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By E-mail

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205499–1090

rule-comments@sec.gov

Re: Release No. 34-93613; File No. S7–18–21
Reporting of Securities Loans

April 1, 2022

Dear Ms. Countryman:

Linklaters LLP[1] ("we", "our" or "us") appreciates the opportunity to comment on the above-referenced U.S. Securities and Exchange Commission (the "**Commission**") release proposing Rule 10c-1 ("**Proposed Rule 10c-1**") under the Securities Exchange Act of 1934 (the "**Exchange Act**").[2] We submit this comment letter to the Commission on behalf of several Canadian pension plans and pension asset managers, each of which acts as a borrower and lender of securities (the "**Canadian Institutions**"). These Canadian Institutions generally either borrow securities through various intermediaries, such as broker-dealers registered with the Commission, or borrow shares through their own relationships with lending programs. They also supply securities they beneficially own to the lending market, by making their shares available to lend either through a lending program run by a lending agent or their own lending program, through which they lend directly to banks, broker-dealers or other entities with which they maintain relationships.

Securities lending is an important income-enhancing or short-term liquidity strategy that carries minimal or controlled risk. The Canadian Institutions may lend cash or securities to (i) generate incremental income or cash for investment, (ii) support an investment strategy, or (iii) enhance liquidity management. The Canadian Institutions may short sell securities, and deliver borrowed securities, to enhance returns,

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[1] Linklaters LLP is a leading global law firm. With more than 2,800 lawyers practicing in over twenty countries, we help clients navigate constantly evolving markets and regulatory environments, pursuing opportunities and managing risk worldwide.

[2] Reporting of Securities Loans, 86 Fed. Reg. 69,802 (proposed Dec. 8, 2021).

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as part of a long-short investment strategy or to offset or otherwise manage certain exposures. The Canadian Institutions may borrow cash or securities to satisfy cash flow needs to avoid the untimely sale of assets or to cover short sales of securities. In sum, the Canadian Institutions are active participants in the securities lending markets.

1 Executive Summary

Proposed Rule 10c-1 would apply to "any person"[3] that loans a "security"[4] on behalf of itself or another. Lenders would be required to report certain material terms for each securities lending transaction and related information to a registered national securities association (an "**RNSA**"), and RNSAs would be required to disseminate to the public certain information concerning each securities lending transaction and certain aggregate loan information. We respectfully believe that the scope of the proposed rule, particularly outside the U.S., is unclear and potentially overbroad. Thus, we offer suggestions below for clarifying the proposed rule's extraterritorial scope. Moreover, we believe that the rule, as proposed, would impose burdens on securities lending activities, particularly those conducted by non-U.S. participants, that are disproportionate to the potential benefits of mitigating systemic risk and increasing market transparency.

Accordingly, we suggest below that the Commission:

(i) clarify that Proposed Rule 10c-1 does not apply to non-U.S. persons that do not use any U.S. jurisdictional means in connection with a securities lending transaction or, alternatively, exclude Canadian Institutions from the scope of the proposed rule;

(ii) include a set reporting hierarchy—analogizing to the security-based swap reporting "waterfall" in the Commission's Regulation SBSR—to determine the counterparty that will be responsible to report the required information; and

(iii) eliminate the requirement in Proposed Rule 10c-1(e) to report end-of-day information on securities "available to lend" and "on loan".

2 Clarify the Extraterritorial Scope

Proposed Rule 10c-1 does not, on its face, prescribe a clear scope of extraterritorial application. To provide legal certainty as to its cross-border application, we recommend that the Commission clarify that, given that it would be promulgated under Section 10(c)(1) of the Exchange Act, Proposed Rule

[3] Section 3(a)(9) of the Exchange Act defines the term "person" to mean a natural person, company, government, or political subdivision, agency, or instrumentality of a government.

[4] Section 3(a)(10) of the Exchange Act broadly defines the term "security" to include, among other financial instruments, any note, stock, treasury stock, security future, security-based swap, bond, debenture, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security".

10c-1 would not apply to non-U.S. persons[5] that do not use any U.S. jurisdictional means to effect, accept, or facilitate a securities lending transaction.

Section 984(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**") added Section 10(c)(1) to the Exchange Act, which provides that "it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of *interstate commerce or of the mails, or of any facility of any national securities exchange*—(1) To effect, accept, or facilitate a transaction involving the loan or borrowing of securities *in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors*" (emphasis added). Section 984(b) of the Dodd-Frank Act requires the Commission to "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", and Proposed Rule 10c-1 would be promulgated as directed thereby.

Based on the foregoing language, a non-U.S. person should not be subject to Proposed Rule 10c-1 (or any other rule in the future promulgated under Section 10(c) of the Exchange Act) if that non-U.S. person does not make use of a "means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange" (*e.g.*, the telephone, facsimiles, the internet, or wires) to effect, accept, or facilitate a securities lending transaction.

Proposed Rule 10c-1 clearly should not apply to a stock loan outside the U.S. between two Canadian Institutions involving only non-U.S. issuers. The application of the rule to other non-U.S. lending arrangements is less clear. For example, we believe that the rule should not apply to a loan of a U.S.-listed security between two Canadian Institutions if the borrower and lender are not actually using the facility of an exchange (or otherwise using any other U.S. jurisdictional means). Expressly excluding the transactions of such non-U.S. borrowers and lenders strikes a reasonable balance between the Commission's goals of protecting investors and the burdens caused by regulating entities that operate outside of the U.S. Indeed, the Commission might reasonably conclude that any securities lending transaction involving a non-U.S. borrower and a non-U.S. lender (with no U.S. person participants) should be excluded from the scope of the proposed rule even if some negligible means of U.S. jurisdictional means, such as the facility of a national securities exchange, is used.

As another option to consider, given that the Commission has asked whether certain types or categories of lenders should be excluded from the requirements under Proposed Rule 10c-1, we believe that Canadian Institutions should be excluded from the scope of the rule.[6] Canadian Institutions could be excepted or exempted from the requirements because they are subject to statutory or regulatory

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[5] The Commission could leverage the U.S. person definition in the security-based swap cross-border context. *See* 17 C.F.R. § 240.3a71-3(a)(4) (*e.g.*, a U.S. person would include any: natural person who resides in the U.S., discretionary or non-discretionary account of a U.S. person, estate of a decedent who was a U.S. resident at the time of death, a partnership, corporation, trust, investment vehicle, or other legal person that either: is organized, incorporated, or established under the laws of the U.S; or has its principal place of business in the U.S.).

[6] *See* Reporting of Securities Loans, 86 Fed Reg. at 69,808 ("Are there certain types or categories of Lenders that should be excluded from the requirements under proposed Rule 10c-1 to provide 10c-1 information to an RNSA? If so, please identify such Lender or Lenders, and explain why they should be excluded from the requirements under proposed Rule 10c-1. For example, should clearing agencies be excluded from the requirements under proposed Rule 10c-1 to provide Rule 10c-1 information to an RNSA? If so, why? How would such an exclusion impact the information available to the public and regulators? Should a broker-dealer that is borrowing securities from a Lender that is not a broker-dealer have a requirement to provide 10c-1 information to an RNSA rather than the non-broker-dealer Lender? If so, why?").

obligations in their home country jurisdiction that restrict them from engaging in highly leveraged trading or building up excessive risk in the execution of their business or investment strategy.

The legislative history of Section 984 of the Dodd-Frank Act demonstrates that the restrictions on securities lending are necessary to curb *financial institutions' use of securities lending programs as a basis for leveraged and risky trading*.[7] In addressing the appropriate scope of the proposed rule, the Commission should consider taking a risk-based approach that advances the goals of Section 984 of the Dodd-Frank Act by more precisely targeting the segment of the securities lending market that presents the greatest risks to the U.S. financial system, by excluding certain categories of market participants, such as Canadian Institutions. The Commission has previously exempted (or granted other relief to) Canadian retirement funds from a number of U.S. securities legal and regulatory requirements.[8]

3 Include a Reporting Hierarchy

To mitigate the compliance costs and burdens of non-U.S. entities that are not broker-dealers (or otherwise regulated by the Commission), we recommend that the Commission include a set reporting hierarchy—analogizing to the security-based swap reporting "waterfall" in the Commission's Regulation SBSR—to determine the counterparty that will be responsible to report the required information.

Proposed Rule 10c-1 would implement a new stock loan reporting regime that would require all lenders of securities to report certain information to an RNSA.[9] Rule 10c-1(a)(1) proposes a simple reporting hierarchy. First, if a lender is using a lending agent, the lending agent would have the obligation to provide the information to an RNSA on behalf of the lender. Second, persons with a reporting obligation, including a lending agent, may enter into a written agreement with a reporting agent (*i.e.*, a broker-dealer).[10] Finally, lenders are required to provide the RNSA directly with information if the lender is loaning its securities without a lending agent or reporting agent.

As acknowledged by the Commission, the proposed approach is likely to impose significant initial and ongoing annual burden and costs on non-broker-dealers that do not employ a lending agent or that are unable to use a reporting agent to develop and reconfigure their current systems to capture the required data elements.[11] These burdens would include operational changes to internal order routing and execution systems to collect the required information, providing data to the RNSA, monitoring systems, implementing changes, and troubleshooting errors.[12] This represents a significant financial investment and operational lift when, as the Commission acknowledges, requiring broker-dealers to do the reporting

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[7] S. Rep. No. 111-176, at 156 (2010).

[8] See, *e.g.*, Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts, 65 Fed. Reg. 37,671 (June 23, 2000); In the Matter of Investment Dealers Association of Canada, Order Granting Exemption (Release No. 34-42906) (June 7, 2000).

[9] Currently, the only RNSA in the U.S. is the Financial Industry Regulatory Authority ("**FINRA**")

[10] Although the ability to employ a broker-dealer as a reporting agent is ostensibly helpful, a lender would incur the cost of drafting, negotiating, and executing the reporting agreements with the broker-dealer, which could be lengthy and time-consuming and would ultimately be subject to the consent and agreement of the broker-dealer so the extent to which lenders will be able to employ a reporting agent, in practice, is unknown.

[11] Reporting of Securities Loans, 86 Fed. Reg. at 69,826.

[12] *Id.*

could be less costly overall and most broker-dealers already have connections to FINRA, so the overall implementation costs and time associated with connecting to FINRA would be lower.[13]

We believe that the Commission should include a set reporting hierarchy—analogizing to the security-based swap reporting "waterfall" in the Commission's Regulation SBSR—to determine the counterparty that will be responsible to report the required information. For example, the hierarchy could be based on the status of the lender, using many of the classifications in Regulation SBSR, as follows: (i) a lending agent; (ii) a registered broker-dealer; (iii) a registered security-based swap dealer; (iv) a registered major security-based swap participant; (v) a U.S. person; (vi) a non-U.S. person that falls within 17 C.F.R. § 242.908(b)(5);[14] and (vii) a non-U.S. person that does not fall within 17 C.F.R. § 242.908(b)(5).

4 Eliminate the Securities "Available to Lend" and "On Loan" Requirement

We recommend the Commission eliminate the requirement in Proposed Rule 10c-1(e) to report end-of-day information on securities "available to lend" or "on loan." The objective of the proposal is to provide market participants with accurate and timely information, but a reporting requirement for securities "available to lend" or "on loan" would not necessarily achieve this objective. In fact, as the Commission acknowledges, it would likely provide market participants with inaccurate and untimely information.[15]

Proposed Rule 10c-1(e)(1)(iii) defines a security as "available to lend" if it "is not subject to legal or other restrictions that prevent it from being lent." But the Commission recognizes that a security may not be available to lend even if it is not immediately subject to legal or other restrictions.[16] For example, the definition of "available to lend" would capture securities that could become restricted once a limit is reached[17] or a security that is on a firm's restricted list in compliance with its material non-public information policies and procedures. The concept of "other restrictions" is subjective and idiosyncratic to each firm. And the definition may also overstate the number of shares that could actually be lent by failing to capture investment companies' willingness to lend.[18] Many investment companies limit their securities lending to one-third or less of their portfolio at any given moment, but the definition of "available to lend" could potentially capture a much greater share of the portfolio.[19] The "available to lend" definition does not represent a firm commitment to enter into a securities lending transaction.

The practical difficulties with reporting securities "available to lend" would inevitably create issues for reporting securities "on loan." The Commission hopes that information on securities "available to lend" will enable market participants to accurately determine utilization rates.[20] But, if the quantity of securities reported as "available to lend" is either inaccurate or unreported, then the utilization rates will also be inaccurate because the utilization rate is the percentage of shares currently "on loan" relative to the total

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[13] *See id.* at 69,845.

[14] 17 C.F.R. § 242.908(b)(5) would capture a lender that in connection with its securities lending activity, arranged, negotiated, or executed the securities lending transaction using its personnel located in a U.S. branch or office, or using personnel of an agent located in a U.S. branch or office.

[15] Reporting of Securities Loans, 86 Fed. Reg. at 69,818, 69,832 n.207, 69,836–37.

[16] *Id.* at 69,832 n.207.

[17] *Id.* at 69,818.

[18] *Id.* at 69,832 n.207.

[19] *Id.*

[20] *Id.* at 69,816 n.105, 69,817.

number of shares "available to lend". Thus, reporting the number of securities "on loan" together with an inaccurate or non-existent number of securities "available to lend" is at best unhelpful and at worst misleading. As this type of reporting may not produce a useful utilization rate, the inclusion of such a requirement would impose an unnecessary burden on market participants.

Moreover, the potential benefits generated by the proposed requirement to report securities "available to lend" or "on loan" would be undermined by the disconnect between the timing mechanism of Proposed Rule 10c-1(e) and current market practice. Market practice is to disseminate information on securities "available to lend" or "on loan" on the same day.[21] Yet under Proposed Rule 10c-1(e), the RNSA may not make similar information publicly available until the next business day.[22] So, by the time information reached the public under Proposed Rule 10c-1(e), that information would not only be outdated, but market participants would have already had access to similar information for up to 24 hours. A shorter reporting timeframe that matches market practice would not address the concerns, particularly given the significant operational burden and financial cost for market participants, like the Canadian Institutions, that are not broker-dealers, do not currently report to FINRA, and are not otherwise registered with the Commission.

Taking into account the serious challenges related to accuracy and timeliness when reporting information on securities "available to lend" or "on loan"—and the conflict between these issues and Proposed Rule 10c-1's objectives—we recommend the Commission eliminate this aspect of the reporting requirement.

5 Conclusion

In summary, Linklaters LLP believes that the Commission should consider revising Proposed Rule 10c-1 as recommended above. We appreciate the opportunity to respond to the proposing release, and thank the Commission for considering our recommendations in relation to Proposed Rule 10c-1. We welcome the opportunity to meet and further discuss our recommendations. Please do not hesitate to contact us if you have any questions or concerns.

Yours sincerely,

Linklaters LLP

[21] *Id.* at 69,805, 69,836–37.

[22] *Id.* at 69,836–37.