



# Americans for Financial Reform Education Fund

April 1, 2022

Vanessa A. Countryman  
Securities and Exchange Commission  
100 F St. NE  
Washington, DC 20549

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

Dear Secretary Countryman,

The Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission (the Commission) to increase the transparency and efficiency of the securities lending market. We submitted a comment supporting the reporting requirements in this proposed rule in January 2022; we are submitting this additional comment to address the corporate governance implications of the proposed rule.

The securities lending market—as it pertains to equity shares—has important corporate governance implications, as investors cannot vote shares on loan. Those implications are of particular importance in the current market, as asset managers have grown exponentially, own a significant portion of public companies, and are active securities lenders. The corporate governance rights of retail investors are also impacted by the current securities lending market, as the terms and conditions of margin accounts at many retail brokers allow those brokers to lend shares held in those accounts.

We appreciate the Commission’s proposal, in a separate proposed rule, that would require disclosure of the volume of securities on loan when calculating the quantity of shares entitled to vote.<sup>1</sup> While this would be an important and welcome step, the Commission should enhance this proposed rule’s public disclosures to give investors the tools they need to ensure the securities

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<sup>1</sup> “Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers,” Securities and Exchange Commission, Oct. 15, 2021, File No. S7-11-21 available at <https://www.sec.gov/rules/proposed/2021/34-93169.pdf>.

lending practices of asset managers and retail brokers do not interfere with their role in corporate governance.

### **Asset Managers: Securities Lending and Voting Rights**

The three largest asset managers collectively own about 22% of the average S&P 500 company, up from 13.5 percent in 2008.<sup>2</sup> Researchers found that the votes of these three asset managers could be determinative in a significant number of proxy contests and resolutions related to environmental, social, and governance (ESG) matters.<sup>3</sup> Meanwhile, these asset managers and other large institutional investors are active securities lenders, obtaining significant revenues from the securities lending market.<sup>4</sup>

While investment advisors have fiduciary duties of care and loyalty to act in the best interests of their clients, the decision of whether to forego lending fees to vote could present a conflict of interest between advisors and their clients. Some have raised concerns that in some instances, it may be in the best interest of an asset manager to forego recalling shares in order to maximize gains from share lending, while it may be in the best interest of investors to recall shares to exercise voting rights.<sup>5</sup> There is not much public information about how asset managers allocate revenues from securities lending; therefore, it is difficult to know the extent to which individual investors are or are not benefiting from securities lending revenues,<sup>6</sup> and how those benefits would compare to what they could be gaining from proxy voting. However, it has been reported that one asset management company passes 70% of these revenues to investors and retains the rest, potentially tilting the scale in favor of revenues from securities lending and against recalling shares to vote.<sup>7</sup>

The frequency with which institutional investors choose to forego voting rights to obtain lending fees has increased in recent years. A study found that after the Commission, in 2019,

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<sup>2</sup> Eric Levitz, “Modern Capitalism Is Weirder Than You Think,” *New York Magazine*, Mar. 15, 2022, *available at* <https://nymag.com/intelligencer/2022/03/how-asset-managers-have-upended-how-modern-capitalism-works.html>.

<sup>3</sup> Lucian Bebchuk & Scott Hurst, “The Power of the Big Three, And Why It Matters,” 4, Feb. 21, 2021, *available at* [http://www.law.harvard.edu/faculty/bebchuk/The\\_Power\\_of\\_the\\_Big\\_Three\\_and\\_Why\\_It\\_Matters.pdf](http://www.law.harvard.edu/faculty/bebchuk/The_Power_of_the_Big_Three_and_Why_It_Matters.pdf).

<sup>4</sup> Joshua Mitts, “The Price of Your Vote: Proxy Choice and Securities Lending,” Oct. 11, 2021, *available at* [https://clsbluesky.law.columbia.edu/2021/10/11/the-price-of-your-vote-proxy-choice-and-securities-lending/#\\_edn4](https://clsbluesky.law.columbia.edu/2021/10/11/the-price-of-your-vote-proxy-choice-and-securities-lending/#_edn4).

<sup>5</sup> Edwin Hu, Joshua Mitts, Haley Sylvester, “The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff,” 7-8, Columbia Law School Working Paper Series, Dec. 2020, *available at*

[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3673531](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3673531); Joshua Mitts, “The Price of Your Vote: Proxy Choice and Securities Lending,” *The CLS Blue Sky Blog*, Oct. 11, 2021, *available at*

[https://clsbluesky.law.columbia.edu/2021/10/11/the-price-of-your-vote-proxy-choice-and-securities-lending/#\\_edn4](https://clsbluesky.law.columbia.edu/2021/10/11/the-price-of-your-vote-proxy-choice-and-securities-lending/#_edn4).

<sup>6</sup> Joshua Mitts, “The Price of Your Vote: Proxy Choice and Securities Lending,” *The CLS Blue Sky Blog*, Oct. 11, 2021, *available at*

[https://clsbluesky.law.columbia.edu/2021/10/11/the-price-of-your-vote-proxy-choice-and-securities-lending/#\\_edn4](https://clsbluesky.law.columbia.edu/2021/10/11/the-price-of-your-vote-proxy-choice-and-securities-lending/#_edn4).

<sup>7</sup> Edwin Hu, Joshua Mitts, Haley Sylvester, “The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff,” 7, Columbia Law School Working Paper Series, Dec. 2020, *available at*

[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3673531](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3673531).

issued guidance on funds' ability to lend shares rather than vote them in some circumstances, funds made 58% more shares available for lending immediately prior to shareholder meetings, a trend that was particularly pronounced in stocks with high index fund ownership.<sup>8</sup> The 2020 GameStop proxy fight is a notable example of the effects of increased lending ahead of important votes. That year, the ownership of 43.57% of GameStop was concentrated amongst four large asset managers.<sup>9</sup> However, these entities and others decided to forego their voting rights in order to continue obtaining lending fees paid by investors shorting the stock.<sup>10</sup> The result was that two challengers obtained board seats, even though they had previously lost proxy battles.<sup>11</sup>

### **Retail Investors: Securities Lending and Voting Rights**

Retail investors' voting rights are also affected by the securities lending market. At least five large discount brokers include terms that allow the broker to lend the shares in the investor's margin account.<sup>12</sup> The terms of one of these brokers allows the broker to place any security within an investor's portfolio in the margin account,<sup>13</sup> while the terms of another allow the broker to lend out *any* security in the investor's portfolio "to the extent permitted by law."<sup>14</sup> Because terms related to brokers' ability to lend shares are "buried deep in the terms and conditions, or in some cases the supplementary conditions," many retail investors are likely unaware that they could be disenfranchised.<sup>15</sup>

### **Recommendation: Publicly Disclose Daily Amounts of Shares on Loan and Shares Available for Lending, Disaggregated by Lender**

Paragraph (e) of the Commission's proposed Rule 10c-1 would require lenders to provide daily disclosures of the total amount of each security available to loan and the total amount of each security on loan. However, under the Commission's proposed rule, the identity of the lender would not be publicly disclosed. In addition to the information disclosed under paragraph (e) that the proposed rule contemplates making public in aggregated form, we recommend that the Commission require daily public disclosure of the total number of shares of each stock available to loan and the total number of shares of each stock on loan, disaggregated by lender.

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<sup>8</sup> *Id.* at 1.

<sup>9</sup> *Id.* at 16.

<sup>10</sup> Dawn Lim, "How Investing Giants Gave Away Voting Power Ahead of a Shareholder Fight," *The Wall Street Journal*, Jun. 10, 2020, available at <https://www.wsj.com/articles/how-investing-giants-gave-away-voting-power-ahead-of-a-shareholder-fight-11591793863>.

<sup>11</sup> Edwin Hu, Joshua Mitts, Haley Sylvester, "The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff," 17 n.45, Columbia Law School Working Paper Series, Dec. 2020, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3673531](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3673531).

<sup>12</sup> Scott Hirst & Adriana Z. Robertson, "Hidden Agendas in Shareholder Voting," 14, Working Paper, Aug. 2021, available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3833304](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3833304).

<sup>13</sup> *Id.* at 15.

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

We believe this additional disclosure is necessary for investor protection and market integrity. As the leader of a firm that assists companies with shareholder outreach has noted, “Securities lending has changed the way ownership is understood. Ownership and economic interests are decoupled from voting.”<sup>16</sup> If asset managers and the investors they serve cannot vote their shares because they are on loan, the ability of long-term investors to engage in systematic stewardship becomes jeopardized.

In order for investors to ensure asset managers fulfill their fiduciary duties, transparency of their share lending practices is needed. In late 2021, BlackRock announced that it would allow investors to direct voting of shares held by certain index funds.<sup>17</sup> However, BlackRock retained the right to “determine eligibility criteria under this program based upon, among other things . . . financial considerations, including the decision to lend securities.”<sup>18</sup> Lender-specific public disclosures on share lending would allow investors to monitor and advocate for their interests in proxy votes, *and* better understand and advocate for their own ability to direct votes within programs like the one BlackRock recently announced.

These disclosures should be public—as opposed to just for investors—to best ensure accountability to investors and sound corporate governance. Public disclosures would allow non-profit organizations like ours, researchers, and policy makers to provide an extra layer of accountability for investors through data analysis, education, and outreach. Additionally, public disclosures would help inform the education and advocacy efforts of those with a stake in proxy contests, shareholder resolutions, and other important votes.

To provide greater transparency and accountability to retail investors, the Commission should also consider mandating retail brokers disclose to their clients when they lend out their shares and when they make their shares available for lending. In addition, the Commission should investigate whether it would be in the best interest of retail investors to mandate retail brokers give investors the option of requiring their shares be recalled ahead of record dates.

We thank the Commission for engaging in this rule-making process to bring much-needed transparency to the securities lending market. We appreciate the Commission’s consideration of our recommendations to make the rule as effective as possible, keeping in mind its corporate governance implications. For further discussion, please contact Natalia Renta at [natalia@ourfinancialsecurity.org](mailto:natalia@ourfinancialsecurity.org).

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<sup>16</sup> Dawn Lim, “How Investing Giants Gave Away Voting Power Ahead of a Shareholder Fight,” *The Wall Street Journal*, Jun. 10, 2020, *available at* <https://www.wsj.com/articles/how-investing-giants-gave-away-voting-power-ahead-of-a-shareholder-fight-11591793863>.

<sup>17</sup> “Working to expand proxy voting choice for our clients,” BlackRock, Oct. 2021, *available at* <https://www.blackrock.com/corporate/about-us/investment-stewardship/proxy-voting-choice>.

<sup>18</sup> *Id.*

Sincerely,

Americans for Financial Reform Education Fund