CITADEL

April 4, 2022

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090

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

Dear Ms. Countryman:

We appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") on the proposal to require securities lending transactions to be publicly reported within 15 minutes of being effected (the "Proposal").[1]

Citadel is a leading investor in the world's financial markets, managing in excess of $46 billion in investment capital on behalf of a diverse array of investors, including pensions (local, corporate, and union), endowments, healthcare providers, foundations, and insurance companies. Founded in 1990, our flagship fund has delivered a 19.3% annualized return since inception, returns driven by the very fundamental research that may be negatively impacted by the Proposal.

Crucially, the Proposal fails to provide market participants with clarity regarding the specific types of transactions that would be subject to the new disclosure regime. While several elements of the Proposal support the conclusion that the Commission intended to focus solely on securities lending transactions entered into between lending programs and broker-dealers (referred to as the "wholesale market" in the Proposal), the Proposal also briefly discusses securities transactions entered into in order to fulfill delivery obligations arising from customer short sales ("Short Sale Linked Activity," referred to as the "retail market" in the Proposal).

To the extent the Commission intended to propose requiring public reporting of Short Sale Linked Activity, it would transform the proposed securities lending disclosure regime into a transaction-by-transaction short sale public reporting regime. This would raise a number of concerns that the Commission did not adequately consider, including increasing the costs associated with establishing short positions, facilitating the copycatting of investment and trading strategies, disincentivizing fundamental research, and impairing price discovery, liquidity and market efficiency. All of these consequences of the Proposal will impede the ability of fund managers to continue to deliver superior risk-adjusted returns for investors.[2]

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[1] 86 FR 69802 (Dec. 8, 2021), available at: https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf.

[2] *See, e.g.,* Letter from Charles Schwab & Co., Inc. (Jan. 7, 2022), available at: https://www.sec.gov/comments/s7-18-21/s71821-20111345-264955.pdf; Letter from Fidelity Investments (Jan. 7, 2022), available at: https://www.sec.gov/comments/s7-18-21/s71821-20111708-265037.pdf; Letter from the Standards Board for Alternative Investments (Jan. 21, 2022), available at: https://www.sec.gov/comments/s7-18-21/s71821-20112833-265517.pdf.

Further, by impairing the ability of fundamentally-driven active investment managers to effectively take and manage short positions, the Proposal will have material negative consequences for the wide swath of retail and institutional investors who today benefit from efficient, low cost index funds and other passive investment vehicles. Active managers, who invest time and resources to identify both under-valued and over-valued securities, play a critical role in driving the informed prices and rational allocation of capital that passive investors depend upon. The successful growth of indexing and other passive investment strategies has been underpinned by active management strategies that drive and maintain the efficient pricing of securities. Compromising the ability of active managers to effectively implement their investment theses, particularly with respect to stocks they believe are over-valued, would cause stock prices to deviate from their fundamental value and capital to be misallocated, to the detriment of all investors.

Importantly, ignoring all of these significant costs in favor of a transaction-by-transaction short sale public reporting regime contradicts the Commission's own reasoning in its recent rule proposal regarding "Short Position and Short Activity Reporting by Institutional Investment Managers" (the "Short Position Reporting Proposal"),[3] which was issued *after* this Proposal and in which the Commission concluded that *aggregate* and *delayed* disclosure of short sale positions was preferable to *transaction-by-transaction* and *intra-day* disclosure.

Below, we detail why including Short Sale Linked Activity fails to satisfy a cost-benefit analysis, represents a reversal of Commission position, and is inconsistent with the Securities Exchange Act of 1934 ("Exchange Act"). In any event, given the lack of clarity regarding the scope of the Proposal, and the inadequate economic analysis contained therein, we urge the Commission to re-propose the rule in order to enable market participants to meaningfully comment.

[3] Release No. 34-94313 (Feb. 25, 2022), available at: https://www.sec.gov/rules/proposed/2022/34-94313.pdf.

TABLE OF CONTENTS

I. The Commission Did Not Adequately Assess The Economic Consequences Of The Proposed Rule.

The Commission "has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation.'"[4] The Exchange Act additionally prohibits any rulemaking that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes" of the statute.[5] The Commission's "failure to 'apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation' makes promulgation of the rule arbitrary and capricious and not in accordance with law."[6]

In the Proposal, the Commission appears to be considering whether to apply transaction-by-transaction public reporting requirements to two distinct types of activities: 1) securities loan transactions entered into between lending programs and broker-dealers (referred to as the "wholesale market" in the Proposal) and 2) Short Sale Linked Activity (referred to as the "retail market" in the Proposal).[7]

The scope of the Commission's proposal is unclear. Despite the overall lack of clarity, several elements of the Proposal support the conclusion that the Commission intended to focus solely on the "wholesale market" as described above, including:

- The Proposal by its terms covers "security loans." Customer short sales, and Short Sale Linked Activity, are not typically documented under securities lending agreements, booked as securities loans, or treated as securities loans for financial reporting purposes.[8]

- Neither the "Discussion of Proposed Rule" section of the Proposal nor the proposed rule text mentions the "retail market" a single time.

- The Commission asserts a central benefit of the Proposal is a reduction in short selling costs, which will encourage more fundamental research and short selling, thereby improving overall price discovery and market efficiency.[9] In contrast, requiring transaction-by-transaction reporting of Short Sale Linked Activity would significantly increase the costs associated with short selling, as described in more detail below.

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[4] *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (quoting 15 U.S.C. §§ 78c(f), 78w(a)(2), 80a-2(c)).

[5] 15 U.S.C. § 78w(a)(2).

[6] *Bus. Roundtable*, 647 F.3d at 1148 (quoting *Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005)).

[7] *See* Proposal at 69805.

[8] *See* Letter from SIFMA (Jan. 7, 2022), available at: https://www.sec.gov/comments/s7-18-21/s71821-20111680-265019.pdf.

[9] Proposal at 69839.

The conclusion that the Proposal intends to focus solely on the "wholesale market" is further supported by the Commission's longstanding policy position that transaction-by-transaction public reporting of short sales would impair overall market efficiency, competition, and capital formation for myriad reasons.[10] Indeed, this position was reiterated only recently by the Commission in its Short Position Reporting Proposal that was issued *after* this Proposal.

Notwithstanding the above, to the extent the Commission intended to propose requiring transaction-by-transaction public reporting of Short Sale Linked Activity, it must, at a minimum, re-propose the rule to make this clear to market participants (thereby providing an opportunity to meaningfully comment), perform a more credible cost-benefit analysis, and reconcile the inconsistent positions taken in this Proposal and the recently issued Short Position Reporting Proposal. As we detail below, a reasoned analysis leads to the conclusion that this Proposal should indeed focus solely on the traditional securities lending activity the Commission defines as the "wholesale market."

A. The Commission Underestimated The Costs.

The Commission did not adequately assess the costs of the Proposal, particularly to the extent the Commission intends to apply the reporting requirement to Short Sale Linked Activity.

The Commission's economic analysis of the Proposal identifies short sellers as one of the primary beneficiaries of the Proposal, with the Commission asserting that overall short selling costs will decline, leading to more fundamental research, improved price discovery, and greater liquidity in both stock and options markets.[11] But the opposite is true. The disclosure of Short Sale Linked Activity will increase the costs of short selling, lead to less fundamental research, degrade price discovery, and increase price volatility.[12]

A public reporting requirement for Short Sale Linked Activity will harm the market for short sales. While there is some correlation between securities lending activity in the "wholesale market" and short sales, particularly for hard-to-borrow securities, the Commission acknowledges that it is imperfect, as security loans may be entered into for a variety of purposes, including to cover failures to deliver and to enable lenders to borrow cash.[13] In contrast, there is a *perfect* correlation between a short sale and the associated Short Sale Linked Activity, which facilitates the customer fulfilling the delivery obligations arising from the short sale. As a result, deeming Short Sale Linked Activity to be covered by the public reporting requirements of this Proposal would transform the proposed securities lending disclosure regime into a transaction-by-transaction short sale public reporting regime (albeit with a two-day delay, as the Short Sale Linked

[10] *See, e.g.,* Short Sale Position and Transaction Reporting, Staff of the Division of Economic and Risk Analysis of the U.S. Securities and Exchange Commission (June 5, 2014), available at: https://www.sec.gov/files/short-sale-position-and-transaction-reporting%2C0.pdf.

[11] Proposal at 69839.

[12] *See also* Expert Report of James A. Overdahl, Delta Strategy Group at ¶¶ 16-26 ("Overdahl Report").

[13] *See, e.g.,* Short Position Reporting Proposal at page 103.

Activity is typically effected on the settlement date of the short sale[14]). This will have enormous costs.

In its recent Short Position Reporting Proposal, the Commission cataloged the many harms associated with a transaction-by-transaction short sale public reporting regime as documented in the relevant academic literature, including:

- Increased costs associated with establishing short positions, particularly larger positions that require a longer period of time to enter into, which would be more difficult and costly if information regarding the trading strategy was publicly disclosed;[15]

- Heightened risk of copycatting investment and trading strategies and herding based on the publicly disclosed information, which could result in diminished returns;[16]

- Heightened risk of disclosing the identity of the firm engaging in a particular trading strategy, which could lead to issuer retaliation. The Commission found that even anonymized and aggregated data would not remove this risk, as only a small group of funds regularly engage in short selling, and often only one fund is shorting a particular issuer;[17]

- Negative impacts on options market making and convertible debt issuances, both of which often employ or rely upon short selling for hedging purposes;[18]

- Heightened risk of short squeezes based on the publicly disclosed information;[19]

- Reduced short selling as a result of the costs detailed above, which results in less fundamental research and an impaired ability to pursue fundamentally-driven actively-managed investment strategies. As a result, there is impaired price discovery and market efficiency, reduced external monitoring of issuer management, and less associated securities lending revenue for beneficial owners.[20]

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[14] We note this will shrink to a one-day delay if the Commission's proposal regarding "Shortening the Securities Transaction Settlement Cycle" is finalized. Release No. 34-94196 (Feb. 9, 2022), available at: https://www.sec.gov/rules/proposed/2022/34-94196.pdf).

[15] Short Position Reporting Proposal at page 101.

[16] *Id.* at page 174. *See also The public disclosure of net short positions*, ESMA Report on Trends, Risks and Vulnerabilities (No. 1, 2018); *Market Impact of Short Sale Position Disclosures*, Copenhagen Economics (July 2021); John Heater, Ye Liu, Qin Tan, and Frank Zhang, *Mandatory Short Selling Disclosure Could Lead to Investor Herding Behavior*, Columbia Law School Blog (Sept. 2021).

[17] Short Position Reporting Proposal at pages 40, 59, 106, and 138.

[18] *Id.* at pages 142 and 163. *See also* Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, *Convertibles and Hedge Funds as Distributors of Equity Exposure*, The Review of Financial Studies (Oct. 2012).

[19] Short Position Reporting Proposal at page 40.

[20] *Id.* at pages 125, 144, 148. *See also The Invisible Hand of Short Selling: Does Short Selling Discipline Earnings Management? Review of Financial Studies* (Oct 2014); P. Asquith & L. Meulbroek, *An empirical examination of short*

The Commission has cataloged all of these well-documented harms associated with a transaction-by-transaction short sale public reporting regime, yet did not consider them when analyzing the current Proposal. Furthermore, the Commission fails to acknowledge the direct link between this Proposal and the Short Position Reporting Proposal, and the necessity of adopting a consistent approach across both proposals. Further, by impairing the ability of fundamentally-driven investment managers to effectively take and manage short positions, the Proposal will also have material negative consequences for the wide swath of retail and institutional investors who today benefit from investing in index funds and other passive investment vehicles that depend upon fully informed and efficient markets. To the extent the Commission is considering including Short Sale Linked Activity in a securities lending transparency regime, it must re-issue its economic analysis to address these and other omissions[21] and revisit its central assertion that short sellers will be one of the primary beneficiaries of the Proposal.[22]

B. The Commission Overstated The Benefits.

The Commission admits that it lacks the data necessary to calculate any benefit of the proposed rule. The Commission claims that the proposed reporting rule would "improve transparency" in the securities lending market "through increased completeness, accuracy, accessibility, and timeliness of securities lending data."[23] This improvement in transparency, the Commission continues, would "reduce information asymmetries" in the market, as well as "reduce the costs of short selling, potentially affecting markets more broadly."[24] The Commission, however, cannot "accurately assess any potential increase or decrease" in transparency because the Commission does not know what the "baseline level of price transparency and information disclosure" is.[25] The Commission reiterates several times that it lacks the necessary information to assess the existing level of transparency in the securities lending marketplace.[26]

The Commission's attempts to determine that transparency baseline fall short. For example, the Commission asserts that the "securities lending market is characterized by asymmetric information" because the "current 'give-to-get' model of commercial data for securities lending means that only those market entities with data to report for themselves are able to get access to

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interest (1996) (working paper); V. W. Fang, A. H. Huang, & J. M. Karpoff, *Short selling and earnings management: A controlled experiment*, 71 J. of Finance 1251 (2016).

[21] *See* Overdahl Report ¶¶ 16-29.

[22] *See id.* ¶¶ 21-26.

[23] Proposal at 69836.

[24] *Id.* at 69837.

[25] *Am. Equity Inv. Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010).

[26] *See, e.g.*, Proposal at 69836 ("Due to uncertainties about existing data … the Commission has some uncertainty in describing how much more complete, accurate, and timely the data provided by the proposal will be."); *id.* ("[I]t is not clear whether these [existing] data vendors require their data contributors to report transactions within 15 minutes thus the Commission is uncertain about the comprehensiveness of existing intraday data offerings."); *id.* ("While the Commission understands that most of the major data vendors provide some data on transactions intraday, it is unclear if all do.").

the data."[27] But the "give-to-get" model is not the only model for commercial data for securities lending. As the Commission notes elsewhere, securities lending data can also be gleaned from "surveying fund managers about their borrowing experience."[28] The Commission does not explain why this survey data is inadequate or unavailable, and it offers no reason to believe that the survey and "give-to-get" data are materially different. The Commission also suggests that give-to-get data could be biased in a "systematic fashion,"[29] but this suggestion has "no basis beyond mere speculation."[30]

By not quantifying the asserted deficiencies in existing data or any improvements that would be fostered by the proposed rule, the Commission has neglected its statutory duty to assess the economic consequences of the Proposal. The Commission admits that it has access to at least some securities lending data,[31] but says that it "is not practicable … to quantify certain economic effects" of the Proposal given the "number and type of assumptions" that would be necessary.[32] This is a notable shortcoming; the Commission admits that it did not make the type of "tough choices about … competing estimates" that the Exchange Act requires the Commission to make, nor did it "hazard a guess as to which is correct."[33]

Recognizing the lack of data supporting the Proposal, the Commission "requests that commenters provide relevant data and information to assist the Commission in quantifying the economic consequences of the proposed Rule."[34] But under the notice-and-comment requirements of the APA, "the most critical factual material that is used to support the agency's position" must be "made public in the proceeding and exposed to refutation."[35] The "information that must be revealed for public evaluation" includes "the technical studies and data upon which the agency relies."[36] Consequently, the Commission is foreclosed from "extensive reliance upon extra-record materials in arriving" at its estimates concerning the proposed rule, unless it provides "further opportunity for comment" on those materials and the Commission's analysis of them.[37] In other words, if the Commission decides to adopt the proposed rule, and it relies on new data to support its analysis, then the Commission must re-open the comment period so as to avoid violating the requirements of 5 U.S.C. § 553(c).

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[27] *Id.* at 69830.

[28] *Id.* at 69832.

[29] *Id.* at 69830.

[30] *Bus. Roundtable*, 647 F.3d at 1150; *see* Proposal at 69832 ("Because the data are missing, the extent of the biases cannot be determined.).

[31] Proposal at 69832.

[32] *Id.* at 69830.

[33] *Bus. Roundtable*, 647 F.3d at 1150.

[34] Proposal at 69830.

[35] *Chamber of Commerce v. SEC*, 443 F.3d 890, 900 (D.C. Cir. 2006) (internal quotation marks omitted).

[36] *Id.* at 899 (internal quotation marks omitted).

[37] *Id.* at 901.

Even if the Commission could show that the Proposal would meaningfully increase transparency in the securities lending market, the Commission cannot explain *why* that increase in transparency would be valuable to market participants. Securities loans are not fungible. The fee for a particular loan depends on a variety of factors that are unique to each transaction, including the length of the loan, the counterparty's creditworthiness, and whether the counterparty has a history of recalling loans.[38] The proposed disclosures will not—and could not feasibly—contain this information, which the Commission agrees is necessary to "compare the fees on different loans."[39] The Commission's proposal is akin to requiring banks to publicly disclose mortgage transactions without any reference to the borrower's credit score; the information is of extremely limited use.

The studies cited by the Commission prove the point. In asserting that increased transparency will benefit the market, the Commission cites a number of studies concerning "the implementation of TRACE in the corporate bond markets."[40] But the corporate bond markets involve irrevocable purchases and sales of fungible securities without any ongoing relationship between the buyer and seller after the completion of the transaction. In contrast, securities loans are revocable and not fungible; as discussed, their terms turn in substantial part on specific attributes of each counterparty. Unlike a bond transaction, no two loans are alike. This difference explains why public reporting is useful in the bond markets, but not in the securities lending markets.[41] The Commission neglects to consider this aspect of the problem.[42]

The Commission is on especially weak ground to the extent it seeks to apply the Proposal to Short Sale Linked Activity. As discussed above, Short Sale Linked Activity is even less fungible than "wholesale" loan transactions, with the lending fee governed by the brokerage agreement between an investor and its broker-dealer. The fee turns on a number of factors wholly unrelated to the loan itself, including the suite of services the investor purchases from the broker-dealer and the investor's trading volume. The Commission does not explain why it would be useful for one investor to know what another investor paid on a loan without knowing any of the material facts of the other investor's relationship with its broker-dealer. Moreover, the Commission does not explain how an investor would make use of this data, even assuming it conveys useful information. As the Commission acknowledges, the "costs associated with switching broker dealers may be high"; accordingly, "[s]witching broker-dealers may not be cost effective."[43] The Commission does not compare the cost savings the Commission claims investors could realize by switching broker-dealers in light of the information disclosed under the Proposal to the costs of doing so.

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[38] Proposal at 69839; *see id.* at 69806 (explaining that a counterparty's ability or willingness to recall a loan undermines the value of the loan).

[39] *Id.* at 69839.

[40] *Id.* at 69837.

[41] *See* Overdahl Report ¶ 12; *see also Bus. Roundtable*, 647 F.3d at 1150 (vacating rule where Commission "relied upon insufficient empirical data" and "unpersuasive studies").

[42] The Commission also cited a study regarding the Brazilian securities lending market, but in that market, the exchange simply published a loan fee benchmark, not transaction-by-transaction reports, as contemplated by the Proposal. Proposal at 69837.

[43] *Id.* at 69837 n.221.

The Commission instead claims that "the data would provide benchmark statistics that may enable smaller borrowers to select higher performing broker-dealers initially."[44] But, again, that is speculation. The Commission offers no evidence to suggest that the lending fees broker-dealers charge are so meaningfully different (after controlling for various commercial factors) that investors would rationally rely on historical lending fee data to select a broker-dealer initially. Further, if investors, in selecting a broker-dealer, would actually value "benchmark statistics" on the lending fees broker-dealers charge, then the Commission should consider requiring broker-dealers to disclose benchmark statistics on the lending fees they charge. The Commission offers no valid reason to require transaction-by-transaction reporting.

The Commission suggests that market participants who make their securities available for lending through lending agents desire more transparency in the "retail market."[45] But that suggestion is unsupported. The Commission cites a single source—an interview with one individual, [46] who states that "[a]s a lender, we monitor fees paid to us by the agent, but we only see one side of the trade. We have no sight of the pricing paid by a hedge fund or prime broker, for example, when they borrow those securities."[47] However, the Commission neglects to estimate the number of market participants that are seeking the same disclosure. "Without this crucial datum, the Commission has no way of knowing whether the rule" will even conceivably produce information that is sufficiently valued "to be of net benefit."[48] That a single person would like to see certain data is not evidence that requiring the disclosure of that data is worth the massive cost.[49]

C. The Commission Has Failed To Assess The Cumulative Impact Of Its Recent Rulemakings.

Finally, the Commission has not assessed the cumulative impact of its myriad recent position and activity disclosure-related proposals on market participants. This Proposal cannot be viewed in isolation;[50] the public disclosure it contemplates must be assessed along with the additional public disclosure contemplated in recent Commission proposals regarding large security-based swap positions, beneficial ownership reporting and short position and activity reporting. In aggregate, these proposals materially undermine the ability of fund managers to protect the confidentially of investment and trading strategies, thereby reducing incentives to engage in fundamental research and negatively impacting overall price discovery and market efficiency. Given that the Commission has elected to issue all of these proposals near simultaneously, it has

[44] *Id.*

[45] *Id.* at 69832.

[46] *Id.* at 69832 & n.203.

[47] Bob Currie, *The Power of Reinvention*, Sec. Fin. Times, at 16, 20 (Aug. 31, 2021), available at: https://www.securitiesfinancetimes.com/sltimes/SFT_issue_285.pdf.

[48] *Bus. Roundtable*, 647 F.3d at 1153.

[49] *See also* Overdahl Report ¶¶ 5-7 (explaining that the proposed rule is not efficiency enhancing, but is rather a simple wealth transfer).

[50] *See also* Overdahl Report ¶ 31.

the obligation to assess the cumulative impact of these proposals as part of the relevant economic analysis.[51]

II. At The Very Least, The Proposal Should Be Limited To "Wholesale" Securities Lending Activity.

At the very least, and given the enormous costs associated with requiring transaction-by-transaction reporting for Short Sale Linked Activity, the Commission should limit the Proposal to the "wholesale" market. That is not only what a sound economic analysis supports; it is consistent with the Commission's determinations in related contexts.

Not only did the Commission catalog the well-documented costs associated with a transaction-by-transaction short sale public reporting regime in its recent Short Position Reporting Proposal, it also concluded that these costs significantly outweigh any purported benefits.[52] As a result, the Commission concluded that, in order to promote efficiency, competition, and capital formation, it was appropriate to only publicly disclose aggregate market-wide information regarding short sales, and to do so with a one month publication delay.[53] Importantly, the Commission found that even the publication of aggregate delayed short sale data would not fully address the concerns detailed above, and that the Short Position Reporting Proposal on balance would "increase the cost of short selling."[54]

If the Commission were to seek to include Short Sale Linked Activity in this Proposal, thereby transforming the proposed securities lending transparency regime into a transaction-by-transaction short sale public reporting regime, and yet assert that the purported benefits of doing so outweigh the costs, it would represent a departure from the analysis contained in the Short Position Reporting Proposal.[55] The Commission must acknowledge, and provide a reasoned basis for, this inconsistent approach.

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[51] *See generally* the comment file on Release No. 34-93784, including Letter from 85 Law and Finance Professors, at 1 (Mar. 21, 2022), available at: https://www.sec.gov/comments/s7-32-10/s73210-20120780-272960.pdf; Letter from the Investment Company Institute, at 20 (Mar. 21, 2022), available at: https://www.sec.gov/comments/s7-32-10/s73210-20120723-272883.pdf; Letter from the Committee on Capital Markets Regulation, at 13 (Mar. 21, 2022), available at: https://www.sec.gov/comments/s7-32-10/s73210-20120760-272940.pdf. *See also* Overdahl Report ¶¶ 30-33.

[52] Short Position Reporting Proposal at page 174. *See also* Short Sale Position and Transaction Reporting, *supra* note 10.

[53] Short Position Reporting Proposal at page 174.

[54] *Id.* at page 147.

[55] We note that the two-day reporting delay (shrinking to a one-day delay if the Commission's proposal regarding "Shortening the Securities Transaction Settlement Cycle" is finalized) arising from the fact that the Short Sale Linked Activity is typically effected on the settlement date of the short sale is immaterial to the overall analysis. As noted herein, the Commission recognized that short positions often take time to fully establish and concluded in the Short Position Reporting Proposal that even the publication of aggregate information with a one-month delay would increase the cost of short selling. Furthermore, the Commission found that publishing aggregate information with less than a month delay would increase the associated costs to an unpalatable extent and reduce overall short selling (*see* Short Position Reporting Proposal at page 187).

In light of the above, to the extent the Commission intends to include Short Sale Linked Activity in this Proposal, it must maintain consistency with the Short Position Reporting Proposal by recommending the public disclosure of aggregate data only, with a delay of not less than one month.

In addition, the Commission should give greater consideration to the correlation between securities lending activity in the "wholesale market" and short sales, particularly for hard-to-borrow securities, as it may be appropriate to only disclose aggregate data there as well so as not to impair efficiency, competition, and capital formation.

III. The Proposed Reporting Rule Exceeds The Commission's Statutory Authority.

Section 984(b) of the Dodd-Frank Act authorized the Commission to engage in a single rulemaking: "Not later than 2 years after the date of enactment of this Act, the Commission shall 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."[56] The proposed reporting rule exceeds this authority in three independent ways: the Commission has *already* exhausted its rulemaking authority under Section 984(b); that authority expired nearly a decade ago; and the Commission now appears to be seeking to regulate a host of transactions that do not involve the "loan or borrowing of securities."

A. The Commission Has Already Exhausted Its Rulemaking Authority Under Section 984(b).

Like other federal agencies, the Commission "literally has no power to act . . . unless and until Congress confers power upon it."[57] Here, Congress authorized the Commission to engage in a single rulemaking: to "promulgate rules" "[n]ot later than 2 years after" Dodd-Frank's enactment "to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities."[58] The Commission exhausted that authority on November 18, 2016, when it explicitly invoked Section 984(b) to promulgate rules intended "to increase the transparency of information available related to the lending of securities."[59] The Commission does not have authority, six years later, to promulgate an entirely new set of rules aimed at the same issue.

If Congress had wished to give the Commission perpetual rulemaking authority, "it knew how to say so."[60] Other provisions of the Dodd-Frank Act broadly authorize the Commission, "by rule," to prohibit or impose conditions or limitations on various activities, without any temporal

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[56] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 984(b), 124 Stat. 1376, 1933 (2010).

[57] *N.Y. Stock Exch. LLC v. SEC*, 962 F.3d 541, 553 (D.C. Cir. 2020) (ellipsis in original) (quoting *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986)).

[58] Dodd-Frank Act § 984(b), 124 Stat. at 1933.

[59] *Investment Company Reporting Modernization*, 81 Fed. Reg. 81,870, 81,887-88 & n.192 (Nov. 18, 2016).

[60] *Union of Concerned Scientists v. U.S. Nuclear Regulatory Comm'n*, 824 F.2d 108, 115 (D.C. Cir. 1987).

limitation on the Commission's authority.[61] That Congress did not use similarly broad language in Section 984(b) "is significant because Congress generally acts intentionally when it uses particular language in one section of a statute but omits it in another."[62] Thus, Congress's choice to authorize the Commission, in certain sections, to issue rules at any time, but not in Section 984(b), shows that Congress did not intend to grant the Commission a perpetual, never-ending authority to promulgate transparency rules relating to securities lending.

By ignoring the limits on its rulemaking authority, the Commission creates the exact type of uncertainty that Congress, in Section 984(b), intended to forestall. There is a robust academic literature that details how regulatory uncertainty disincentivizes investment and market innovation.[63] The Congress that passed the Dodd-Frank Act understood this reality; it emphasized over and over again that the Act would provide legal certainty to market participants.[64] Section 984(b) was a key component of Congress's efforts. Instead of granting the Commission a freewheeling authority to alter a fundamental aspect of the securities lending market—what information about a market participant's transactions would be made publicly available—Congress authorized the Commission to create a single set of transparency rules within two years, and then leave it alone. The market could then grow and evolve with everyone knowing exactly what information would—and would not—be publicly disclosed. The Commission's proposal undermines Congress's plan by upsetting, nearly a decade after Dodd-Frank was passed, a foundational element of the securities lending market.

B. The Commission's Rulemaking Authority Has Expired.

The proposed reporting rule exceeds the Commission's authority in a second respect: it is nearly ten years too late. Congress explicitly provided that the Commission could "promulgate rules" aimed at increasing the transparency in the securities lending market "[n]ot later than 2 years after the date of enactment of [the Dodd-Frank Act]."[65] The Dodd-Frank Act was enacted on July 21, 2010. Accordingly, the Commission lacks authority to promulgate rules under Section 984(b) "later than" July 21, 2012. The Commission's December 8, 2021 proposal is too late.

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[61] *See, e.g.*, Dodd-Frank Act § 921, 124 Stat. at 1841 (codified at 15 U.S.C. § 78o(o)).

[62] *Dep't of Homeland Sec. v. MacLean*, 574 U.S. 383, 391 (2015).

[63] *See, e.g.*, Scott R. Baker, et al., *Measuring Economic Policy Uncertainty*, 131 Q. J. Econ. 1593, 1593 (2016) (finding that "policy uncertainty is associated with greater stock price volatility and reduced investment and employment in policy-sensitive sectors like defense, health care, finance, and infrastructure construction"); Richard G. Newell, *The Energy Innovation System: A Historical Perspective*, *in* Accelerating Energy Innovation: Insights from Multiple Sectors 25, 38 (Rebecca Henderson & Richard G. Newell eds., 2011) ("[R]esearch suggests that changing regulatory conditions or simple uncertainty about future conditions tend to have a dampening effect on private-sector investment in new technologies.").

[64] *See, e.g.*, H.R. Rep. No. 111-370, at 11 (2009) ("The amendment ... provides legal certainty for certain contracts…."); 155 Cong. Rec. H14408, H14416 (daily ed. Dec. 9, 2009) (statement of Rep. Perlmutter) ("certainty will be restored"); 156 Cong. Rec. S6192, S6913 (daily ed. July 22, 2010) ("Congress recognized that the capital and margin requirements in this bill could have an impact on swaps contracts currently in existence. For this reason, we provided legal certainty to those contracts currently in existence…."); *see also* Statement By President Barack Obama Upon Signing H.R. 4173, *available at* 2010 U.S.C.C.A.N. S26, S26 (July 21 2010) ("[The Bill] provides certainty to everybody, from bankers to farmers to business owners to consumers.").

[65] Dodd-Frank Act § 984(b), 124 Stat. at 1933.

This is not a case where the negligence of an agency employee caused the Commission to miss a statutory deadline by a month or two. With the exception of one proposal in 2016, every Commission, across three presidential administrations, for ten years, has declined to propose transparency rules under Section 984(b). The Commission cannot now claim that Section 984(b) authorizes a rulemaking that Congress said should have been completed a decade earlier. Indeed, as detailed above, the Commission's insistence on pressing ahead with this rulemaking a decade after Congress's deadline upsets the regulatory certainty that Congress had sought to provide.[66]

C. The Commission Lacks Authority To Regulate Short Sale Linked Activity.

The Commission lacks statutory authority to regulate Short Sale Linked Activity. Section 984(b) authorizes 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."[67]

"When interpreting statutes, courts take note of terms that carry 'technical meaning[s].'"[68] The "loan or borrowing of securities" is one such term. When a market participant wishes to buy or sell a security, the market participant typically places an order with a securities intermediary, such as a broker-dealer. In today's market, the vast majority of market participants also "hold their securities in book-entry form through a securities intermediary…. This is often referred to as owning in 'street name.'"[69] When owning in "street name," a market participant "does not own the securities directly."[70] Instead, the market participant "has an entitlement to the rights associated with ownership of the securities,"[71] which are "legally owned by and registered in the name of the [intermediary's] nominee."[72]

It is the securities intermediary—the broker-dealer—that borrows or loans securities. In what the Commission calls the "wholesale market," broker-dealers borrow securities from lending programs—either for the broker-dealer's own "market making activities or on behalf of [its] customers."[73] These transactions are made pursuant to written securities lending agreements and are recorded as loans on the broker-dealer's books and records.[74] In the United States, a Master

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[66] *Supra* at 13.

[67] Dodd-Frank Act § 984(b), 124 Stat. at 1933.

[68] *Van Buren v. United States*, 141 S. Ct. 1648, 1657 (2021) (alteration in original) (quoting A. Scalia & B. Garner, *Reading Law: The Interpretation of Legal Texts* 73 (2012)).

[69] *Notice of Filing of Proposed Rule Change Amending NYSE Rules 451 and 465*, Exchange Act Release No. 68,936, 2013 WL 603321, at *2 (Feb. 15, 2013).

[70] *Id.*

[71] *Id.*

[72] *Transfer Agent Regulations*, Exchange Act Release No. 76,743, 2015 WL 9311555, at *16 (Dec. 22, 2015).

[73] Proposal at 69805.

[74] Letter from SIFMA, *supra* note 8, at 10.

Securities Loan Agreement is typically used by the broker-dealer to set out the rights and obligations of the "Lender" and "Borrower."[75]

In contrast, in what the Commission calls the "retail market," a broker-dealer facilitates a customer's short sale. While the "broker or dealer" may go into the wholesale market to "[b]orrow [a] security, or enter[] into a bona-fide arrangement to borrow [a] security," to facilitate the customer's short sale,[76] the broker or dealer does *not* enter into a lending transaction with the customer. The customer's short sale is not typically booked as a loan on the broker-dealer's books and records, and is not typically governed by a securities lending agreement;[77] the transaction, instead, is typically governed by a brokerage-account agreement,[78] which reflects the market reality that *the broker-dealer*, not the customer, borrows the security to facilitate the customer's trade.[79]

The Commission's own rules reflect this understanding. Before a broker-dealer may accept a customer's short sale order, "*the broker or dealer*" must "[b]orrow the security, or enter[] into a bona-fide arrangement to borrow the security."[80] The transaction between the broker-dealer and a lending program (the "wholesale market") is a securities loan, but the transaction between a broker-dealer and its customer (the "retail market") is not. Thus, the Commission lacks authority under Section 984(b) to regulate it. Accordingly, to the extent the Commission intended to propose requiring transaction-by-transaction public reporting of Short Sale Linked Activity, the Proposal exceeds the Commission's authority.

D. Section 984(a) Does Not Authorize The Proposed Reporting Rule.

The Commission suggests that Section 984(a) of the Dodd-Frank Act may also authorize the proposed reporting rule,[81] but that is incorrect. Section 984(a) makes it unlawful for any person 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."[82] The proposed reporting rule exceeds the Commission's authority under Section 984(a) in two respects.

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[75] Master Securities Loan Agreement (2017 version), available at: https://www.sifma.org/wp-content/uploads/2017/06/MSLA_Master-Securities-Loan-Agreement-2017-Version.pdf.

[76] 17 C.F.R. § 242.203(b)(1)(i).

[77] *See, e.g.*, Letter from SIFMA, *supra* note 8, at 9 & n.38, 10.

[78] *See, e.g.*, Letter from Fidelity Investments (Jan. 7, 2022), available at: https://www.sec.gov/comments/s7-18-21/s71821-20111708-265037.pdf.

[79] *See, e.g.*, E*Trade Customer Agreement (effective Jan. 1, 2022), available at: available at: https://us.etrade.com/l/f/customer-agreement (Margin Account Supplement) ("If the Account Holder sells a security short, E*TRADE will borrow the security from a third party for delivery at settlement."); InteractiveBrokers LLC Client Agreement (Apr. 16, 2021), available at: https://gdcdyn.interactivebrokers.com/Universal/servlet/Registration_v2.formSampleView?formdb=3203 ("IBKR may reject any short sale if IBKR does not believe it can borrow the relevant security for delivery.").

[80] 17 C.F.R. § 242.203(b)(1)(i) (emphasis added).

[81] *See* Proposal at 69803 n.2.

[82] Dodd-Frank Act § 984(b), 124 Stat. at 1932 (codified at 15 U.S.C. § 78j(c)(1)).

First, Section 984(a) applies only to transactions "involving the loan or borrowing of securities."[83] As discussed above, to the extent the Commission intended to propose requiring transaction-by-transaction public reporting of Short Sale Linked Activity, the Proposal exceeds the Commission's authority.

Second, Section 984(a) authorizes the Commission to promulgate rules regulating the "effect[ing], accept[ing], or facilitat[ing]" of transactions "involving the loan or borrowing of securities."[84] To "effect," "accept," or "facilitate" a transaction means to "bring about" or "execute" the transaction;[85] "to receive" the transaction "with an accepting mind";[86] or "to assist" or "aid" the transaction.[87] All three words refer to the manner in which a transaction is completed. They do not authorize the Commission to impose reporting requirements "*after* each loan [transaction] is effected."[88]

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In conclusion, we believe the Commission has neglected to consider the substantial costs associated with requiring the public reporting of Short Sale Linked Activity, including increasing the costs associated with establishing short positions, facilitating the copycatting of investment and trading strategies, disincentivizing fundamental research, and impairing price discovery, liquidity and market efficiency. Further, the Proposal is at odds with the Commission's separate conclusion that only *aggregate* and *delayed* disclosure of short sale positions is preferable to *transaction-by-transaction* and *intra-day* disclosure. At a minimum, given the lack of clarity regarding the scope of the Proposal, and the inadequate economic analysis contained therein, we urge the Commission to re-propose the rule in order to enable market participants to meaningfully comment.

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[83] 15 U.S.C. § 78j(c)(1).

[84] *Id.*

[85] *Webster's New International Dictionary* 819 (2d ed. 1934).

[86] *Id.* at 14.

[87] *Id.* at 908.

[88] Proposal at 69812 (emphasis added).

Please feel free to call the undersigned at [redacted] with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger
Managing Director
Global Head of Government & Regulatory Policy