1101 PENNSYLVANIA AVENUE
WASHINGTON, D.C. 20004
[redacted]
www.csfme.org

January 7, 2022

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

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

Dear Ms. Countryman:

The Center for the Study of Financial Market Evolution ("CSFME" or the "Center")[1] writes today to supplement our December 15, 2021 comments[2] on the Securities and Exchange Commission's ("Commission") November 18, 2021 proposal, "*Reporting of Securities Loans.*" (the "Proposal")[3]

About CSFME

CSFME is an independent, nonprofit organization whose mission is to improve transparency, reduce risks, support research, and promote sound regulation of financial markets. It does so by conducting data-driven analysis, providing investor education and outreach, and supporting regulatory reviews in otherwise opaque markets.

The Center serves individual and institutional investors, banks, brokers, other financial market participants, academic institutions, and government regulatory agencies. Since its founding, CSFME has focused its research on securities lending, repo, and securities finance activities and has a long history of working with securities lending data.

Our principals have more than 45 years of directly relevant experience in evaluating securities finance transactions and securities lending programs. Prior to forming the Center, CSFME's founder created the first securities loan pricing and benchmarking systems and pioneered many of the securities lending metrics used today.

Since the 2008 financial crisis, CSFME has closely monitored efforts to bring securities lending out of the stigma of "shadow banking." Recommendations have been made by global standard setting bodies, including the Financial Stability Board and Basel Committee on Banking

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[1] Founded in 2006, the Center for the Study of Financial Market Evolution (www.csfme.org) is a nonprofit organization whose mission is to support research that promotes sound regulation of capital markets.
[2] https://www.sec.gov/comments/s7-18-21/s71821-20109658-264014.pdf
[3] Reporting of Securities Loans, Rel. No. 34-93613, 86 Fed.Reg. 69802 (proposed November 18, 2021),(codified at 17 CFR 240). ("Proposing Release" or "Proposal").

Supervision, as well as government data-gathering agencies, such as the U.S. Office of Financial Research. Regulators have responded with new disclosure regulations, most notably the Securities Finance Transaction Regulation ("SFTR")[4] of the European Securities Markets Authority.

The Center has provided extensive feedback on the various regulatory frameworks proposed as well as substantive comments on details of models and pilots for data collection.[5] We have provided written commentary and met with the Commission's staff to provide input on earlier work on implementing aspects of Section 984(b) of the Dodd-Frank Act,[6] including an August 6, 2021 letter to Chairman Gensler wherein we advised the Commission of our plans to research many of the aspects of our suggestions below.[7]

Our December 15, 2021 Comments

In our initial comment letter on the Proposal we endorsed the Commission's goals, but pointed out that the proposed disclosure system creates a "free-rider" problem. The potential benefits of the disclosures under rule 10c-1 would seem to flow to all participants in the securities lending markets. However, the choice to impose the reporting duty on lenders alone would burden that investor seqment with nearly the entire cost of compliance.

We also pointed out that the data proposed to be collected under rule 10c-1 provides very little value to those lenders. Under the Proposal, the data reported to the RNSA would be insufficient to build peer groups for performance measurement and not granular enough to assist with counterparty credit risk management. Without more value to lenders who bear the costs of compliance, we warned that the 10c-1 rule proposal will not succeed as currently specified.

We indicated that, given time for further research, we would study the feasibility of pooling data from lenders to apply mapping techniques and distributed ledger technologies. Our goal would be to derive metrics for optimizing loan recalls to vote proxies, for validating cross-border loans, and for improving counterparty risk management.

Proposed Disclosure System

We reiterate our support for the Proposal's goals and commend the Commission's approach in principle. Faced with a statutory mandate and hindered by the very lack of transparency the Proposal is intended to address, the Commission has developed a disclosure regime that is

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[4] Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R2365&from=EN
[5] https://www.fsb.org/wp-content/uploads/CSFME-on-1411DEG.pdf
[6] https://www.sec.gov/comments/df-title-ix/lending-borrowing/lendingborrowing-22.pdf. See also, https://www.sec.gov/comments/df-title-ix/lending-borrowing/lendingborrowing-16.pdf,
[7] Blount, Edmon W. Letter to Chairman Gary Gensler, "Re: Section 984(b) of the Dodd-Frank Act, Loan or Borrowing of Securities," August 6, 2021 (unpublished).

superior to earlier disclosure regimes, including the SFTR. In crafting the Proposal, it is clear that the Commission has closely examined and taken into account lessons learned from the implementation of earlier disclosure regimes. It is also apparent that the Commission has thoughtfully considered the policy recommendations of global standard setters for addressing the role the lack of transparency in the securities lending markets played in the 2008 Financial Crisis.

While we support the proposed disclosure system in principle, we believe it can be improved. As stated in our earlier comment letter, proposed rule 10c-1 burdens lenders with virtually all the costs of implementation and compliance, while providing no benefit to those lenders.[8] The rule in its current formulation constitutes a tax on lenders and a *de facto* subsidy to other non-paying investors and to borrowers, who will have unfettered access to the same loan data. As described more fully below, we propose an alternative or alteration to the reporting system under proposed rule 10c-1 that would provide regulators, investors, and brokers with the same data and in the same time frame as in the Proposal, but with greater benefit to lenders who bear almost all the cost of the regime. We also believe that the alternative we propose could be achieved at significantly less cost in implementation and ongoing application than the estimates in the Proposal.

For the most part, we believe lenders are prepared to pay certain costs associated with bringing more transparency to the securities lending markets. Lenders understand that the entire market community benefits from timely, actionable information. However, the drafters of the Proposal were forced to rely on incomplete information by their own admission, so we believe that the proposal underestimates the start-up and ongoing costs.

The Commission's estimates of $375 million and $140 million for intitial and ongoing costs relied exclusively on data from filings by registered investment companies.[9] Obviously, the proposed rule would apply broadly to all lenders, including public pension plans and sovereign wealth funds.[10] Therefore, excluding non-registered lenders from the calculations presents an incomplete estimate.

The Commission also uses an inappropriate set of precedents for its operational estimations. The Consolidated Audit Trail (CAT) and its predecessor the Order Audit Trail System (OATS)[11] are not at all similar to the proposed disclosures. The data associated with securities lending transactions is markedly different from that in the equity markets, for which CAT and OATS were designed. Unlike trades and orders, securities lending data must report on returns, recalls, and buy-ins of the original loan, as well as corporate actions, income distributions and other assets services.

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[8] CSFME, "Who Bears the Cost of the SEC's Securities Lending Dislcosure Proposal?" November 30, 2021 https://csfme.org/Full_Article/who-bears-the-cost-of-the-secs-securities-lending-disclosure-proposal
[9] Proposal at 68922
[10] Proposal at 69807 *et seq.*
[11] Proposal at 69823

We propose an alternative to the proposed disclosure framework that could ameliorate some of the technical, reconciliation, formatting, and programming costs associated with feeding data to the RNSA. Our alternative would also provide lenders who bear the ultimate cost of compliance with rule 10c-1 with a better value proposition in exchange for bearing this burden.

A Data Trust

We propose the reporting system be adapted to accommodate a data trust formed by beneficial owners in the securities lending industry. A data trust is an evolving, but very real "mechanism for individuals to take the data rights that are set out in law (or the beneficial interest in those rights) and pool these into an organization – a trust – in which trustees would exercise the data rights conferred by the law on behalf of the trust's beneficiaries."[12] Every data trust's central organizing principal is that the trustees are instructed to use their data assets for the owners' exclusive benefit. The key features of a data trust are ownership and control.[13]

Though new, data trusts are not novel concepts, and have been adopted as secure data-sharing solutions by governments and groups of private companies. For example, Virginia's Commonwealth Data Trust combines the data of 2,000 operational data systems, controlling everything from library data to crime, corrections, EMS, hospital, patient, and aviation records.[14] Similarly, private data trusts such as that of the Mayo Clinic are designed to collect all "data from patient care, education, research, and administrative, transactional systems, [that is] organized to support information retrieval, business intelligence, and high-level decision making."[15]

Although a data trust for securities lenders and borrowers would be an original application of the concept, Truata, the European Mastercard data trust may provide a useful precedent.[16] Truata was formed to anonymize customer transaction data for analysis and compliance with the EU's strict consumer privacy regulations. Truata's beneficiaries are competitors, just like securities finance market participants, so they rely on robust usage and encryption policies that make it difficult for owners to use the data as a weapon against one another.

We believe if lenders were permitted to join together to form a data trust they could pool not just the information required by rule 10c-1, but also "know your customer," proxy voting, ESG, and other transaction data for their own benefit. The data trust could in turn provide a single

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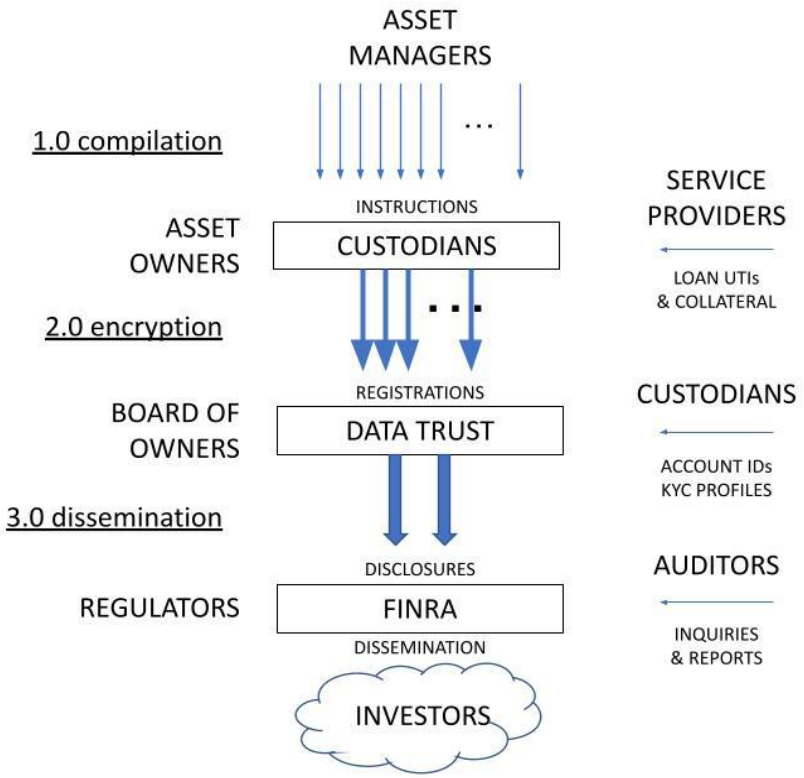
[12] https://www.adalovelaceinstitute.org/feature/data-trusts/ A "data trust" is established when separate entities place data under the control of a board of trustees (or other governing body) with a fiduciary duty to manage and safeguard the data in the interest of the data owners.
[13] CSFME, "New Trends in Data Ownership: How Data Trusts Can Transform Securities Finance." November 15, 2021. https://csfme.org/Full_Article/new-trends-in-data-ownership
[14] https://www.cdo.virginia.gov/resources/commonwealth-data-trust/
[15] https://pubmed.ncbi.nlm.nih.gov/20190054/
[16] https://www.truata.com/

transaction data feed to the RNSA in whatever format and frequency the Commission chooses for the final rule.[17]



Compliance Cost Reductions

The data trust model we propose introduces a number of efficiencies that would reduce both the cost of implementation as well as the ongoing costs of compliance with rule 12b-1 across the entire industry:[18]

- Reconciliation, error correction, formatting would be carried out more efficiently at the data trust level;[19]

[17] See Proposal, Question 54.
[18] Should the Commission decide to extend the comment period for the Propoal, CSFME or its sister consulting organization intends to model and quantify the magnitude of these potential savings over the estimates in the Proposal.
[19] To achieve the most efficiency from reconciliation and error correction, the data trust would need to be authorized to create UTIs for its members rather than the RNSA.

- Non-members of FINRA (the RNSA) would not be required to contract with a member to report their lending transactions;[20]
- A single transaction feed to the RNSA of reconciled and formatted data rather than hundreds of transaction feeds from lenders, lending agents, and reporting agents would reduce the compliance costs to the RNSA and any resulting fees charged by the RNSA to recapture those costs;[21]
- Lenders could divert their existing transaction data feeds to the data trust for reconciliation and formatting, reducing or eliminating the need to perform these functions in-house.

Benefits of Industry-wide Pooled Data

To Regulators

The difficulty the Commission faced in obtaining industry-wide securities lending data for the Proposal itself makes the case for a data trust. However, even the elements proposed to be collected by rule 10c-1 are simply insufficient for effective regulatory market surveillance. The kind of market transparency contemplated by the Proposal, while potentially helpful to investors, would not have revealed to regulators the perilous risk-concentration in the Archagos situation.[22] The benefit of a data trust to regulators is that it could provide comprehensive industry-wide qualitative and quantitative data, not merely the elements required by rule 10c-1. Access to the breadth of structured securities lending transaction and other data housed in the data trust would allow regulators to employ next-generation market surveillance methods, potentially identifying and heading off the next Archegos, stopping the next market shock, and containing any contagion to other sectors.[23]

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[20] The data trust would itself have operating costs borne by its members; however we believe the other benefits will more that defray or offset the costs of forming and operating the trust. Again, provided additional time for comment, we intend to model and quantify the costs of running the data trust against its benefits.

[21] Rule 10c-1 Proposing Release, p. 69820; see also p. 69821.

> *"To fund the reporting and dissemination of data provided pursuant to this Rule, the Commission is proposing paragraph 10c-1(h), which would reflect that the RNSA has authority under Exchange Act Section 15A(b)(5) to establish and collect reasonable fees from each person who provides any data in proposed paragraphs (b) through (e) of proposed Rule 10c-1 directly to the RNSA."*

[22] Smialek, Jeanna, "Meme Stocks and Archegos: Fed Calls Out Financial Weak Spots," New York Times, October 18, 2021.https://www.nytimes.com/2021/05/06/business/economy/financial-stability-report.html

[23] Modern encryption protects data trust participants, while still permitting extensive regulatory access.

To Lenders

A voluntary industry-wide securities lending data trust would provide a scalable alternative to today's *ad hoc* and incomplete data sharing. Under common ownership, and employing common rules for encryption, data security, privacy, anonymization, and confidentiality, securities lending market participants can realize the full value of their transaction-level data by combining it.

As the Proposal points out,[24] lenders currently provide securities lending transaction data to several data service providers in exchange for analytics and performance metrics. The "give to get" model employed by data service providers has outlived its usefulness. An industry-wide securities lending data trust would free data owners from the cycle of providing data to aggregator firms, who then process it and sell it back to securities lending market participants. The data service providers would still be able to provide valuable analysis, benchmarking, and other services. But with the data owners keeping control of their data in a data trust, the aggregators just would no longer have the securities lending data market to themselves. By contributing to a data trust, the lenders and borrowers who generate valuable transaction data would continue to assert full ownership of the data they generate, and they could also realize even more value by using it to prove compliance with market practices and regulations.

Pooling transaction-level in a data trust would allow lenders themselves to construct databases or registries useful for compliance and risk management:

- Counterparty risk management/metrics[25]
- ESG compliance metrics;
- Proxy metrics;
- Cross-border compliance.

Only a single industry-wide collection of securities lending transaction data, like the data trust we propose, will make these uses possible. To construct these registries, full mapping is needed to determine the purpose of each borrow. As the SEC's counterparts in the EU have come to realize, securities finance transaction data without end-to-end mapping can leave regulators blind to abusive trading and unable to police securities lending designed to evade cross-border surveillance.

The securities finance databases of leading data providers such as FIS Astec, Datalend, and IHS Markit, designed more than 20 years ago for performance benchmarking, are inadequate when queried for the purpose of the loans themselves. None of the existing databases were intended or designed to map loans edge-to-edge, that is, from the principal lender to the

[24] Proposal at VI.B.5.
[25] The safer marketplace afforded by data trust (in terms of counterparty risk management) can be factored into indemnity purchased by lenders from their agents, further reducing lending costs.

principal borrower. The fungibility of securities allows the systems of the intermediaries to pool the loans and distribute the borrowed securities through a highly-efficient netting system that breaks the chain of loans and borrows. As a result, it is extremely difficult to link the source and use of the borrowed securities.

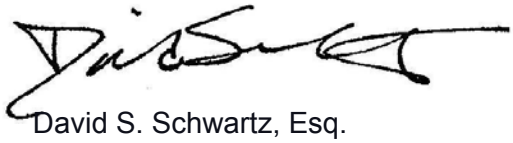
End-to-end mapping also creates an environment in which lenders can direct their loans to borrowers whose activities comport with the lenders' ESG principles. A complete understanding of how investors are integrating their approaches to ESG and securities lending is vital as the Commission builds its proposals for ESG for asset managers.[26] The largest lenders are among the most interested in linking their loans to the strategies of their preferred borrowers. However transparency from lender to borrower is currently limited due to the a) fungible nature of the securities on loan, b) nuances of clearing and settlement practices, and c) confidential terms of certain provisions in the brokers' and borrowers' agreements. Lending in full compliance with ESG principles will require more information about the borrowing trader's policies and intentions. Thus, end-to-end mapping is the key to making securities lending part of an ESG strategy and should figure into any regulatory efforts under Section 984(b).[27]

Conclusion

The alternative we propose would not only provide regulators, investors, and brokers the same data and in the same time frame as the Proposal but would also create a more equitable value proposition for those most burdened by the disclosure regime. Given more time, we believe we can demonstrate that our suggested alterations to the rule 10c-1 framework can provide better value to participants in the securities lending industry at less cost, and yield more efficient and effective market surveillance for regulators.

We look forward to discussing how our recommendations can help the Commission meet its responsibilities under Section 984(b) to develop effective new disclosure regulations.

Sincerely,



David S. Schwartz, Esq.
Managing Director

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[26] ESG policies touch on securities lending programs with respect to voting rights, transparency in the lending chain, collateral and cash reinvestment, lending over record date, and the short side of the market https://www.islaemea.org/wp-content/uploads/2021/05/PASLA_RMA_Global_Framework_for_ESG_and_Securities_L endingGFESL.pdf

[27] CSFME, Squaring ESG with Securities Lending, October 20, 2020. https://csfme.org/Full_Article/squaring-esg-with-securities-lending