Submission of Mr. Paul Lynch
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SEC Securities Lending and Short Sales Roundtable
September 30, 2009
Panel 1 — Controls on "Naked" Short Selling:
Examination of Pre-Borrow and Hard Locate Requirements

State Street Securities Finance is opposed to proposals to impose new "pre-borrow" or "hard locate" requirements in connection with short selling of equity securities.

While we agree with the Commission's, and other observers', view that "naked" short selling is abusive and harmful to the financial markets, we are concerned that imposing "pre-borrow" or "hard locate" requirements will have little impact on controlling "naked" short selling, but will disrupt the legitimate short selling that is an essential part of our financial markets.

We support regulations that contribute to a more efficient short sale marketplace, including the Commission's now permanent Rule 204 of Regulation SHO. Rule 204 significantly strengthened the close out requirements for failures to deliver securities from sales of equities, and, according to preliminary analysis by the Commission's Office of Economic Analysis, has had a positive impact since first adopted as a temporary rule in October 2008.

Rule 204, and other actions by the Commission, have been successful in addressing "naked" short selling, while preserving the ability of market participants to engage in legitimate short selling --- which provides the marketplace with liquidity, price discovery and pricing efficiency, and contributes to the dynamics which lead to capital formation.

Given the success of Rule 204, and other actions by the Commission, we believe imposing additional "pre-borrow" or "hard locate" requirements is unnecessary, will reduce the efficiency of short sales, and have a number of unintended results.

As an agency securities lender a "pre-borrow" requirement may in fact lead to more securities lent and potentially higher fees paid as inventory is depleted. This could benefit, in the short-term, my clients and my firm, but the long term consequences may be adverse for the overall markets, and ultimately detrimental to my clients and my firm.

Since asset managers are constantly adapting to changing economic environments and markets, a "pre-borrow" regulation in practice leads to multiple "pre-borrows" for every eventual short sale, due to many "locates" never materializing in a short sale. Any type of "pre-borrow" activity that would encumber my clients' assets would require a form of a borrowing fee, whether or not a physical delivery was made. As a result the structure created by the proposed rules would utilize inventory unnecessarily and increase fees due to supply/demand dynamics. Short term this would be beneficial to lenders, but long term market consequences may be adverse to all.

The long term increased borrowing costs, the potential increased prime brokerage capital usage, and the securities lending inventory illiquidity resulting from a “pre-borrow” or “hard locate” requirements could lead to a number of detrimental consequences for legitimate short sale activity. As legitimate hedges and short sale strategies are restricted, market volatility will increase.

In summary, we believe a “pre-borrow” requirement could expose the market to detrimental consequences, while showing no empirical evidence that it improves market efficiency, or has any measurable impact on “naked” short selling beyond the Commission’s existing policies and regulations.

Background Information

Paul F. Lynch is a senior managing director and head of global trading, ECM, risk and portfolio strategy for State Street’s Securities Finance division.

Prior to assuming his current role, Mr. Lynch managed global trading for Securities Finance. Previous roles included managing the equity trading strategy group and overseeing the post-acquisition conversion of Deutsche Bank Global Security Services’ global portfolio management, trading, and collateral management functions. He was also instrumental in the development of EquiLend, an electronic securities lending platform developed by State Street and nine other industry leaders. In addition, he has been responsible for asset/liability risk management and portfolio strategy, euro implementation and product management for the third-party lending product.

Mr. Lynch joined State Street in 1996 as manager of the financial accounting department. Prior to that, he held positions in financial service firms, including Mellon Trust Asset Management, American Express and Coopers & Lybrand.

Mr. Lynch holds a Bachelor of Arts degree in economics from Boston College and a Master of Science degree in accounting from Northeastern University. He holds the Chartered Financial Analyst (CFA) designation and Series 7 and Series 63 registrations. He is a member of the CFA Institute and the Boston Security Analysts Society.

State Street Securities Finance lends securities and provides liquidity in more than 45 markets around the world. We have been providing securities lending services since 1974, with over $400 billion on loan, from customers located all over the world and who include pension funds, asset managers, mutual funds, insurance funds, endowments and foundations, and central banks. State Street Securities Finance offers securities lending services for customers whether their assets are custodied at State Street or elsewhere; we are one of the world’s leading third-party lending providers. As a full service securities lending provider, State Street’s Securities Finance can facilitate multiple routes to market, including traditional agency based securities lending, auction lending, and exclusive lending arrangements.