



Americans for Financial Reform Education Fund

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

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

Dear Ms. Countryman,

The Americans for Financial Reform Education Fund appreciates this opportunity to provide comment on the Securities and Exchange Commission (“the Commission”) proposed rule related to expanding the disclosures around securities lending, a less visible but crucial part of the financial system where most participants currently have little to no information.

As the Commission notes, the size of the securities loan market is about \$1.5 trillion, and given its large size and potential knock-on effects for other markets, there is an urgent need to require securities lenders to provide greater details of their loans to a registered national securities association (RNSA) as outlined by the proposed changes to Rule 10c-1 under the Exchange Act.

The collection of this data will be useful for both regulatory agencies and the public and will contribute to the safety and soundness of the financial system. Disruptions in the securities lending markets were one of the contributing factors to insurer AIG needing to be rescued in 2008; other large insurers continue to run large securities lending programs today to finance the purchases of various assets.

Increased Reporting Requirements Are a Step in the Right Direction

As a 2012 report by the Financial Stability Board¹ highlighted, securities lending can exacerbate market “runs,” incentivize increased leverage among banks and other financial institutions, and

¹ Financial Stability Board. Strengthening the Oversight and Regulation of Shadow Banking. Apr 16, 2012. https://www.fsb.org/wp-content/uploads/r_120420c.pdf

further grow the “shadow banking system.” Apart from increased reporting, the SEC should consider substantive changes to securities lending that will decrease its likelihood of spreading risk among market participants and exacerbating panics.

Leading up to the Great Financial Crisis of 2008 insurance company AIG had an \$88.4 billion securities lending business to generate additional income. The cash generated from its securities lending was then used to invest in subprime residential mortgage bonds and other less liquid and longer-term securities.² As AIG’s mortgage insurance business started to experience heavier losses, securities borrowers reduced the amount of cash they were willing to provide to AIG, forcing the insurer to suddenly sell the mortgage bond holdings that it had bought with its securities lending proceeds at fire sale prices. By December 2008 AIG’s securities lending program had shrunk to \$3 billion.

Post-2008 insurers and shadow banks are still major participants in securities lending

Even following AIG’s near failure during the 2008 financial crisis, large insurers and hedge funds remain still active participants in securities lending.

MetLife’s securities lending program, for example, is currently around \$30 billion. A major factor supporting its designation as a Systemically Important Financial Institution (SIFI) by the FSOC was its great reliance on various short-term funding mechanisms such as securities lending.³

The FSOC Nonbank Designations Committee noted in its analysis that any disruption stemming from MetLife’s securities lending could spill over into forced sales of its corporate debt and asset backed securities holdings.⁴

Reporting needs to apply to all securities and all entities involved in lending to avoid regulatory arbitrage

The Commission should require that the additional reporting requirements under Rule 10c-1 include all securities and apply to all entities, including lending where non broker-dealers are involved.

² Foley-Fisher, Nathan et al. Federal Reserve. Over-the-Counter Market Liquidity and Securities Lending. December 2018. <https://www.federalreserve.gov/econres/feds/files/2019011pap.pdf>

³ Foley-Fisher, Nathan et al. Federal Reserve. Capturing the Illiquidity Premium. February 2020. https://www.researchgate.net/publication/339239124_Capturing_the_Illiquidity_Premium

⁴ Financial Stability Oversight Council. Basis for the Financial Stability Oversight Council’s final determination regarding MetLife, Inc. Dec 18, 2014. <https://www.treasury.gov/initiatives/fsoc/designations/documents/metlife%20public%20basis.pdf>

Such a comprehensive framework will prevent market participants from conducting lending from a non-covered entity to avoid complying with disclosure rules. The failure to apply existing financial regulations equally across different entities has already led to a significant shift in financial activity to more lightly regulated firms⁵, and the Commission should avoid allowing the same to occur in the securities lending market by ensuring all entities and all securities are covered.

Required reporting of lending fees benefits investors and other regulators

The current lack of transparency into the securities lending market is a disservice to investors who receive a very wide range of pricing. It also hampers regulators who have little to no visibility into distress in securities lending that may lead to assets they were used to purchase needing to be sold suddenly.

As data from a joint securities lending data pilot program from the Treasury's Office of Financial Research, Federal Reserve, and Commission shows, securities lenders at various times in 2015 could expect to see lending fees range anywhere from 5bps to 60bps on US Treasuries and Agency bonds. The range was even larger for foreign stocks where fees ranged from 7bps to 200bps.⁶

While lending fees naturally are expected to differ from one borrower to another based on the demand for specific securities and the riskiness of a counterparty, that difference should not be a result of the kind of information asymmetry that currently exists in the \$1.5 trillion securities lending market.

Market participants and regulators alike will greatly benefit from the greater transparency that comes from reporting every securities lending transaction as a result of the proposed changes to Rule 10c-1, just as they have from the trade-by-trade reporting that was instituted in the corporate bond market since Trade Reporting and Compliance Engine (TRACE) was introduced. Following the introduction of TRACE in 2002, studies have shown that trading costs decreased by an astounding 22.9% for non-investment grade bonds, leading academics to compare the

⁵ Metrick, Andrew and Tarullo, Daniel. Brookings Institute. Congruent financial regulation. Mar 24, 2021. <https://www.brookings.edu/bpea-articles/congruent-financial-regulation/>

⁶ Baklanova, Viktoria et al. Treasury Office of Financial Research. A Pilot Survey of Agent Securities Lending Activity. Aug 23, 2016. https://www.financialresearch.gov/working-papers/files/OFRwp-2016-08_Pilot-Survey-of-Securities-Lending.pdf

significance of its impact to that of the introduction of stock market tickers in the early 20th century.⁷

FINRA should initially collect and disseminate securities lending data, but this role should eventually transition to the SEC

The Financial Industry Regulatory Authority (FINRA) is the only RNSA that exists now, and the Commission should rely on FINRA to aggregate and disseminate the additional data on the securities lending market under the proposed changes to Rule 10c-1.

As the Commission recognizes in its proposal, many existing FINRA members already subscribe to the TRACE corporate bond system and the Commission does not currently have the systems in place to collect individual trade data as proposed by the Rule.

Given how important proper visibility into the securities lending market is for regulators, the Commission should consider ways to eventually transition the collection and dissemination of the data collected under Rule 10c-1 to an internal SEC process. Such a transition would be helpful in enabling better enforcement against any violations that occur in the securities lending market and allow the Commission to better share relevant data with other members of the Financial Stability Oversight Council.

We appreciate your consideration of these issues. If you have any additional questions please do not hesitate to reach out to Andrew Park (andrew@ourfinancialsecurity.org)

⁷ Asquath, Paul et al. University of Chicago. The Effects of Mandatory Transparency in Financial Market Design: Evidence from the Corporate Bond Market. Apr 4, 2019. <https://home.uchicago.edu/~tcovert/webfiles/trace.pdf>