

Managed Funds Association

The Voice of the Global Alternative Investment Industry

Washington, D.C. | New York



April 1, 2022

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”)¹ submits these comments to the Securities and Exchange Commission (“Commission” or “SEC”) to supplement our comment letter dated January 7, 2022,² and in response to the Commission’s request for additional comment regarding the reporting of securities loans and proposed rule 10c-1 (the “Proposed Loan Disclosure Rule”).³ We appreciate the Commission’s reopening of the comment period in light of the proposed rule regarding short position disclosures (“Proposed Short Position Disclosure Rule”).⁴

Like the Proposed Short Position Disclosure Rule, the Commission proposed the Loan Disclosure Rule to address Dodd Frank’s mandate to increase transparency in the securities markets.⁵ Also like the Proposed Short Position Disclosure Rule, the Proposed Loan Disclosure Rule involves market data that is highly proprietary and confidential. Unlike the Proposed Short

¹ MFA represents the global alternative investment industry and its investors by advocating for sound industry practices, regulatory, tax and other public policies that foster efficient, transparent and fair capital markets. MFA’s more than 150 member firms collectively manage nearly \$1.6 trillion across a diverse group of investment strategies. MFA is an advocacy, education, and communications organization established to enable investment advisers in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA has a global presence and is active in Washington, D.C. London, Brussels, and Asia.

² Letter from Jennifer W. Han, Executive Vice President, MFA to Vanessa Countryman, Secretary, Securities and Exchange Commission (dated Jan. 7, 2022) (“January Comment Letter”) available at https://www.managedfunds.org/wp-content/uploads/2022/02/MFA-Comment-Letter-SEC-Securities-Lending-Proposal.final_.1.7.2022.pdf.

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

⁴ *Short Position and Short Activity Reporting by Institutional Investment Managers*, 87 Fed. Reg. 14,950 (Mar. 16, 2022).

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

Position Disclosure Rule, however, the Proposed Loan Disclosure Rule failed to consider and balance the significant costs and harms to market participants and the market itself with the objective and potential benefits of increased transparency.

We believe that the economic impact analysis in the Proposed Short Position Disclosure Rule is more reflective of market realities. The analysis in the Proposed Short Position Disclosure Rule also rightly informed the Commission's stated preference for aggregated and delayed reporting of short position information.⁶ By contrast, the Proposed Loan Disclosure Rule lacked a meaningful analysis of the economic impact and is one-sided. It touted the benefits of increased loan price transparency without affording appropriate weight to the costs and harms associated with such transparency. This bias is reflected in the rule itself, which 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. The Proposed Loan Disclosure Rule thus stands in stark contrast to the Proposed Short Position Disclosure Rule in which the Commission deliberately and thoughtfully acknowledged the negative impacts of revealing market participants' trading strategies on market efficiency and liquidity, and attempted to appropriately balance the potential benefits and harmful effects of increased disclosure.

As discussed more fully below, we believe the potential harms to market participants and market efficiency more broadly that are discussed in the Proposed Short Position Disclosure Rule are equally relevant, if not more so, in the securities lending context. Accordingly, we ask the Commission to reconsider the Proposed Loan Disclosure Rule and, specifically, the proposal to disseminate transaction-by-transaction data on an intra-day basis, given the Commission's own analysis in the Proposed Short Position Disclosure Rule that such reporting would create significant harm to market participants.

I. The Commission Correctly Acknowledged the Costs and Harm of Revealing Confidential Short Position Information on a Disaggregated and Close to Real-Time Basis in Its Proposed Short Position Disclosure Rule.

The Commission's Proposed Short Position Disclosure Rule explicitly recognized and considered the potential harms of revealing trading strategies to stock price efficiency. 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."⁷ In particular, the Commission recognized that public disclosure of such information could (1) reveal

⁶ While MFA generally favors the aggregated and delayed reporting proposed in the Proposed Short Position Disclosure Rule over the individual transaction and real-time reporting proposed in the Proposed Loan Disclosure Rule, we intend to submit a separate letter with our comments on the proposed Rule 13f-2, Form SHO, and related short position and activity reporting requirements.

⁷ 87 Fed. Reg. at 14994.

participants' short position information, (2) reveal participants' trading strategies, and (3) increase threats of retaliation.⁸

In the Proposed Short Position Disclosure Rule, the Commission recognized these potential harms and specifically sought to mitigate the risks to market participants by proposing to require dissemination of short position information on an aggregated and delayed basis. For example, the Commission recognized that increased disclosure of short position information would provide less incentive to produce fundamental research and trade on new information. The Commission also recognized that markets participants could attempt to use publicly disclosed activity data to extract information about the specific trading strategies that short sellers use to implement their trades (*i.e.*, to “reverse engineer” a seller’s trading strategy). Market participants could, in turn, attempt to identify similar patterns in the data and alter their trading strategies to attempt to profit from any predictability in the short seller’s trading strategy. Public disclosure of a short seller’s identity may also expose market participants to retaliation by other market participants or issuers.

As we explained in our January Comment Letter, these very same potential harms apply in the context of disclosing securities lending data. In fact, we believe the harms may even be more pronounced in the context of the Proposed Loan Disclosure Rule given the granularity of the potential data to be made public and the frequency of reporting. The Proposed Loan Disclosure Rule would effectively serve as a proxy disclosure for actual short selling activity and short positions. This disclosure would, in turn, result in less overall short selling activity and less efficient price discovery. In contrast to the analysis in the Proposed Short Position Disclosure Rule, the Proposed Loan Disclosure Rule provides no substantive analysis of the risk to market participants relating to any of the above concerns.

Even more troubling is that the economic analysis of the Proposed Loan Disclosure Rule purports to treat the public disclosure of loan-by-loan information as an unmitigated benefit to the short selling market, even though the Commission concluded the opposite in the Proposed Short Position Disclosure Rule.⁹ The economic analysis in the Proposed Loan Disclosure Rule merely states that the public disclosure of transaction-level loan information may result in reduced borrowing costs, which may in turn reduce the cost of short selling. While the release notes that “reduc[ing] costs to short selling would benefit investors by enabling them to profitably engage in more fundamental research,” in turn leading to better investment decisions for these investors, the release provides no analysis of the potential costs or harms of revealing market participant position and strategy information described in the Proposed Short Position Disclosure Rule.¹⁰ The absence of these considerations is significant because they informed the Commission’s decision in the Proposed Short Position Disclosure Rule to propose public disclosure of only anonymous aggregated position and related activity information on a monthly

⁸ 87 Fed. Reg. at 14994-95.

⁹ 86 Fed. Reg. at 69839.

¹⁰ *See* 87 Fed. Reg. at 69839.

basis. These costs and harms should also be considered with regard to securities loan data. Furthermore, it would be arbitrary decision making for the Commission to conclude that the costs of a disaggregated and close to real time disclosure regime outweigh the benefits in the context of the Proposed Short Position Reporting Rule but not in the context of the Proposed Loan Disclosure Rule.

II. The Commission’s Proposal to Reveal Confidential Securities Lending Transaction Information on a Loan-by-Loan and Close to Real-Time Basis Will Result in Significant Costs and Harm to the Market and Market Participants.

MFA reiterates our position set forth in our January Comment Letter that the Proposed Loan Disclosure Rule will not yield the benefits the Commission is seeking to achieve and is concerned that it will result in harmful consequences to investors and the overall market. We continue to have strong objections to the dissemination of transaction-by-transaction data as we are concerned that dissemination of such information, even in anonymized form, will result in concrete harms to market efficiency. Specifically, we believe the rule if adopted as proposed will dissuade investors from pursuing fundamentally-driven, actively-managed investment strategies (with material knock-on impacts to the efficiency of passive/index-based investing); increase imitative behavior and herd behavior; decrease economic incentives for individuals to engage in fundamental research; increase the potential for manipulative activities; and diminish market quality from less efficient price discovery. We also believe that the proposed rule will lead to the disclosure of valuable information regarding the trading strategies of market participants. As a result, we believe that Proposed Loan Disclosure Rule would directly undermine the balance (and benefits) the Commission is seeking to achieve with aggregated and delayed public reporting in the Proposed Short Position Disclosure Rule.

The Proposed Loan Disclosure Rule would require that lenders and lending agents report to FINRA, within 15 minutes of a transaction’s execution, certain information related to the transaction. This information includes the securities lending fee or rate charged on each securities lending transaction, terms that are privately negotiated and customer specific. Once received by FINRA, the Proposed Loan Disclosure Rule would require that FINRA assign each loan a unique transaction identifier and make the loan information and data elements publicly available as soon as practicable.¹¹

Public dissemination of transaction-by-transaction data—*in close to real-time*—would provide enough information for the market to glean valuable information regarding specific investor’s investment and trading strategies and enable sophisticated market participants to reverse-engineer and reconstruct trading strategies, short positions, or holdings, resulting in significant harm to investors. Perhaps most concerning is that the public disclosure of lending

¹¹ 87 Fed. Reg. at 69818. The Proposed Loan Disclosure Rule would also require broker-dealer lending agents to disclose the inventory of their securities “owned by [their] customers who have agreed to participate in a fully paid lending program, and the securities in [their] margin customer’s accounts.”

activity for specific securities in close to real-time would effectively serve as a proxy for disclosing short selling activity because the heightened lending activity could signal to the market that a short position was established or increased. The current proposal would allow observers to access transaction-by-transaction information to reverse engineer market participants' trading strategies and positions. As detailed in our January Comment Letter, we believe this will ultimately increase the overall costs and risks associated of short selling. These include the expense required to create and maintain the new infrastructure for loan data reporting, as well as, for example, increasing slippage costs, copycat short selling activity and risks of retaliatory trading. By increasing the overall costs and risks of establishing short positions, we believe the proposal is likely to reduce overall short selling activity, the opposite of what the proposal suggests.

III. The Commission Should Revise the Proposed Loan Disclosure Rule to Mitigate the Significant Costs and Harm That Were Recognized in the Proposed Short Position Disclosure Rule and Would Result from Revealing Confidential Lending Information on a Loan-by-Loan, Fifteen Minute Basis.

Rather than proceed with the current proposal, the Commission should propose an approach to reporting of securities loans that is consistent with the policy goals and economic analysis in the Proposed Short Position Disclosure Rule and appropriately balances the Commission's desire for transparency against the severe costs associated with revealing confidential position and trading information. To this end, we reiterate our suggestions from our January Comment Letter that the proposed rule should only apply to the Wholesale Market, require dissemination of aggregated transaction data on a weekly basis, and impose more prescriptive confidentiality and information security requirements on registered national securities associations ("RNSAs").

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. Under the APA, the SEC has a foundational duty of reasoned decision-making when it comes to rulemakings. In order to conduct a proper rulemaking, the SEC will need 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.'"¹² This core APA requirement includes the obligation to "consider ... important aspect[s] of the problem" before the agency,¹³ and obligates the SEC to respond to significant points raised in public comments.¹⁴ The SEC is further obligated to pay careful attention to the potentially significant costs, as well as supposed benefits, of additional regulation

¹² *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

¹³ *Id.*

¹⁴ 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).

of market participants. As the Supreme Court has explained, “reasonable regulation ordinarily requires paying attention to the advantages *and* the disadvantages of agency decisions.”¹⁵

We also urge the Commission to conduct a revised cost-benefit analysis of the impact of the Proposed Loan Disclosure Rule on trading strategies and the detrimental impact on investors, the markets, and capital formation. We would expect this analysis to appropriately consider and balance the harms of public disclosure against the benefits of public disclosure in a manner that is consistent with the Commission’s own Proposed Short Position Disclosure Rule.

We further note that the Proposed Loan Disclosure Rule and Proposed Short Position Disclosure Rule are only two of a recent spate of rule proposals that could have wide-ranging effects on the U.S. financial system, and the alternative investment industry in particular. We are concerned about the impact that the proposed regulations will have in aggregate on the alternative investment industry and thus its investors. Each new regulation raises the barrier of entry for new entrants and saddles existing market participants with significant additional costs. In considering these new proposals, we urge the Commission to consider the overall regulatory burden on managers when determining whether to impose additional costly, and potentially harmful regulations.

We would be pleased to discuss our comments in further detail with Commission staff. If you have any questions, please do not hesitate to contact Matthew Daigler, Vice President, Senior Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jennifer W. Han

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¹⁵ *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015).