Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York

August 4, 2023

Via Web Submission

Ms. Vanessa Countryman
Secretary
United States Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

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

Dear Ms. Countryman:

Managed Funds Association ("**MFA**" or "**We**")[1] appreciates this opportunity to submit these additional comments to the Securities and Exchange Commission ("**Commission**" or "**SEC**") to supplement our prior comment letters regarding the proposed reporting of securities loans and proposed rule 10c-1 (the "**Proposing Release**" and the "**Proposed Securities Lending Rules**").[2] We appreciate the Commission's request for additional comment,[3] and the additional opportunity for a careful consideration of the interplay between the Proposed Securities Lending Rules and the related SEC proposal regarding short sale position reporting rules (the "**Proposed Short Sale Reporting Release**" and the "**Proposed Short Sale Reporting Rules**").[4]

MFA's members represent a sizable portion of securities lending industry participants and stakeholders both in the U.S. and globally. While we support the stated goals of the Dodd-Frank Act to improve the transparency of information available to brokers, dealers, and investors with respect to the borrowing or lending of securities,[5] the Proposing Release goes far beyond increasing securities lending

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1 MFA, based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 170 member firms, including traditional hedge funds, credit funds, and crossover funds, that collectively manage nearly $2.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

2 Reporting of Securities Loans, 86 Fed. Reg. 69802, 69804 (Dec. 8, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf.

3 Reopening of Comment Period for Reporting Securities Loans, 87 Fed. Reg. 11,659 (Mar. 2, 2022).

4 Position and Short Activity Reporting by Institutional Investment Managers, Exchange Act Release No. 94313 (Feb. 25, 2022), 87 FR 14950 (Mar. 16, 2022).

5 *See* Section 984 of the Dodd-Frank Act, Pub. L. 111-203, 984(b), 124 Stat. 1376 (2010).

transparency and would create an entirely new reporting regime that is largely duplicative of the Proposed Short Sale Reporting Rules, requires the reporting of securities holdings that are unlikely to ever be lent, captures routing activity that is not securities lending, and fails to consider the very real costs to the beneficial owner as its investment holdings and trading strategies are reported on a near real-time basis.

MFA is submitting this comment letter, supplementing our previous comment letters, to provide the Commission and its Staff a constructive path forward as it works to finalize the Proposed Securities Lending Rules. The changes we are recommending today reflect our members' extensive experience with securities lending transactions, both as lender and borrower, and build upon several member firms' experiences complying with analogous European reporting requirements, discussed below.

We urge the Commission to reconsider the Proposed Securities Lending Rules given the very real costs to the securities owner that, while discussed in detail in the Proposed Short Sale Reporting Release, are notably absent from the Proposing Release. If the Commission elects to move forward with the Proposed Securities Lending Rules, we recommend that the rules be revised considerably to minimize the risk of duplicative or misleading information being reported and to protect the proprietary trading information of both lenders and borrowers and their respective clients and investors.

I. Executive Summary

A. It is imperative that the Proposed Securities Lending Rules and the Proposed Short Sale Reporting Rules work together and not result in the reporting of duplicative or misleading data.

B. Revisions to the Proposed Securities Lending Rules are necessary to reflect the operational realities of the securities lending business and to better align with existing reporting requirements. These suggested revisions are as follows:

1. Narrow the definition of "securities loan" to exclude short positions and other transactions that are not the subject of a securities loan agreement;
2. Recalibrate the level of detail of securities loans that are reported so that only wholesale, aggregated loan positions are reported to avoid revealing strategies and information proprietary to the investment manager and avoid reporting data that is misleading or confusing to market participants;
3. Revise the timing of reporting requirement;
4. Limit the scope of securities loans to be reported, at least initially, to U.S. exchange-listed equities;
5. Clarify the extraterritoriality limitations of the Proposed Securities Lending Rules;
6. Adjust the scope of reporting to include only lent securities to avoid reporting positions where there is no practical lending interest or where portfolio restrictions would effectively make a security unable to be lent;
7. Empower the beneficial owner of the securities to determine the reporting party that would submit reports on behalf of the beneficial owner;
8. Withhold any public reporting of securities loans as the rule is being implemented as regulators gain familiarity with the reported data and systems can be tested and monitored as the rule being implemented; and

9. Impose stringent confidentiality obligations on FINRA.

C. The Commission should take a careful, deliberate, and phased implementation approach.

II. Specific Recommendations to Improve the Quality of Securities Loan Data Reported

A. The Proposed Securities Lending Rules Are Closely Interrelated to the Proposed Short Sale Reporting Rules – the Two Initiatives Must Work with Each Other

The Proposal must be considered in connection with the statutory scheme set forth in the Exchange Act, and the Commission's own statements in the Proposed Short Sale Reporting Release. The Commission has proposed a separate short sale reporting framework under a different section of the Dodd-Frank Act mandate for securities lending reporting,[6] evidencing Congress's intent to bifurcate the reporting of securities lending transactions from the reporting of short positions and short sale activity.[7]

As we have discussed previously, not only are short positions not "stock loans" for purposes of the Proposed Securities Lending Rules, including them could result in serious data issues and double counting that could cause significant confusion in the markets and harm to the very investors for whom the Proposed Securities Lending Rules are intended to benefit.

Capturing short transactions under the Proposed Securities Lending Rules *in addition* to the Proposed Short Sale Reporting Rules would lead to unnecessary overlap in reporting regimes and data integrity issues with the data that is reported. To avoid such data issues and duplicative, overlapping reporting, we recommend revising the definition of a "securities loan," as discussed below in Section II.B.1.

We agree with the SEC's position in the Proposed Short Sale Reporting Release and its acknowledgement of the negative impacts of revealing market participants' trading strategies on market efficiency and liquidity. We support an appropriate balancing of the potential benefits and harmful effects of increased disclosure, and as such note again that the same rationale applies equally to securities loans. To avoid undoing the Commission's thoughtful approach in the Proposed Short Sale Reporting Release, it is imperative that the same logic apply to the level of reporting in the Proposed Securities Lending Rules, as we discuss below in Section II.B.2.

In the context of analyzing the impact of publishing short position and related trading activity information, the Commission noted that the "data has the potential to reveal some of the information that short sellers may have acquired through fundamental research."[8] In particular, the Commission recognized that public disclosure of such information could (1) reveal participants' short position information, (2) reveal participants' trading strategies, and (3) increase threats of retaliation.[9] We agree, and as such recommend tailoring the Proposed Securities Lending Rules to mitigate against imitative

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[6] *See id.*

[7] As the SEC acknowledged in the Proposing Release for the Proposed Short Sale Reporting Rule, FINRA and many exchanges already offer publicly available data on short sale activity. Short Sale Reporting Proposal, *supra* note 4. For example, short positions are already properly included as part of "short position reporting" under the existing FINRA short interest reporting requirements (reporting by clearing brokers of gross settled firm and customer short positions), which FINRA is considering expanding.

[8] Proposed Short Sale Reporting Release, 87 Fed. Reg. at 14994.

[9] Proposed Short Sale Reporting Release, 87 Fed. Reg. at 14994-95.

trading or reporting data so granular that market participants can reverse engineer to determine the proprietary trading strategies of individual managers.

The SEC noted in the Proposed Short Sale Reporting Release that it would be appropriate to delay the reporting of short sale data to avoid the publication of incomplete and inaccurate data. The same rationale once again applies to securities loans.

B. Revisions to the Securities Lending Reporting Framework Are Necessary to Avoid Misleading or Inaccurate Reporting

1. The SEC Must Distinguish Between Stock Loans from Short Positions, Short Arranged Financing, and Repurchase Transactions

It is imperative that the SEC refine and narrow what it means to "loan a security" under the Proposed Securities Lending Rules to distinguish short positions from stock loans, consistent with longstanding precedent. The reporting obligation would appear to apply to all types of securities lending arrangements, far beyond traditional securities loans. Short sales settled by a broker-dealer are not documented or booked as a securities loan between the parties and are instead governed by a brokerage account agreement and the U.S. margin rules. Short positions are neither carried on a firm's books and records as securities loans, nor are they treated as securities loans for financial reporting purposes. Moreover, including short positions as stock loans under Proposed Rule 10c-1 could result in serious data issues and double counting that could cause significant confusion in the markets and harm to investors. We recommend revising the proposed securities loan definition to limit it to transactions covered by a securities lending agreement against a transfer of collateral, and documented as a securities loan on the lender's books and records. We further recommend that this definition expressly exclude short positions, short-arranged financing in connection with prime brokerage client short activities, and repurchase agreements.

2. Once Public Dissemination Begins, FINRA Should Disseminate Only Wholesale, Aggregated Reporting Data – Not Retail, Customer-Level Loan-by-Loan Data

To protect the proprietary nature of an investment manager's market data and trading strategies, it is critical that the Proposed Securities Lending Rules be revised to capture only wholesale securities lending activity. Wholesale securities lending activity is where the securities owner (e.g., a mutual fund or insurance company) loans securities, through a securities lending agreement, to a broker-dealer. Like the Proposed Short Sale Reporting Rules, the Proposed Securities Lending Rules involve market data that is highly proprietary and confidential to the investment manager and is for the benefit of the manager's clients and investors in private funds offered by the manager. Any final rule adoption that makes the securities loan data public on individual, retail-level loans risks revealing sensitive information about the funds' trading strategies, and as such it is imperative that the Commission revise the scope of the Proposed Securities Lending Rules to capture only the wholesale lending amounts lent through a particular lending agent or broker-dealer to a borrower such as a prime broker.

Public disclosure of customer-level securities lending activity as proposed by the Commission would signal to all other market participants that a short position is being established, creating a market impact that will increase the costs associated with continuing to build a short position over time (particularly in hard-to-borrow or "special" securities) and potentially leading to copycat short selling activity, thereby disincentivizing fundamental research and overall short selling activity. Advisory clients and investors in private funds would suffer as the costs of establishing the short position become more

costly and potentially prohibitive because imitative market participants will drive up transaction costs -- all to the detriment of investment performance.

Moreover, as it relates to individual loan transaction data, it is important to consider that in the securities lending environment loans are typically aggregated or blocked among various lenders of the securities lending agent, and then become the subject of one aggregated loan to the borrower after the terms and collateral are executed. Securities borrowers tend to have a specific quantity of securities they seek to borrow and, to minimize operational and administrative risks, generally prefer to enter into one securities loan arrangement than negotiate, settle, and manage collateral for multiple loans in the same security. The securities loan amounts that would be reported under any adopted Commission rule should reflect this aggregate amount: loan-by-loan reporting would grossly overstate the quantity of securities loans in each name loaned and distort the true demand of a particular name in the securities lending market.

We lastly recommend that the SEC pare back several of the granular reporting elements that would be difficult to apply and/or misleading, such as margin percentage, type of collateral, and pricing.[10] The Proposed Securities Lending Rule's requirements, for example, requires the rebate rate to be reported in the pricing field, even though the rebate rate will fluctuate potentially daily, as the reference rate – typically the overnight banking funding rate – changes, and as such would be subject to frequent amendment that could be confusing to market participants. MFA looks forward to discussing the individual reporting elements with Commission and Division Staff.

3. The Requirement to Report Trades Within 15 Minutes Should Be Replaced with a Requirement to Provide End-of-Day Reports on a T+1 Basis

The SEC's proposal to require the reporting of the material terms of a securities loan within 15 minutes of a loan "being effected" is unworkable in a securities loan context. The SEC bases the proposed requirement on FINRA's TRACE reporting regime for corporate fixed income securities transactions, but that does not mean that it should apply the same approach to a very different set of transactions. Securities loans do not involve an outright purchase or sale but may be on-loan for extended periods, can be returned at any time, and may subsequently be re-lent. The terms of a securities loan are typically negotiated throughout the day and often not finalized until the end of the day or the next day. Borrower collateral also must be delivered to the lending agent, which often is delivered overnight and available to the lending agent the following morning. Information that is reported within 15 minutes of the initial agreement to borrow would not reflect final terms and would result in inaccurate and misleading information being reported, only for the reported information to be amended perhaps more than once after the loan terms are finalized.

We recommend that the SEC require reporting of all information by the end of the following business day after the securities have been lent. A delayed reporting of securities loan information is

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[10] We recognize that registered funds are already required by the SEC to provide public reporting and disclosure regarding their securities lending activities and are not suggesting those requirements be changed. Among other things, registered funds must publicly report the fund's securities on loan, collateral received, and the borrowers of those securities (Items B.4 and C.12 of Form N-PORT), as well as the fund's securities lending agents, compensation types paid to securities lending agents, and whether the securities lending agent or another party has agreed to indemnify the fund with respect to securities lending losses (Item C.6 of Form N-CEN). With the exception of certain non-public information reported on Form N-PORT, the information reported on the form for the third month of each fund's fiscal quarter is made publicly available upon filing.

more consistent with comparable global reporting standards and leverages firms' experience in reporting under those standards. More importantly, a delayed reporting would better protect firms' proprietary trading strategies, the benefits of which should inure to the funds and clients of the manager. Delayed reporting also would provide an opportunity for the terms of the securities loan to be finalized to avoid reporting incomplete or misleading data.

4. Scope of Reporting Should Be Phased-In, Beginning with U.S.-Listed Equity Securities

Implementing a securities loan reporting regime will be a considerable undertaking for the SEC, FINRA, and market participants. U.S. exchange-listed, equity securities (*i.e.*, NMS securities) are typically among the most frequently lent, and as such a risk-based approach would support the Commission limiting the initial tranche of securities loans to be reported to securities loans of NMS securities. After the SEC and FINRA gain familiarity with the reported data, the Commission then should evaluate whether to propose rule revisions that would expand the reporting obligation to additional asset classes.

5. The SEC Should Clarify the Cross-Border Application of the Reporting Requirements

We encourage the Commission to clarify the cross-border implications of any final securities lending reporting rule it adopts. The intent behind the Proposed Securities Lending Rules would appear to be to increase transparency in securities lending in U.S. markets, and as such we would recommend that the Proposed Rule be amended to define "securities" as one issued either by a U.S. issuer or listed or traded on a U.S. exchange.

Absent clarification, a transaction between two non-U.S. persons involving a non-U.S. security could potentially be deemed within the scope of the rule under an expansive "conducts and effects" analysis. It would be inappropriate to apply the Proposed Securities Lending Rules to non-U.S. entities such as UCITS, AIFs, or other funds that are subject to reporting under SFTR[11] and not otherwise subject to U.S. regulatory requirements. The Commission also should expressly state that portfolio information of non-U.S. entities would not be required to be reported because of the securities lending activity of any of their U.S.-registered affiliates.

6. The SEC Should Limit the Reporting Requirement to Securities Actually Lent, As Opposed to "Available to Lend," to Avoid Grossly Inflating the Securities Available for Loan

We do not support the proposed requirement to calculate securities "available to lend" because it would result in a considerable over-inflation of the number of securities realistically lendable at any given time. The SEC acknowledged as much in the Proposing Release by stating that the proposed definition of "available to lend" would overstate the quantity of securities that are available to lend "because the data would include securities that would be restricted if a limit was reached."[12] We agree. An overinflated universe of securities that are reported as "available to lend" moreover does not reflect the market reality that there is little to no interest in borrowing most non-treasury debt securities and ignores the fact that

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[11] *See, e.g.*, Financial Conduct Authority, UK Securities Financing Transactions Regulation ("**UK SFTR**"), available at https://www.fca.org.uk/markets/sftr.

[12] Proposing Release, 86 Fed. Reg. at 69,818.

portfolio restrictions or other limits may render a security or groups of securities effectively unable to be lent.

While a lender's portfolio holdings may be eligible securities for lending, they are unlikely to be "available to lend" at all times.[13] For instance, footnote 110 of the Proposing Release and its accompanying text highlight instances where entire portfolios would have to be included even though there may otherwise be portfolio restrictions.[14] Requiring reporting of *all* securities in a portfolio eligible for lending would provide misleading information to the market and potentially places lenders and end-borrowers at risk. Over-reporting of securities for which there is no lending also would undermine the goals of Dodd-Frank of increasing the transparency in the securities loan market. The Commission is encouraged to more carefully calibrate any rulemaking to require only the reporting of securities that are actually lent to minimize the reporting of securities that either the lender would decline to loan or that there is no market interest in borrowing.

7. The Beneficial Owner of the Lent Securities Should Determine Which Entity Submits Reports

The beneficial owner should be able to decide whether it would prefer the lending agent (or reporting agent) to report or require the broker-dealer borrower to report. Some beneficial owners also may prefer to report securities loans themselves. Empowering the owner of the securities to determine the manner of reporting would reduce the implementation costs for lenders and mitigate the risk of inaccurate data being reported. Responsibility for reporting obligations would be included in either the master securities lending agreement between lender and borrower or in the securities lending agent agreement between lender and lending agent, or both.

8. The Commission Should Not Allow Public Dissemination as the Reporting Regime Is Implemented

The SEC should defer public dissemination of data to a later stage of implementation to allow the SEC to gain experience with the data and for the reporting entities to grow familiar with the reporting process. This is consistent with the approach taken by FINRA (and the SEC) of not publicly disseminating trading data for a newly reported asset class until FINRA and market participants have had an opportunity to gain experience with the asset class.[15]

9. Any Final Rule Adopted by the Commission Should Impose Express Confidentiality Obligations on FINRA with Respect to the Securities Loan Data

It is important to protect the confidentiality of the securities lending information that would be reported to FINRA, particularly since many securities lenders have not provided information to FINRA

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[13] For example, certain portfolios may be subject to exclusive lending arrangements. In other circumstances, lenders will make their portfolio available to lend, but are not likely to lend 100% of their securities at once for risk management purposes. The Investment Company Act of 1940 ("**1940 Act**") also prohibits a registered fund from having on loan at any time securities representing more than one-third the fund's total value. *See* 1940 Act, §18.

[14] Proposing Release, 86 Fed. Reg. at 69,817.

[15] *See, e.g.*, Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Granting Approval of Proposed Rule Change Relating to TRACE Reporting and Dissemination of CMO Transactions, Release No. 34-78925 (Sept. 23, 2016), available at https://www.sec.gov/rules/sro/finra/2016/34-78925.pdf.

previously. We recommend that any final rule impose explicit confidentiality obligations on FINRA. As we discuss, the Proposed Securities Lending Rules would require the reporting of a large amount of sensitive and non-public securities lending data that, in the strictest sense, is an asset of the lender for the benefit of the manager's clients – the ultimate owners of the securities -- that the manager is obligated to protect.

We further recommend that the Commission exercise its regulatory oversight of FINRA to ensure that FINRA implements adequate data security measures given that FINRA will serve as repository for significant quantities of sensitive and non-public securities lending data. The SEC should examine FINRA specifically to ensure FINRA's compliance with the data security requirements that the SEC imposes with any adoption of the Proposed Securities Lending Rules, with revisions as we have suggested.

C. The Commission Should Implement a Phased Reporting of Limited, Aggregate Data

We recommend that the first phase of the reporting regime should be confidential only for the SEC to gain experience with the data that is reported before it is disseminated to the public. FINRA took a similar approach, as discussed above, when implementing the TRACE program. Once the SEC and FINRA have become familiar with the securities lending data being reported, then the SEC can propose rules that would make available to the public some subset of the aggregated, reported data.

Those required to report should be given an appropriate implementation period – which we anticipate will need to be extensive - following FINRA's publication of specifications to develop procedures and build out the systems to comply with the Proposed Securities Lending Rules. Even as clarified and narrowed as our letter recommends, the Proposed Securities Lending Rules' reporting regime would require considerable time and cost to develop, test, launch, and monitor.

III. The Commission's Cost-Benefit Analysis in the Proposing Release Remains Incomplete and One-Sided and Must Be Revised

The economic analysis of the Proposing Release suggests that public disclosure of loan-by-loan information is an unmitigated benefit to the short selling market, even though the Commission concluded the opposite in the Proposed Short Sale Reporting Release.[16] The economic analysis in the Proposing Release merely states that the public disclosure of transaction-level loan information may result in reduced borrowing costs, but provides no analysis of the potential costs or harms of revealing market participant position and strategy information that was described in the Proposed Short Sale Reporting Release.[17] The absence of these considerations is significant because they informed the Commission's decision in the Proposed Short Sale Reporting Release to propose public disclosure of only anonymous aggregated position and related activity information on a monthly basis. These comparable costs and harms also must be considered with respect to securities loan data, as it would be arbitrary for the

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[16] 86 Fed. Reg. at 69839.

[17] 86 Fed. Reg. at 69839.

Commission to conclude that the costs of disaggregated and virtually real time disclosure outweigh the benefits in the Proposed Short Sale Reporting Release but not in the Proposing Release.[18]

We also would note that the SEC is further obligated to consider carefully the potentially significant costs, as well as supposed benefits, of additional regulation of market participants. As the Supreme Court has explained, "reasonable regulation ordinarily requires paying attention to the advantages and the disadvantages of agency decisions."[19] This bias is reflected in the Proposing Release and the Proposed Securities Lending Rules, in which the Commission proposes to require close to real-time public reporting of sensitive, proprietary market information at the transaction level, as opposed to aggregated and delayed reporting, making the Commission's consideration of our the above suggestions all the more critical.

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[18] We note that the Administrative Procedure Act ("**APA**") requires the SEC to build a comprehensive and rigorous record and assess the significant costs of regulation. The SEC is to "examine the relevant data" -- including quantitative and qualitative evidence submitted -- "and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choices made.'" Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983). This core APA requirement includes the obligation to "consider … important aspect[s] of the problem" before the agency. *See id.* The SEC also is obligated to respond to significant points raised in public comments. *See PPL Wallingford Energy LLC v. FERC*, 419 F.3d 1194, 1198 (D.C. Cir. 2005); *Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 299 (D.C. Cir. 2001); *Tesoro Alaska Petroleum Co. v. FERC*, 234 F.3d 1286, 1294 (D.C. Cir. 2000).

[19] *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015).

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Thank you for your consideration of our comments. MFA respects the Commission's efforts in seeking to fulfill its obligations under the Dodd-Frank Act, and we would suggest that the above revisions would enable it to do in a manner that minimizes duplicative and potentially misleading and harmful reporting when considering the Proposing Release in tandem with the reporting obligations proposed under the Proposed Short Sale Reporting Rules. If you have any questions, please do not hesitate to contact Jeff Himstreet or the undersigned at [redacted].

Respectfully yours,

\s\ Jennifer W. Han

Jennifer W. Han
Executive Vice President
Chief Counsel & Head of Global Regulatory Affairs

cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
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