



April 26, 2022

Mr. Haoxiang Zhu, Director  
Division of Trading and Markets  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Dear Director Zhu:

Thank you for taking the time to speak with us today.

We asked that the final 10c-1 reporting rule not prevent a data trust from submitting reports on behalf of participating lenders and borrowers. We explained that all the Commission's goals can be achieved if loans are consolidated and validated in a data trust before reporting to FINRA. So long as reporting is not limited to broker-dealers, we suggested that the data trust could be a better alternative than the current proposal. Here's a recap of our answers to your questions:

Q. Why will lenders contribute data to the trust?

A. Better risk protection. By pooling data on counterparty exposures, service providers can feed new surveillance tools, creating an anti-Archegos network. Default indemnification will cost less at providers using internal models for risk capital.

Q. What will it cost lenders to get data out of the trust?

A. Less than today. Lenders now pay for their own data in bundled fees, plus profits for vendors and custodians. Data trustees could set a cost-plus schedule for compiling and encrypting members' raw data files while approving the rates for all reporting services, just like a normal trust. Assuming new vendors can compete, the cost of reports should decline.

Q. What incentive does a prime broker have to report today's hedge fund loans to a data trust?


A. Both PBs and HFs want reliable supply, while lenders want borrowers whose loans are socially acceptable. The data trust can validate loans if prime brokers report the purpose of their trading desks' borrowings. Customer loans can be reported based on their KYC profiles. The data trust will be a competitive advantage to qualified service providers.

As an incentive to participation in a data trust by traders, the validation process can establish loans' economic substance by mining the data to map loans along the supply chain, from lenders to borrowers based on their permitted Reg T purposes. Proof of compliance would be a significant ESG credential for cross-border traders. Supporting information for validation can be submitted to the data trust along with the transaction reports.

The data trust can also attract participation beyond the SEC's jurisdiction. For example, state government and other sovereign funds may resist submitting to FINRA the needed confidential information, even when encrypted. However, lenders will be more likely to submit to their own data trust, where a board of owners can control the use of their data and benefit from the possibility of confidential analytics beyond the realm of data vendors. For example, the data trust administrator can calculate "effective availability" of lendable securities by sharing an encrypted ledger with asset managers and service providers, so as to consider blocked and restricted positions within an otherwise lendable portfolio. Locate information at the ISIN and sector level can also be disclosed by prime brokers to the data trust and monitored as a way of anticipating turmoil in the securities funding markets.

These are just a few of the investor protections and regulatory efficiencies that we envisage from the progress of the data trust, unless the final rule prevents reporting by non-broker-dealers. We would be pleased to continue the discussion at your convenience.

Respectfully submitted,



Edmon W. Blount  
Founder and Director Emeritus

P.S. We will be using the attached slides next week at the 27<sup>th</sup> Annual Beneficial Owners' Securities Finance Conference in Scottsdale, AZ, to explain the data trust alternative.

cc: David Schwartz, Executive Director, CSFME

# **GREENING OF SECURITIES FINANCE THE PATH FORWARD**

**SOCIAL RESEARCH DATA TRUSTS  
FOR SECURITIES LENDERS**

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**PRESENTATION TO THE  
SECURITIES AND EXCHANGE COMMISSION**

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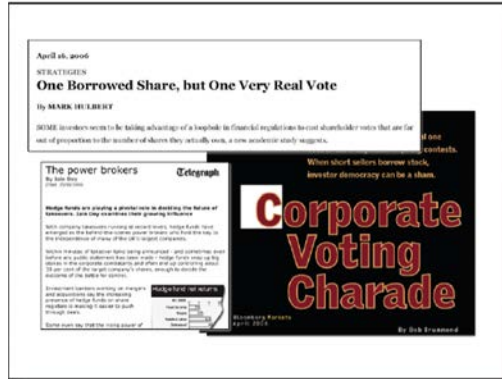
Edmon W. Blount, Founder and Director Emeritus  
David S. Schwartz, Executive Director  
Center for the Study of Financial Market Evolution Washington, D.C.

# A Challenging Environment for Asset Managers who Lend Securities

- Growing influence of academic and media critics on poorly-informed regulators and courts:
  - Complaints of malfeasance and voting indifference.
  - Claims of underperformance by securities lenders.
- Rising litigation costs for Global Securities Lenders.
- Increasing global pressure for as-yet-undefined ESG compliance.
- European legislative outrage over complex tax abuses leading to extensive cross-border loan audits.
- Looming operational risks from the upcoming T+1 cycle:
  - Service providers' capital-limited indemnities.
  - Potential central clearing expenses for the buy-side.

# Media Criticism by Poorly-informed Academics

2006



## Claims that heat Controversies

- “Empty Voting” Manipulation
- Withholding Tax Fraud
- Non-voting Greed
- Underperformance

2020



2017



2021

# Critical July 2021 George Mason ROA Study 'Active Lenders Perform Worse'

MARKETS | JOURNAL REPORTS FUND/ETFS

## Your Fund Manager Is Lending Out Your Holdings. Should You Be Worried?

Fund managers who are lending out their shares to short sellers are underperforming by quite a bit



The author, a George Mason professor, studied what happens to investors when a fund manager lends out a good amount of the underlying portfolio.  
PHOTO: JOHNNY SIMON/WLS; IMAGE: ISTOCKPHOTO/GETTY IMAGES

By Derek Horstmeyer  
Updated July 3, 2021 2:13 pm ET

Wall Street Journal, July 3, 2021

<https://www.wsj.com/articles/fund-manager-lending-holdings-11625335488>

“[I]nvesting in a fund manager who is lending out the underlying shares in a portfolio isn’t only going to be a hit to your returns, on average. It also means a more bumpy ride (higher volatility) along the way—and just may be a signal of an active mutual fund that you may want to avoid.”

Dr. Horstmeyer is a professor of finance at George Mason University’s business school in Fairfax, Va.

### Lending Effect

Fund managers who are more active about loaning out shares will perform worse

■ Under 1% loaned out\* ■ Over 1% loaned out\*

#### 10-year annualized return



#### 5-year annualized return



#### Volatility



\*Average annualized returns presented for fund managers that loan out less than 1% of the holdings in their portfolio

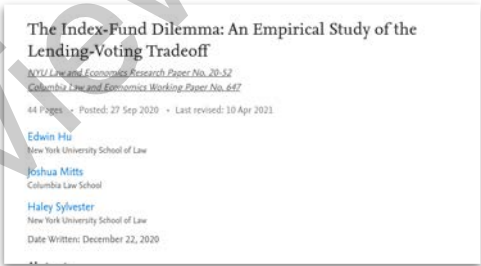
\*Average annualized returns presented for fund managers that loan out greater than 1% of the holdings in their portfolio

Source: Derek Horstmeyer, George Mason University

# Critical NYU-Columbia Law Paper: ‘Lenders evade fiduciary duties’



- Alleged lending conflicts prevailed over proxy voting:
  - SEC’s relaxed rules allowed advisers to favor income over votes.
  - Lenders reduced turnout in contested elections.
- Asserted dynamic model for index advisers’ loans:
  - Straw man attack on advisers’ recall decisions.
  - Behavioral model inferred questionable motives to explain lenders’ record-date spikes.
- Relied on methodological [Econ 101] flaws in analytics:
  - Pricing power ascribed to lenders, not borrowers.
  - Supply-demand curve ignored in rate models.



## Blount’s Opinion:

‘This paper will be used by a class of investors to support claims that index managers have neglected their ESG duties in favor of higher fees.’ ...

‘For rebuttal, it is clear that industry practices are *misunderstood*, as described by the academics.’ ...

**‘No opinion is rendered on the merits.’**

# Rising Litigation Costs for Global Securities Lenders

NEWS

## Germany: Top court issues first ruling in 'cum-ex' case

The judges confirmed the sentence issued by a lower court and the three-figure fine handed to the Warburg Bank. Numerous "cum-ex" trials are still pending in German courts.

## German supreme court ruling a green light for more aggressive cum-ex enforcement

Swiss approve extradition of key figure in German "cum-ex" tax fraud case

- "A German banker involved in the case was sentenced to five-and-a-half years in jail."<sup>1</sup>
- "Prosecutors hope that the trials will . . . aid in the uncovering of similar cases."<sup>1</sup>
- "the sentences against the two traders will set a precedent in other trials connected to the scandal."<sup>1</sup>
- Nearly 900 individuals and firms are under investigation in connection with cum-ex schemes and that this number continues to rise.
- "The Justices' decision to uphold the first criminal convictions for so-called *cum-ex* trading will help local prosecutors unleash a swathe of new charges."<sup>2</sup>

<sup>1</sup> <https://www.dw.com/en/germany-top-court-issues-first-ruling-in-cum-ex-case/a-58669226>

<sup>2</sup> <https://globalinvestationsreview.com/enforcement/german-supreme-court-ruling-green-light-more-aggressive-cum-ex-enforcement>



# Intensifying Legal Scrutiny of Global Lenders

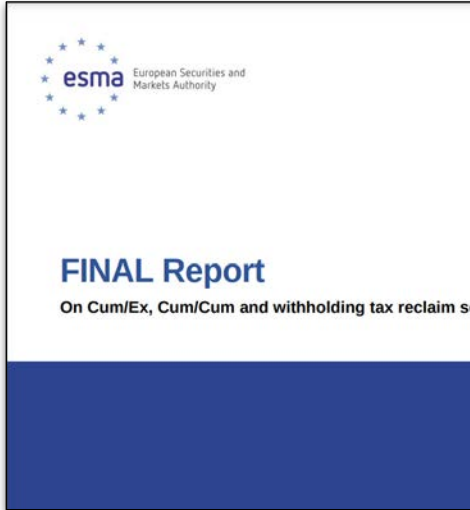
## Cross-border Tax Abuse



From Reclaim  
Accommodation to  
Criminal Activity

Originally ~  
Tax-exempt foreign entities lent dividend-paying stocks to domestic taxpayers, thus avoiding the years-long reclaim process for taxes unnecessarily withheld.

# CSFME's Compliance Solution for ESMA



## CSFME to ESMA, 5 November 2020:

- 'ESMA infers a **currently unattainable standard** of compliance for off-shore lenders in the global finance markets.'
- 'Lenders and service providers **rarely know the end purpose** of their loans.'
- 'Only **end-to-end loan mapping** can separate benign from abusive SFTs in spike data.'

## ESMA to CSFME, 9 December 2020:

- 'National Conduct Authorities would consider an end-to-end mapping solution as a complement to the enhanced prevention and auditing framework ESMA recommended to the European Parliament.'

## ESMA to CSFME, 13 April 2021:

- 'We remain interested in your techniques to render more effective identification of WHT schemes.'

Social Research Topic:

## Cross-Border Loan Registry

Do U.S. lenders wish to respond to European authorities with a solution to the abuses that have been perpetrated by nefarious members of the securities finance community, perhaps USING THEIR ASSETS?

Should members **share their SFTR records** to identify benign and compliant loans, and ask service providers to finance a “visa” fee?



Should lenders **facilitate a visa platform**, as well as related social research projects to benefit members and clients?

# Analytics using Shared Regulatory Data

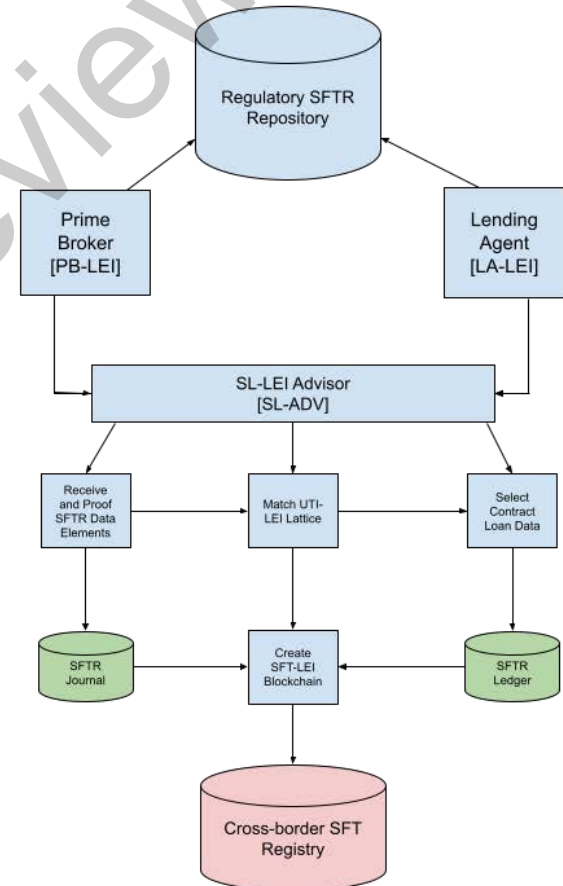
In 2015, the Financial Stability Board defined file layouts for the Securities Financing Transaction Regulation. ESMA enforced SFTR disclosures at account level in June 2020.

SFTR data reports can enable *end-to-end loan mapping at account-level* to prove economic substance to isolate abusive tax transactions.



# Use Case: Loan Registry on a Blockchain for Asset Owners

- A Data Trust can accept SFTR filings from service providers and match data owners as borrowers and lenders.
- Distributed ledger technologies can link the loans' encrypted unique transaction identifiers (UTIs) for confidential end-to-end mapping and purpose tests.
- Anonymized data can be made accessible to participating entities to support research for the benefit of, and as approved by the Data Trust owners.



# Existing Databases Cannot Support a Registry

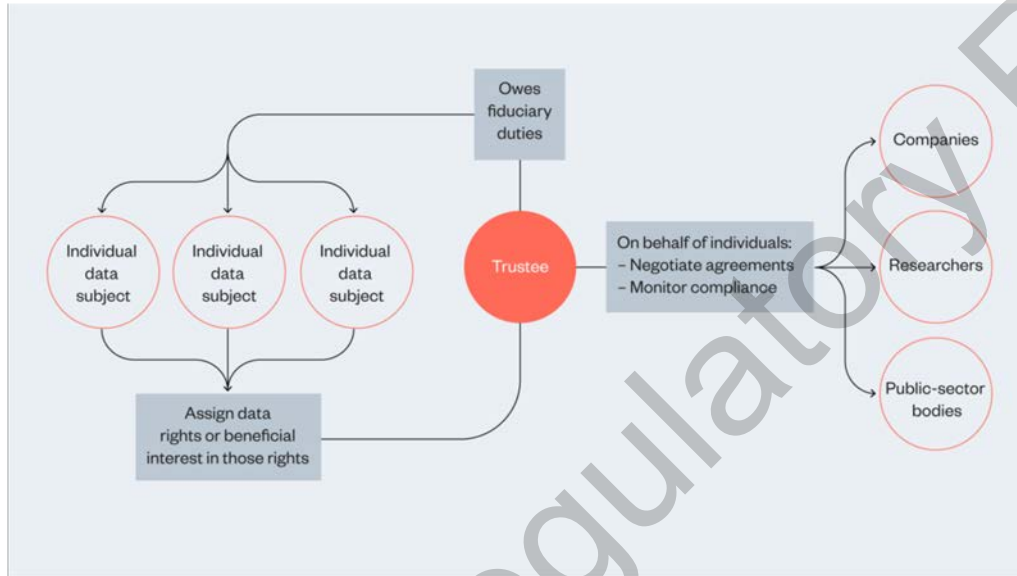


- SFTR repositories (TRs) and industry databases used for performance benchmarking\* **cannot show the purpose of cross-border loans:**
  - Scope of TRs is limited by borders, so governments cannot 'see' the entire trade;
  - Account IDs and contract risk profiles are screened by NDAs, so vendors cannot link the lender SFTR to the end-borrower SFTR.
- Only the account principals can authorize use of SFTRs for mapping their loans end-to-end.

\* <https://csfme.org/Commentary/apple-sauce-or-orange-juice#data-vendor-source> 12



# A Data Trust can support a Registry



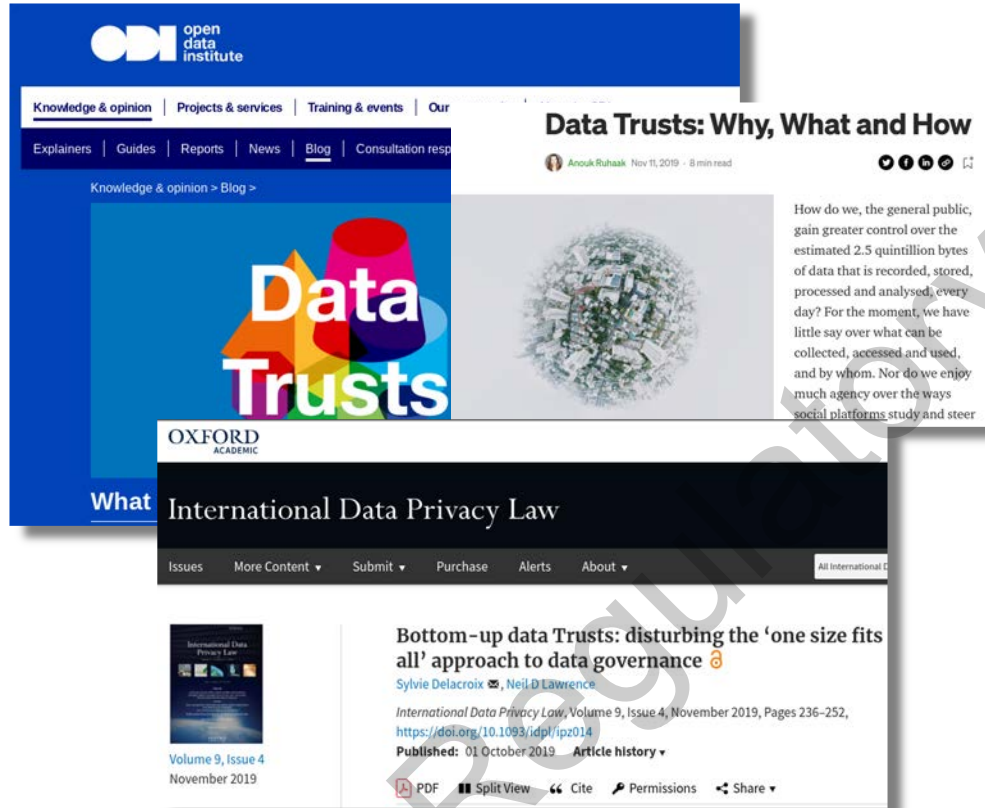
<https://www.adalovelaceinstitute.org/feature/data-trusts/>

A data trust would provide asset managers with a **legal framework** for combining their SFTR data to validate end-to-end loan strategies. Mapped records could also help with extended N-PX and Reg SHO reporting.

A data trust **protects** its members by using common rules for data security, privacy, structure and time-stamping.

Data Trust services could enable members to **securely connect** their SFTR data sources and create a shared ledger in a neutral venue.

# An Loan Registry would be NDA-compliant



Members' data would be pooled in a legal structure ("data trust") for purposes of their own choosing – on a cost-plus basis – and analysis by qualified and approved analysts.

Among the benefits to members would be:

- Total control by data owners
- Lowered cost of T+1 entry and operation
- Outsourced facilities management
- Stewardship Board support
- Flexible and extensible data structures
  - Encryption and anonymization
  - ESG and Proxy metrics
  - CCP pre-pairing compatible
  - Peer-to-Peer compatible
  - Smart contract compatible



# A Loan Registry could Lower Litigation Costs

Modern litigation is data intensive,  
disruptive and *expensive*.

## For In-house Counsel:

- ✓ Trust data is more secure than legacy files as a result of encrypting, masking, and selectively including privileged information.
- ✓ Discovery costs can be reduced by:
  - Querying records in a data trust using SFTR format standards\*,
  - redacting by field (not record), and
  - reducing disruption to operations staff through parallel cloud storage (*i.e.*, not siloed across multiple legacy systems).

\* Courts will rule on discovery motions with full awareness of SFTR data availability.

## For Litigators:

- ✓ Facilitated court-ordered or scenario analysis (*e.g.*, “but for” analysis).
- ✓ Access to protected data for expert witness analytics.

## For Academics and Forensic Experts:

- ✓ Defensible, validated and coherent transaction data.
- ✓ Easier queries for identifying, extracting, and producing relevant data.
- ✓ Replicable computation of industry norms, benchmarks, and historical trends.

# Securities Loan Registry Could Reduce T+1 Compliance Costs

**Encrypted trust datasets could lessen the  
urgency to replace legacy systems**

- Blockchains can assist legacy systems with straight-through-processing (STP) of crucial loan recalls.
- ‘Golden records’ can be used for proof of regulatory compliance, as in:
  - Assisting borrowers by retaining Reg SHO locate details using the ESMA model.
  - Capturing recall metrics on proxy voting for expanded Form N-PX reporting.
- Smart contracts can monitor counterparty leverage and risks .\*
- ESG-compliant lenders and borrowers can be matched.
- Loans can be mapped for end-to-end transaction research.
- Secure affirmations and disclosures can help control intra-day exposures in a T+1 regime.\*\*

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\* Blount, Edmon W., ASC, to SEC Chair Gary Gensler, 6 August, 2021

\*\* U.S. Securities and Exchange Commission, “Statement of Acting Chair Lee and Commissioners Peirce, Roisman, and Crenshaw Regarding Recent Market Volatility,” Jan. 29, 2021, <https://www.sec.gov/news/public-statement/joint-statement-market-volatility-2021-01-29>

# A Data Trust could host “Smart Contracts”



**Harvard Law School Forum on Corporate Governance**

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## An Introduction to Smart Contracts and Their Potential and Inherent Limitations

Posted by Stuart D. Levi and Alex B. Lipton, Skadden, Arps, Slate, Meagher & Flom LLP, on Saturday, May 26, 2018

Comments Off     Tweet

**Tags:** Blockchain, Contracts, Cybersecurity, [Financial technology](#), Legal systems, Risk, Risk management

**More from:** Alex Lipton, Stuart Levi, Skadden

**Editor's Note:** Stuart D. Levi is a partner and Alex B. Lipton is an associate at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden publication.

"Smart contracts" are a critical component of many platforms and applications being built using blockchain or distributed ledger technology. Below, we outline the background and functions of smart contracts, discuss whether they can be deemed enforceable legal agreements under contract law in the United States, and highlight certain legal and practical considerations that will need to be resolved before they can be broadly used in commercial contexts.

### An Introduction to Smart Contracts

**Digital agreements** among transacting parties

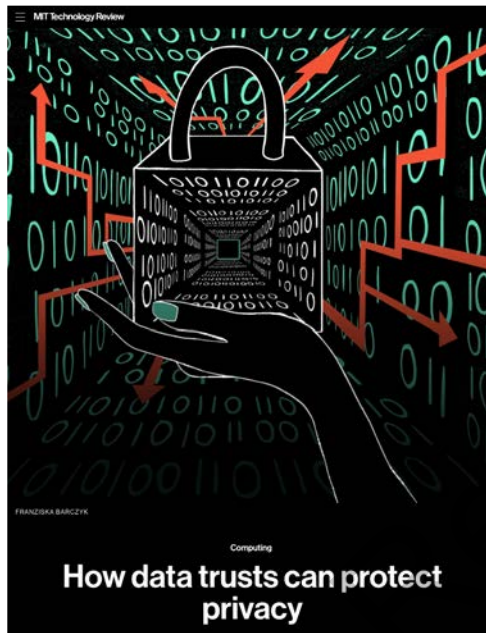
- that are written in **computer code** and
- deployed to a **blockchain**, where they
- **self-execute** for preset terms and conditions.

**Potential Use cases in Securities Lending:**

- ❓ Managing counterparty risks
- ❓ Shortening settlement cycles (T+0)
- ❓ Aiding central clearing
- ❓ Integrating ESG with securities lending
- ❓ Managing collateral risks
- ❓ Managing regulatory compliance risks

# Proposed NEXT STEPS for the Data Trust

- Consult Members and Service Providers
- Define Research Goals and Constraints
- Specify Legal and Technical Requirements
- Draft Request for Proposal, if approved




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**DATA TRUST**

BROWSE: Home / Programs & Resources / ICTR Informatics Core

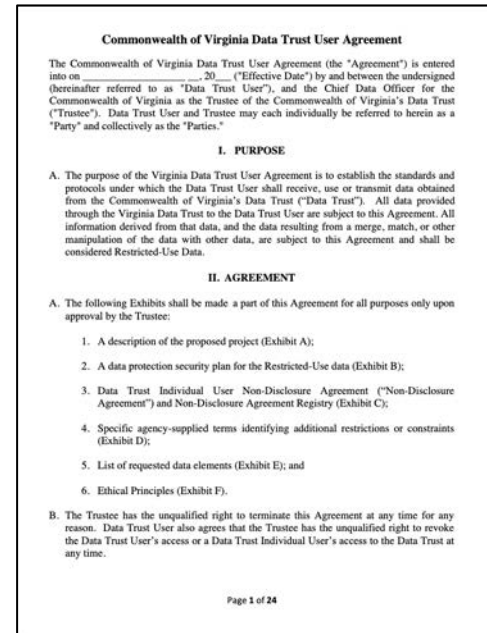
**CONNECTION REQUEST**

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COVID-19 CLINICAL RESEARCH CENTER  
NEWS & EVENTS  
PROGRAMS & RESOURCES  
REQUEST A SERVICE  
ICTR PARTNERS  
COLLABORATIONS  
COMMUNITY ENGAGEMENT IN RESEARCH

*The Data Trust provides Johns Hopkins Medical Center with the technical infrastructure, standards, policies, procedures, and organization needed to protect patient and member-related data from across the system to support our mission.*

The goals of the Data Trust are to:

- Ensure security and privacy of our patients' data.
- Consolidate teams to address organizational priorities and redundancy.
- Increase the value of data through better integration and analysis. Investigators may be referred for a Data Trust review if review triggers, such as the sending of identifiable patient data to external servers, Hopkins or storing large amounts of patient data outside of secured servers.



**Commonwealth of Virginia Data Trust User Agreement**

The Commonwealth of Virginia Data Trust User Agreement (the "Agreement") is entered into on \_\_\_\_\_, 20\_\_\_\_ ("Effective Date") by and between the undersigned (hereinafter referred to as "Data Trust User"), and the Chief Data Officer for the Commonwealth of Virginia as the Trustee of the Commonwealth of Virginia's Data Trust ("Trustee"). Data Trust User and Trustee may each individually be referred to herein as a "Party" and collectively as the "Parties."

**I. PURPOSE**

A. The purpose of the Virginia Data Trust User Agreement is to establish the standards and protocols under which the Data Trust User shall receive, use or transmit data obtained from the Commonwealth of Virginia's Data Trust ("Data Trust"). All data provided through the Virginia Data Trust to the Data Trust User are subject to this Agreement. All information derived from that data, and the data resulting from a merge, match, or other manipulation of the data with other data, are subject to this Agreement and shall be considered Restricted-Use Data.

**II. AGREEMENT**

A. The following Exhibits shall be made a part of this Agreement for all purposes only upon approval by the Trustee:

1. A description of the proposed project (Exhibit A);
2. A data protection security plan for the Restricted-Use data (Exhibit B);
3. Data Trust Individual User Non-Disclosure Agreement ("Non-Disclosure Agreement") and Non-Disclosure Agreement Registry (Exhibit C);
4. Specific agency-supplied terms identifying additional restrictions or constraints (Exhibit D);
5. List of requested data elements (Exhibit E); and
6. Ethical Principles (Exhibit F).

B. The Trustee has the unqualified right to terminate this Agreement at any time for any reason. Data Trust User also agrees that the Trustee has the unqualified right to revoke the Data Trust User's access or a Data Trust Individual User's access to the Data Trust at any time.

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# CSFME and ASC are available as Subject Matter Experts in Securities Finance

## The Impact of Data-Based Models on Financial Markets

6/7/2021

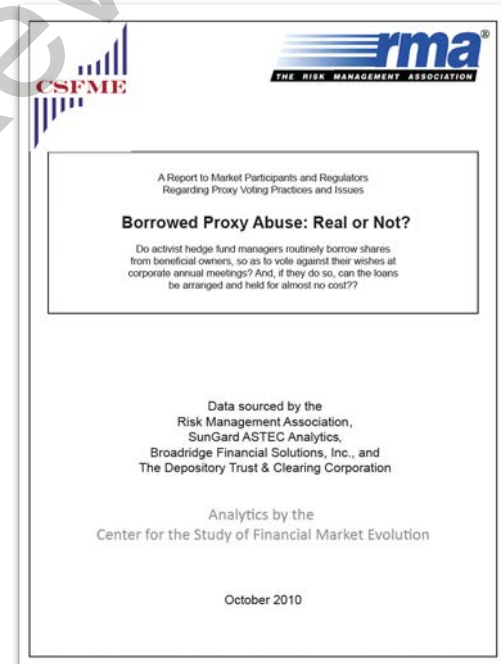


Ed Blount, Executive Director, Center for the Study of Financial Market Evolution, discusses how data-based models can be used to change the negative views of financial markets that are held by some bank customers and regulators, especially in the wake of the pandemic.

### References:

1. Malfeasance, defined as "Evil-doing; the doing of that which ought not to be done; wrongful conduct, especially official misconduct; violation of a public trust or obligation; specifically, the doing of an act which is positively unlawful or wrongful, in contradistinction to misfeasance, or the doing of a lawful act in a wrongful manner." American Heritage Dictionary, at [www.wordnik.com/words/malfeasance](http://www.wordnik.com/words/malfeasance)
2. Hu, Edwin and Mitts, Joshua and Sylvester, Haley, The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff (December 22, 2020). NYU Law and Economics Research Paper No. 20-52, Columbia Law and economics Working Paper No. 647, Available at SSRN: [ssrn.com/abstract=3673531](https://ssrn.com/abstract=3673531) or [dx.doi.org/10.2139/ssrn.3673531](https://dx.doi.org/10.2139/ssrn.3673531)
3. ESMA, Final Report on Cum Ex and Other Multiple Withholding Tax Reclaim Schemes, Sept. 23, 2020.

<https://www.rmahq.org/podcasts/2021/the-impact-of-data-based-models-on-financial-markets/>



<https://www.sec.gov/comments/s7-14-10/s71410-202.pdf>