RMA Securities Lending Council

December 14, 2021

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

Via email to: rule-comments@sec.gov

Re: File Number S7-11-21
Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers (File No. S7-11-21)

Dear Ms. Countryman:

The Securities Lending Council of the Risk Management Association[1] appreciates the opportunity to comment on the Securities and Exchange Commission's (the "SEC") above-referenced proposal and supports the SEC's goals to improve information reporting. We are writing to provide some additional information with respect to how the securities lending market operates, specifically with respect to the impact on funds of recalling shares to vote. In addition, we express our concerns with respect to potential unintended consequences of requiring funds to report shares not voted because they remained on loan. These consequences include the potential to mislead investors and detrimental impact on funds and their underlying shareholders from factors such as a reduction in market efficiency and increased volatility.

Potential for Misleading Investors

The Proposal, if adopted, would require disclosure of the number of shares the reporting person has loaned, but did not recall to vote. We do not believe that this one piece of information provided in isolation gives investors sufficient information to draw a fully informed conclusion with respect to

1. The RMA Securities Lending Council acts as a liaison for RMA member institutions involved in agent 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.

how their fund's securities lending activities impact proxy voting. This is because it does not provide information with respect to the complex process undertaken, including the many factors considered, by fund managers when implementing the fund's proxy voting policy and deciding whether to recall securities on-loan for the purpose of voting proxies.

Securities lending provides a source of additional income that can add alpha and/or defray fund expenses resulting in additional return for fund shareholders. In determining how best to meet the fiduciary duty of loyalty to fund investors and maximize shareholder value when deciding whether to recall shares to vote, a manager must consider earnings from securities lending and weigh that benefit to fund shareholders against the value that may be created from voting the securities on loan. In making this determination, portfolio managers may consider, among other factors: the costs associated with recalling shares including the impact on future revenue opportunities; the size of the position on loan compared to the fund's overall position in that security[2]; the investment objectives of the fund; the specific nature of the vote and its relative importance in light of the fund's investment mandate; and the size of the fund's position and the ability to influence the outcome of the vote. Simply providing a data point about shares not recalled does not provide context about why the decision was made and the factors that a portfolio manager may consider when making an informed decision about what will provide the greatest benefit to fund shareholders. This may lead investors to draw a simple conclusion that proxy voting provides the greatest benefit to their fund. If shareholders then make a judgment about the stewardship of a fund based solely on the fact that a manager did not recall a generally small portion of its position to vote, then that could interfere with the portfolio manager's fiduciary responsibility to make an informed decision of how best to maximize value for fund shareholders.

The proposed oversimplification of the complex decision process that managers follow when determining whether to recall a typically small portion of their overall position to vote down to a single data point has a potential to mislead investors. It tends to imply to investors that there are competing fiduciary duties, one to vote proxies, and one to earn additional revenue through securities lending. It further implies that ensuring maximum participation in a proxy vote is somehow always the higher of those two duties. They are not competing duties or duties at all rather they are factors that a manager must weigh in the execution of the duty of loyalty to shareholders and an obligation to maximize shareholder value. This overall duty is accomplished through: maximum participation in a vote that the portfolio manager believes to be important to the value of the underlying holding; ensuring that securities lending revenue of a security out on loan continues and that future lending opportunities are not impacted in such a way as to degrade shareholder value; or a combination of voting the position not on loan and continuing to earn and preserve future lending revenue.

[2] For the majority of a fund's on-loan securities, the amount on loan generally represents a small percentage of the fund's overall position. Accordingly, the fund manager may also consider whether recalling that small amount to add to its voting position will have a material impact.

Detrimental Impacts on Funds and Their Underlying Shareholders

In addition, we are concerned that this single data point indicating shares not recalled could be viewed in a negative light by market data firms providing ESG rankings. This could lead these firms to inappropriately compare funds based on the simple percentage of shares recalled to vote, rather than considering the full information about the decision-making process used by the manager to properly exercise their fiduciary duty to investors and to maximize shareholder value. Said differently, funds could receive a lower ESG ranking for the fact that their portfolio managers adhered to their fiduciary principles to seek to achieve maximum shareholder benefit while adhering to their fund's investment mandate. This could conceivably lead portfolio managers to disregard this decision process in order to achieve the highest ranking for their fund and negatively impact the fund's ability to earn securities lending revenue, reduce market liquidity and increase volatility. Certain generalized assumptions with respect to the securities lending market were made in the proposal to explain away these potential consequences. Accordingly, we are providing additional information on the market and our concerns.

Demand in the Equity Securities Lending Market

The majority of the demand in the equity securities lending market comes from large sell-side institutions with prime brokerage businesses. These entities borrow securities generally to facilitate the trading activities and investment strategies of their clients. These borrowers first look to source needed securities internally by rehypothecating securities pledged as margin or through fully-paid lending programs. They also look to create synthetic positions. Only after the internal supply is exhausted and synthetic options are maximized do borrowers look to source securities from institutional investors such as investment funds. When doing so they generally borrow through the agent lending programs of large custodial banks and other third-party lending agents who lend on behalf of many types of institutional investors. In addition, as noted in the proposal, several large fund complexes have their own lending programs.

Investment funds are generally at a disadvantage in the lending market to certain other institutional investors due in large part to their risk weighting under the capital rules, limited collateral flexibility, size, and credit profile. Accordingly, they are generally not preferred counterparties. Some funds overcome this because they may hold a certain amount of in demand securities. In addition, index funds also overcome this lack of preference because their trading strategies provide stability of supply which is highly valued by borrowers as it allows their clients to maintain trades/transactions without the interruption of recalls. If funds are forced to recall securities to vote due to the concerns noted above or a lack of understanding of the manager's proxy voting policy and decision process, then their opportunities to participate in the lending market will be further diminished. This will ultimately reduce potential returns to fund investors by reducing or eliminating the additional income from securities lending that can add alpha and/or defray fund expenses.

Securities Lending Market Impacts

As Commissioner Roisman noted, "if the outcome of this proposal potentially implies that voting shares should be a fund's priority rather than lending out those shares for a return," then it is likely that while well intentioned, the proposal will negatively impact the ability of registered funds to participate in the securities lending market. The proposal states that "we would expect the securities lending supply to be largely unaffected by the proposed amendments, and, therefore, we would expect other market activities that rely on securities lending to be largely unaffected too."[1]

While we agree that the supply of most issuers in the lending market will likely be only minimally affected by funds recalling shares, the majority of the negative impact of the proposal on participation in the securities lending market will not be borne by the borrowers, but rather will largely be borne by the registered funds acting as lenders. The vast majority of lending activity (roughly 90% of outstanding loan balances) resides within a market segment where lending supply is significantly greater than borrower demand. In this instance, should a fund recall shares to vote, the borrower would likely replace the shares with supply from another readily available source. Given this readily available supply, it is incorrect to assume that a fund would be able to immediately put shares back on loan after a record date. Consequently, funds will not be able to easily re-lend their shares after voting, leading to loss of income.[3]

Conversely, for loan activity where there is significant borrower demand, the impact from simultaneous recall instructions across many registered funds would likely have a negative impact on market liquidity, potentially increasing trading costs in the given security and thereby negatively impacting the investor. In addition, borrowers of the high demand securities will be aware of the likelihood of the recall around the proxy date due to the proposed reporting requirement and will prioritize those lenders that are likely to have a more stable supply. In certain cases, recalls across many registered funds may result in a lack of available supply of the in-demand security causing the borrowers' clients to close out their trades which could lead to increased market volatility especially in times of market stress. Ultimately, participants in the lending market that do not have to report proxy votes on Form N-PX will be favoured as lenders because they will be less likely to recall shares in the lead-up to a shareholder vote, which will disadvantage fund shareholders.

Suggested Alternative Disclosure

Rather than providing the sole data point on recalled shares we suggest that it would be more informative to shareholders to provide disclosure about the policy considerations a manager uses in making the decision about whether to recall shares. We suggest that this would include disclosure detailing the factors a manager considers when making decisions about securities lending and recalling shares to vote, which would highlight the need to balance the economic opportunity from lending against the perceived value of a given proxy vote.

2] Proposal, at page 114

[3] The Proposal states that "even if some funds decide to recall loaned securities ahead of proxy voting, we anticipate that these funds would lend their shares again immediately after the vote record date, thus resuming the income stream obtained through security lending." Id., at page 113. We believe this assumption is incorrect for most issuer names where supply of securities to be loaned exceeds demand.

Sincerely,

Francis Garritt	*Mark Whipple*
Francis Garritt	Mark Whipple
RMA Director Securities Lending	RMA Chair Securities Lending