. "Price transparency in OTC equity lending markets: Evidence from a loan fee benchmark" São Paulo School of Economics, Fundação Getulio Vargas, Working Paper Series, Working Paper 524 (Feb. 2020) ("Brazil Study Working Paper") (finding that shortening a benchmark calculated from the mean loan fee of securities loans over a set amount of trading days improved pricing characteristics of the underlying loans when the benchmark was set to three trading days from 15 but finding no significant improvements to pricing characteristics when the benchmark was set to one trading day from three). The official paper of the study is forthcoming in January

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Accordingly, we suggest that a less costly and more incremental approach to the introduction of a reporting obligation in the securities lending market that distributes the cost of implementation in a more balanced way is warranted.

II. Specific Recommendations

A. The requirement to provide reports to an RNSA within 15 minutes after execution or modification should be replaced with a requirement to provide end-of-day reports on T + 1.

Requiring reporting on an intraday basis as proposed would be operationally impractical in many respects and would provide little to no incremental value compared to end-of-day reporting. Such a requirement would exponentially increase the number of execution and modification reports that would be required to be filed, result in the filing of incomplete and error-prone data, limit time and flexibility for data reconciliations and necessitate the development of costly real-time data capture and reporting systems. At the same time, as discussed in Part I, securities lending pricing is highly variable based on party and deal-specific variables, is not highly time dependent in the aggregate and would not be negotiated by participants based on last trade information. Accordingly, there is no compelling reason to believe that real-time dissemination of transactions data will provide materially useful information sufficient to justify a burdensome real-time reporting requirement. In fact, real-time transaction information could be confusing to investors since it will often be unrepresentative of average prices. Indeed, the limited data available in reports cited by the Commission in the Proposing Release suggests that there may be little to no market information gained by reporting securities lending pricing over time periods less than several days.[13]

Real-time reporting would also be highly burdensome, and in some respects simply impracticable because, unlike transactions in the cash markets, many terms of securities loans are either highly subject to intraday revision or are not determined until end-of-day. Under these circumstances, a real-time reporting regime as contemplated by the Proposed Rule would result in a high number of initially incomplete reports requiring subsequent updates and high volume and frequency of minor modification reports that provide little to no incremental value. While parties may agree to basic terms at a particular point in time on a given business day, many securities loan terms are revisited during the course of the day as borrowers engage in cash market selling of the relevant securities, securities on loan are returned (or not returned) and the portfolio characteristics of a lending relationship change with further trading/lending activity. While there are many factors that make loan terms fluid on an intraday basis, a representative sample includes the following:

- *Volume and related pricing*. The size of any given loan to a borrower frequently changes during the day as the borrower engages in short selling and related activities that require borrowing and supply to be managed. Loan size may be revisited

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2022, but the same team released a working paper in February 2020, which we use as a proxy for the upcoming study prior to its release.

[13] Id.

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throughout the day of the loan as actual need (from short sales) and supply (from securities in inventory as well as securities actually returned from other borrowers during the day) are determined. Pricing may also be adjusted as these supply and demand characteristics are worked out on a portfolio basis, credit concentrations develop or decrease or negotiated volume or portfolio thresholds are hit.

- *End-of-day collateralization*. Non-cash collateralization for securities loans is generally managed by lenders and borrowers on a portfolio basis, often with the assistance of a bank custodian providing collateral optimization services. Collateral exposure is aggregated at the legal entity/counterparty level and applied to the underlying loan as part of an end-of-day allocation process at the tri-party collateral agent or custodian bank. A reporting entity would therefore be unable to incorporate specific collateral data into intraday reports. It would also be unable to report collateral characteristic related to actual collateralization for a loan without first running an allocation process to attribute the collateral received on a portfolio basis to the individual loans in the portfolio. Finally, collateral allocation may also trigger pricing revisions, which would need to be reported as modifications.

- *Agency lending principal identification process*. As a general matter, Lending Agents execute loans with borrowers on a bulk basis, allocate loans to individual beneficial owners at the end-of-day and only thereafter report the individual beneficial owners to borrowers pursuant to the agency lending disclosure initiative (and frequently only to back office and legal/credit personnel at the borrower to protect sensitive data). As such, this data too could only be reported on an end-of-day basis after allocation.

- *Bilateral validation processes.* For a variety of reasons, there can be characteristic breaks between lender and borrower records relating to, *e.g.*, rebate rates, underlying beneficial owners accounts and lot sizes. To ensure these breaks are addressed, current Lending Agent practice is for loan activity from the previous business day to be reconciled each morning on T + 1 as part of the loan transaction comparison process. This involves the validation of each key field between borrower and lender records with any breaks highlighted for remediation.

As these examples indicate, data reported during the course of the day would fluctuate substantially, would be incomplete in many respects and would likely include meaningful levels of exception reporting, outcomes that could be mitigated by giving borrowers and lenders the ability to conduct reconciliations at the end of the day prior to reporting. In a Congressional Study cited in the Proposing Release, the SEC's Division of Economic and Risk Analysis acknowledged similar concerns in the context of a report mandated by Section 417(a)(2) of the Dodd-Frank Act (which obligated the SEC to study the feasibility of requiring reporting of short sale positions in publicly listed securities in real time) (the "Short Sale Reporting Study"). The Short Sale Reporting Study stated that: "[i]n discussions with the Division, most market participants said that they would not be likely to trust identified Real-Time Short Position

Reporting data, and would prefer verified data with a time delay, which they believe would likely be more accurate than real-time data."[14]

In addition, we believe that the net burden of real-time reporting would be substantial. Real-time loan reporting would: (1) require each reporting institution to build fully-automated data capture and reporting systems; (2) limit flexibility around data capture and aggregation; (3) exponentially multiply the volume of reports generated; and (4) place high demands around the process and timing for data validation and reconciliation. In this regard, while the SEC acknowledges the significant ongoing burdens that the Proposed Rule would impose, these costs and burdens do not appear to have been fully captured in its analysis.

As noted in Part 1, there is a material risk that burdensome implementation costs will drive lenders from the market. The SEC acknowledges this to a degree in the Proposing Release, noting "[r]eduction in information asymmetry could result in reduced revenue for some broker-dealers and lending programs…It is possible some broker-dealers and lending programs [beneficial owners] may choose to exit some or all of the market for lending services as a result of this loss of revenue."[15] Next-day reporting would provide more appropriate flexibility for developing systems and processes for reporting at substantially lower cost. As the European Union equivalent of the Proposed Rule, the Securities Financing Transactions Regulation ("SFTR") imposes a next-day reporting requirement for securities lending. As such, moving to the same requirement in the U.S. may also permit lenders currently subject to SFTR to leverage existing processes and systems with an overall reduction in implementation costs.

B. The requirement to report securities available-to-lend should be eliminated.

Requiring lenders to report securities available-to-lend would provide little to no tangible benefit for the securities lending market, would likely deter lending and the use of reporting agents and should be eliminated. As the SEC acknowledged in the Proposed Rule, the metric envisioned for reporting available-to-lend data—all securities held or owned that are not subject to legal or other restrictions that prevent a specific security from being lent—is artificial and considerably overstates the securities any particular lender is actually willing to lend.[16] On the other hand, the Proposed Rule omits securities that a lender would be willing to lend on days where that lender has no loans outstanding. We respectively submit that issues with respect to data integrity and accuracy would make the reported data so inaccurate and variable as to be essentially meaningless.[17]

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[14] Congressional Study, "Short Sale Position and Transaction Reporting," at 76, *available at* https://www.sec.gov/files/short-sale-position-and-transaction-reporting%2C0.pdf (the "Congressional Study").

[15] 86 Fed. Reg. at 69837.

[16] Id. at 69818 ("The Commission recognizes that the definition of 'available to lend' may overstate the quantity of securities that could actually be lent because the data would include securities that may become restricted if a limit is reached.").

[17] While Lending Agents do currently make "easy to borrow" or other availability lists available to certain borrowers, such lists reflect a fundamentally different process and form of data than the Commission's Proposed Rule. Such lists reflect highly discretionary and changeable judgments of lenders identifying

Looking just at the situation of Lending Agents, securities lending in a portfolio provided to a Lending Agent by a beneficial owner may be limited by (i) negotiated or legal portfolio limits that impact the amounts and types of securities that can be lent, (ii) ad hoc or periodic beneficial owner instructions to limit lending in particular ways based on idiosyncratic preferences (including the individual owner's own portfolio risk management strategies) or external factors and (iii) discretionary transfers in and out of custody accounts unrelated to securities lending interest, and other factors.[18] Indeed, in recent times, beneficial owners have become more active in monitoring and managing their lending arrangements and increasingly require bespoke negotiated controls on how their portfolios are managed. While under the Proposed Rule, a beneficial owner's full portfolio would be required to be reported as "available to lend," provided that the amount of each security in the portfolio does not exceed a relevant limit imposed by contract or law, in actual fact, the amount of each security available to loan (and the amount available in aggregate) could radically fluctuate both intraday and from day-to-day based on a variety of factors, including lending activity, lending market pricing, securities pricing and other variables.

Looking more generally at the lender space, a variety of additional factors would also make the proposed reporting inaccurate. For example, a beneficial owner acting as a direct lender and only intending to lend out specific or a few securities in its portfolio would nonetheless be required to include all the securities it owns as "available to lend." Similarly, a non-U.S. lender interested in deploying part of its portfolio in the U.S. would appear to be required to report its full global holdings. At the same time, if any such lender happened not to have any transactions or reportable loans outstanding on a given day, the entirety of its supply would not be reportable and would potentially "disappear" from the data while that situation persisted.

As a result of the artificiality of the proposed metric, we believe the data regarding securities "available to lend" would be fundamentally unreliable (or misleading) and either widely ignored notwithstanding the considerable costs of implementation or unduly relied upon as an accurate measure of the size of the market. While the metric would generally overstate actual supply, the amount of such overstatement would vary widely and unpredictably and in some cases the number could actually understate supply. For purposes of estimating the actual supply of securities available to lend, a metric based on securities "available to lend" would be entirely unnecessary as more accurate estimates of supply can be extrapolated from fluctuations in trading volumes and fees that the SEC envisions collecting pursuant to the Proposed Rule. In

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portions of the portfolio under their management for which they have greater confidence of ability to lend after analyzing market conditions, market expectations, securities in inventory and various portfolio limits and restrictions. They are best understood as sophisticated predictions on availability based only in part on securities in inventory and could not be made if subject to strict liability for reporting "errors."

[18] *See e.g.* Id. at n. 109 ("As a result, investment companies typically do not have more than one-third of the value of their portfolio on loan at any given point in time"); id. at n. 110 ("For example, a beneficial owner that has program limits permitting the loan of any portfolio security, up to 20% of the portfolio would include 100% of the portfolio as lendable. A beneficial owner that will only lend specified securities, which represent 25% of the portfolio, would list only those specified securities as lendable. Similarly, a beneficial owner that will lend any security in its portfolio but has program limits in place to avoid loaning more than one-third of the value of their portfolio at any time would report 100% of its securities as available to lend.").

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this regard, it is noteworthy that other reporting regimes such as the SFTR do not require lenders to provide data on loan availability.

Importantly, such a requirement would be a disincentive to lending and to use of a reporting agent. Lenders that would otherwise be willing to use broker-dealer reporting agents for their transaction reporting may refrain from doing so if such reporting includes sensitive portfolio data (such as the lender's identity data, transaction data and "available to loan" data). In addition, such reporting would likely introduce cybersecurity risk arising from such data fields being collected in centralized databases with massively high target value to hackers and cybercriminals. As such, this requirement in particular may impose material indirect costs that will reduce liquidity.

C. Broker-dealers should be required to report as both borrowers and lenders rather than requiring reporting by lenders.

As the SEC acknowledges in the Proposing Release, requiring reporting by broker-dealers exclusively would be less costly than requiring reporting by lenders generally.[19] Assuming that the SEC agrees that reporting on "availability" is not warranted, we respectfully submit that such a broker-dealer-only reporting regime would be superior for that reason. This reflects the role of broker-dealers and their affiliates as the primary access point for end-user borrowers, as well as their ability to leverage existing systems and functionality for the reporting of transaction-related data to the RNSA. While the Commission notes that the data obtained from broker-dealer reporting would be somewhat less comprehensive than lender reporting, the data loss entailed should not be substantial. As the only institutions that can engage in agency short selling broadly, broker-dealers are the primary access points and gatekeepers of the securities lending market for end-user borrowers. Existing market data supports the conclusion that the securities lending market would be substantially captured by such a less costly alternative. As detailed in the working paper for the Office of Financial Research ("OFR") cited in the Proposing Release, roughly 85% of loans made by Lending Agents are to registered broker-dealer borrowers.[20]

Further, the data captured through this requirement need not be limited to securities actually borrowed or loaned by broker-dealers as principal or agent. As the SEC notes in the Proposing Release, many hedge funds obtain securities loans from their prime brokers in connection with "arranged" or "enhanced" prime brokerage.[21] These loans made by a broker-dealer affiliate are arranged by the prime broker settling the relevant short sale. As such, the

[19] Specifically, non-lenders would avoid direct costs of reporting and the RMA also expects that the costs for broker-dealers would be lower than for non-broker-dealers because they have existing FINRA reporting requirements, reporting infrastructure and connectivity.

[20] A Pilot Survey of Agent Securities Lending Activity (Off. of Fin. Research, Working Paper No. 16-08, 2016) at 8. https://www.financialresearch.gov/working-papers/files/OFRwp-2016-08_Pilot-Survey-of-Securities-Lending.pdf (the "OFR Survey") (Finding broker-dealers accounted for an average of $869.1 billion of a total average of $1,018.6 billion lent in the period observed).

[21] 86 Fed. Reg. at 69805.

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broker-dealers are agents on these transactions, would generally have access to the relevant transaction data and could readily report the transactions in this market segment.

As relevant to the recommendation in Section II.D.1 below, such a rule would also provide better data integrity as broker-dealers are better positioned than beneficial owners and Lending Agents to evaluate whether a securities loan is made for the purpose of facilitating short sales or settlement of fails rather than some other purpose, which may reflect different pricing considerations. Beneficial owners and lending agents are generally not privy to the purpose of borrowing activity and, therefore, are not positioned to make this determination.

Finally, as RMA believes that broker-dealers also typically receive the largest share of the revenue among the intermediaries in the lending chain and have extensive connectivity to FINRA, they would be better suited to absorb the costs of developing a reporting program. As market intermediaries that participate on both sides of the lending market, they are also positioned to provide that the direct and indirect costs of the rule are more evenly distributed to borrowers and lenders. As we noted in Part I, we are concerned that allocation of the costs of the rule exclusively to the lending side of the market will have negative market effects broadly. If the recommendation to allocate reporting requirements to broker-dealers is not adopted, the SEC should, at a minimum, provide other means for the burden of regulation to be shared by borrowers as well as lenders. As one element, the SEC could impose requirements for the RNSA to consider equity in the allocation of regulatory costs and data benefits when imposing reporting and data fees.

D. <u>The SEC should define and clarify the scope of the rule in several respects consistent with a deliberative and staged approach to implementation.</u>

1. <u>Reports should be limited to "securities loans," which would be defined to include only loans that are for the purpose of providing use of the lent securities to the borrower</u>.

While Section 984(b) clearly provides the SEC with authority to increase transparency with respect to "the loan or borrowing of securities" (as distinct, for example, from repo transactions) the statute does not define the term securities loan for such purpose. Similarly, the Proposed Rule also fails to provide any definition. Leaving this core concept undefined will create tremendous market uncertainty and confusion in implementing the rule, as a securities loan is structurally similar to a number of other types of transactions entered into for other economic purposes, including a margin loan, repo or secured commodity loan (and others). All such transactions involve one "leg" of the transaction that consists of the delivery of a security at time 1 subject to an obligation of the recipient to deliver the same or an equivalent security back at time 2 and another "leg" involving the reciprocal delivery and return of cash or another asset. Although structurally similar, these transactions have different economic purposes, which inform their pricing. Without a definition of "securities loan," the Proposed Rule would leave uncertainty as to which of these structurally similar transactions to report, thereby creating inconsistent reporting practices and "noisy" data, incorporating at least some number of transactions that do not provide pricing information that is relevant to the securities lending market.

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In order to distinguish between a securities loan and these other kinds of transactions, (and to the extent reporting remains a lender requirement rather than a broker-dealer requirement[22]), the Commission should adopt a formal definition for "securities loan" making clear that the reporting requirement only applies to transactions (i) involving a transfer of securities against cash or other assets, (ii) intended by the party making the loan as principal or agent to be for the purpose of earning a return through providing use of the securities to a borrower (as opposed to obtaining cash financing or another asset as in a "collateral upgrade" transaction) and (iii) pursuant to a written securities lending agreement under which the beneficial owner retains the economic interests of an owner of such securities, and has the right to terminate the transaction and to recall the loaned securities on terms agreed by the parties.[23] To create greater certainty, such a purpose should be presumed only when consistent with specified economic indicia of the transaction, specifically that the initial value of the reciprocal assets received as collateral or credit support exceeds the market price of the securities delivered.

Furthermore, the rule also should require the RNSA to exclude certain loans from dissemination and/or aggregation if they are not arm's-length transactions that would be representative of the market. For example, inter-affiliate loans frequently do not represent market prices and should be excluded from such dissemination.

2. "Securities" should be defined as equity securities either issued by U.S. issuers or listed or traded on a U.S. exchange.

While the Proposed Rule would require reporting of loans on any type of security, the scope of securities covered should generally be limited to securities that transact in significant volume in the United States. Specifically, the SEC should at least initially define securities loans covered by the rule to be loans of equity securities that are part of the national market system (effectively stocks listed or traded on a national securities exchange). This recommendation is

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[22] If the Commission accepts the recommendation to apply reporting requirements to broker-dealers rather than securities lenders, the Commission could instead apply the definition of a "permitted purpose" loan provided in Section 220.10(a) of Federal Reserve Board Regulation T to differentiate reportable securities loans from other transactions. Broker-dealers would be better positioned to implement this, and it would ensure consistency with the concepts used to differentiate securities loans from structurally similar transactions in other contexts. Such definition would be problematic to implement in conjunction with a reporting requirement that applies to lenders generally. This is because the Regulation T concept depends on the intent of the borrower rather than the lender in entering into a transaction and non-broker-dealer lenders do not currently collect such information from borrowers on a systematic basis.

[23] This definition is drafted based on the definition of "securities lending" in Regulation R. 17 C.F.R § 247.772(b) ("Securities lending transaction means a transaction in which the owner of a security lends the security temporarily to another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such securities, and has the right to terminate the transaction and to recall the loaned securities on terms agreed by the parties."). As noted elsewhere, the RMA Council believes using pre-existing definitions and regimes will aid in interpreting and establishing these provisions.

We note that if the reporting obligation remains on lenders, it is important that the test for a securities loan depend on the intention of the lender rather than the borrower so that it can be operationalized, which is why we have not advocated for reliance on the "purpose test" used under Federal Reserve Board Regulation T. If the SEC adopts the recommendation to move to a broker-dealer reporting regime, the Regulation T purpose test would be more appropriate (see footnote 21 directly above).

intended both to avoid uncertainty for non-U.S. borrowers and lenders transacting in securities that are primarily relevant in non-U.S. markets and to provide for a measured approach to introducing data reporting and dissemination into the marketplace.

As the Commission is aware, the characteristics of the U.S. equities, corporate debt, asset-backed securities and government bonds markets differ in material respects, not least of which is the number and liquidity of individual issuers. While the number of publicly traded equity securities of U.S. issuers is around 3,600, there are over two million unique issuances of corporate and government bonds and asset-backed securities in circulation. Moreover, the corporate and asset-backed debt markets in particular are characterized by relatively small issuance sizes and substantial differences in instrument characteristics. Given these factors, the rationale for reporting transactions in these securities is much more attenuated than it is for more liquid equity securities. Lending data for any given security is likely to be intermittent and represent a small number of transactions, which will mean that idiosyncratic factors determining the pricing of specific transactions will not be averaged out in the data by the law of large numbers. Similarly, because of the greater diversity of bond characteristics, data from one set of bonds cannot be as easily used as benchmarks for others as might be the case with equity securities. Without volume or homogeneity, there is little indication that data from corporate bond or ABS lending transactions would be sufficiently useful to justify the reporting costs. And because of the relatively infrequent trading in the space, there is far greater risk of loss of anonymity and the use of such data to anticipate or reverse engineer the trading of competitors.

These conclusions are supported by existing data on securities lending. For example, the working paper for the OFR cited in the Proposing Release found that in 2015, $1.450 trillion of U.S. corporate bonds were available for lending by those surveyed but only $62 billion were actually lent, a 4% utilization rate compared to $3.173 trillion of U.S. equity securities available for lending with $315 billion lent, a 10% utilization rate.[24] U.S. treasuries and agencies had $1.132 trillion available and $302 billion lent, a 27% utilization rate.[25] Thus, there were twice as many U.S. equity securities available to lend as U.S. corporate bonds and five times as many actually lent. There were less U.S. Treasuries and agencies available than U.S. corporate bonds, but the utilization rate for U.S. Treasuries and agencies was nearly seven times that of U.S. corporate bonds. These data show that the utilization rate of the securities decreases as the product becomes more individualized. It is also worth noting that there is only a small market for shorting corporate bonds.

At the other end of the liquidity spectrum, the rule should also exclude government securities (as defined in Section 3(a)(42) of the Exchange Act) for different reasons. The market for these products is already fairly transparent because there is sufficient liquidity and demand for loans of these types of securities on platforms and venues that have a high degree of transparency. For these securities, imposing reporting obligations would not provide sufficient additional data to justify the compliance burden.

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[24] OFR Study at 4.

[25] Id.

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Defining “securities” to include equity securities that are part of the national market system initially captures the most relevant and appropriate securities for the reporting regime while not precluding the inclusion of other securities over time as the SEC and market participants gain more experience with the reporting regime.

3. The requirement that any data be disseminated to the public should be eliminated in the first phase of the reporting regime.

As the SEC acknowledges, the Proposed Rule would represent a substantial change for the industry and the way that data is collected and disseminated. The RMA Council believes that such a change merits a staged approach to implementation and that the SEC should first gain experience with data that is reported before it is broadly disseminated to the public. Even if one ignores the potential negative impact on lenders, a sudden shift to widespread public dissemination of transaction-level securities loan information could create market confusion and be destabilizing if the information is not characterized by high data integrity and appropriately managed.[26]

FINRA took a similar phased approach when implementing its TRACE program, where public dissemination of transaction information was implemented in three phases. This allowed FINRA to study the impact of transparency on liquidity in the most liquid segments of the U.S. corporate bond market before expanding to less liquid segments.[27] This gradual phase-in also permitted FINRA to refine the design of the program before it became fully operational and evaluate over time the usefulness and efficacy of the data collected.

4. The reach of the reporting requirements should be limited territorially, setting explicit rules on when transactions involving non-U.S. entities are deemed to be within scope.

The SEC should provide clarity as to which non-U.S. entities would be covered by the rule by explicitly defining the circumstances under which a securities loan will be deemed to be within the U.S. market for purposes of applying reporting requirements. Without such definition, non-U.S. beneficial owners and agent lenders would be left with substantial legal uncertainty, as even a transaction between two non-U.S. persons involving a non-U.S. security taking place offshore could potentially be deemed within the reach of the rule based on court-based concepts of the outer bounds of U.S. jurisdiction over non-U.S. activities.[28] Such cross-border rules should (i) provide clear guidelines as to the scenarios in which transactions involving non-U.S. lenders would be deemed within scope, (ii) be designed to provide for

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26 See our discussion in Section II.E above where we noted the Short Sale Reporting Study cited in the Proposing Release notes that investors hoping to properly sift through real-time data on short sales would require vendors in any case or need to rely on the unprocessed data, which would still be inferior to the capabilities of the larger players.

27 FINRA, “2020 TRACE Fact Book” (2021) *available at* https://www.finra.org/sites/default/files/2021-03/Trace_Factbook_2020.pdf.

28 If our recommendation in Section II.D.2 is accepted, there would still be ambiguity with regard to two non-U.S. parties transacting in U.S. securities abroad.

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competitive equality between U.S. and non-U.S. intermediaries and mitigate risk of market distortions and (iii) to the extent possible, use existing definitions for U.S. and non-U.S. market participants to avoid costly new documentation requirements for parties to communicate their status under the rules. As defining the territorial scope of the rule is a necessary, but also substantial, additional element to the rulemaking, the SEC should provide for a notice and comment period before adopting territorial rules by publishing a reproposal as discussed above.

E. The RNSA should disseminate aggregate reporting data rather than transaction-by-transaction data (when public dissemination begins)

The SEC states that the Proposed Rule is intended to lower barriers for beneficial owners and retail borrowers that do not have access to the same information as more sophisticated investors.[29] Although publishing data on a transaction-by-transaction basis would provide such market participants with more data, the very high volume and granularity of this information would require market participants to deploy substantial resources to both process and analyze the data. Due to the sheer amount of data collected, the Short Sale Reporting Study noted earlier with regard to the short selling market concluded that most investors would not have the capacity to interpret disaggregated real-time data and would need to rely on vendors to aggregate such data, the exact opposite of the intentions behind the Proposed Rule.[30] Such market participants, and indeed the market more broadly, would be better served through the publication of aggregate data showing pricing and volume averages for loaned securities over a specified period of a day or more. As noted earlier, the limited data available on the impact of pricing transparency in the securities lending market supports this conclusion, as it indicates that incremental beneficial effects of such transparency wane when data is aggregated at less than several days.[31]

In addition, while the Proposed Rule would not require disclosure of parties to securities loans, some market participants may be reluctant to report individual transactions on more thinly traded securities, for fear that their strategies may be reverse engineered. Reporting aggregate loan-level information would not raise those concerns, and therefore would be less likely to have a chilling effect on the market.

F. Beneficial owners or those reporting on their behalf should have flexibility to generate their own Transaction Identifiers provided they meet minimum standards for integrity and identification.

As the Proposed Rule is currently formulated, the RNSA is responsible for assigning a loan Transaction Identifier and would presumably provide such a Transaction Identifier at the time a loan is first reported. Thereafter, the reporting entity would be obligated to use this

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[29] *See* 86 Fed. Reg. at 69830.

[30] Congressional Study at 77 ("Most market participants, with the exception of sophisticated professional traders, would be unable to directly and thoroughly analyze data of this size. These market participants would either rely on data vendors to process and analyze identified Real-Time Short Position data into a more convenient form, or risk making inferior decisions based on unprocessed data.").

[31] Brazil Study Working Paper at 22.

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Transaction Identifier in connection with any loan modification reporting in connection with the relevant loan. For many reporting entities, obtaining an identifier from an RNSA on a post-trade basis and then tagging it to the trade for accurate reporting would be onerous as it adds undue complication and expense and introduces operational risk for post-trade errors in aligning trades with identifiers (particularly if a trade has been modified during the course of intraday trade reporting).

The objective of a Transaction Identifier is to uniquely identify a particular transaction; so long as that objective is satisfied, the SEC should be neutral as to the manner in which the Transaction Identifier is produced. Providing the flexibility to the RNSA to allow reporting parties to provide their own Transaction Identifiers would likely materially reduce costs for any such parties. This approach has been successfully deployed in Europe under the SFTR and the U.S. in connection with security-based swap reporting rules, which permit a registered security-based swap data repository to allow reporting parties to use their own identifiers.[32] We would urge the Commission to permit the reporting entity to generate the Transaction Identifiers prior to reporting to the RNSA, with the RNSA available to provide Transaction Identifiers as a back-up for those reporting parties who are unable, for whatever reason, to generate their own Transaction Identifiers. This approach would be consistent with the CPMI-IOSCO Technical Guidance on Harmonisation of the Unique Transaction Identifier, which was co-authored by the Commission staff and advised regulatory authorities to impose Transaction Identifier generation on a data repository as a last resort.[33] So long as a Transaction Identifier serves adequately to uniquely identify a transaction, the SEC should be neutral as to the manner in which it is produced.

G. The SEC should clarify that rebate rates for cash collateralized loans will be reportable using spreads to benchmark rates and that changes in the value of the benchmark rate do not require additional reporting.

The SEC should clarify that rebate rates for cash collateralized loans must be reportable as a spread to a reference benchmark rate (as opposed to as an explicit rebate rate) given that this is how such loans are generally priced. For this purpose, the SEC should provide for the RNSA to include both the reference benchmark rate and spread to the benchmark rate as data fields. The SEC should also provide explicit guidance that such loans only require modification reporting to the extent the reference benchmark or spread to the reference benchmark changes.

III. Conclusion

We appreciate the opportunity to provide these comments and would be happy to engage in a more comprehensive dialog with the SEC. We believe that achieving effective and efficient reform requires healthy and robust collaboration between supervisors and market participants.

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[32] ESMA, "Guidelines: Reporting under Articles 4 and 12 SFTR", ESMA70-151-2838 EN at 4.16(147) (Mar. 29, 2021); 17 C.F.R. § 242.901(g) ("A registered security-based swap data repository shall assign a transaction ID to each security-based swap, or establish or endorse a methodology for transaction IDs to be assigned by third parties.").

[33] *Harmonisation of the Unique Transaction Identifier*, CPMI-IOSCO, February 2017, Section 3.3

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The RMA Council would be pleased to meet with the SEC or its staff to assist the SEC in the development of any of the recommendations discussed in this letter or in any other manner as the SEC undertakes to implement Section 984(b). The RMA Council stands ready to assist the SEC as it continues to consider revisions to the Proposed Rule.

Sincerely,

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