CLIENT ALERT

SEC Issues Proposed Rule for the Reporting of Securities Lending Transactions

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On November 18, 2021, the Securities and Exchange Commission (the "SEC" or the "Commission") voted unanimously to propose a rule (the "Proposed Rule")[1] requiring any person or entity that loans a security on behalf of itself or another person or entity to report the material terms of the transaction to the Financial Industry Regulatory Authority ("FINRA").[2] FINRA would be required to make available to the public certain information it receives concerning each transaction and certain aggregate information. The Proposed Rule is intended to provide investors and other market participants with access to pricing and other material information regarding securities lending transactions in a timely manner.[3]

Background

Securities lending is the market practice by which securities are transferred temporarily from one party, a securities lender, to another, a securities borrower, for a fee. The value of securities on loan in the United States as of September 30, 2021 was estimated at approximately $1.5 trillion.[4] A securities loan is typically a fully collateralized transaction.

1 *See* Reporting of Securities Loans, Securities Exchange Act of 1934 (the "Exchange Act") Release No. 93613 (Nov. 18, 2021) (the "Proposing Release").

2 The Proposed Rule would require reporting to a "registered national securities association." FINRA, however, currently is the only registered national securities association. *See* Proposing Release at 27.

3 *See* Proposing Release at 10.

4 *See* Financial Stability Oversight Council (FSOC), 2020 Annual Report, figure 3.4.2.8, at 41, available at https://home.treasury.gov/system/files/261/FSOC2020AnnualReport.pdf.

Broker-dealers are the primary borrowers of securities; broker-dealers that borrow securities typically re-lend those securities or use the securities to cover fails-to-deliver or short sales arising from proprietary or customer transactions. Securities lending transactions are usually facilitated by a third party agent such as a custodian bank, who lends securities on behalf of its custodial clients for a fee. The beneficial owners of the securities being loaned are generally large institutional investors, including investment companies, sovereign wealth funds, pension funds, collective investment trusts, and insurance companies.[5]

Section 984 of the Dodd-Frank Act provides the Commission with the authority to increase transparency with respect to the loan or borrowing of securities.[6] Although various market participants are required to make specified disclosures regarding their securities lending activities, parties to securities lending transactions are not currently required to report the material terms of those transactions.[7] Currently, the predominant sources of pricing information for securities loans are private vendors. However, the available data is incomplete, as these vendors do not have access to pricing information that reflects all transactions.[8] The Proposing Release notes that the lack of public information creates inefficiencies in the securities lending markets and also impacts the ability of the SEC and other federal financial regulators to oversee these transactions.[9]

Proposed Rule

Lender Obligations

The Proposed Rule would require any person or entity that loans a security (debt or equity) on behalf of itself or another person or entity to provide certain information to FINRA. Each such person or entity that loans a security would be deemed to be a "Lender". For purposes of the Proposed Rule, a "Lender" is defined to include persons or entities that own the securities being loaned ("beneficial owners"), as well as third party intermediaries, including banks, clearing agencies, or broker-dealers that intermediate the loan of securities on behalf of beneficial owners (each, a "Lending Agent").[10]

As defined, a "Lender" would not include the borrower of securities in a securities loan transaction or any third party that intermediates the borrowing of securities on behalf of the borrower. Thus, the borrower would not be obligated to provide

5 *See* Proposing Release at 12-14.

6 Pub. L. 111-203, 984(b), 124 Stat. 1376 (2010). Note that as this section of the Dodd-Frank Act pertains to the loan or borrowing of securities, the Proposed Rule does not address repurchase agreements.

7 *See* Proposing Release at 7.

8 *See* Proposing Release at 20.

9 *See* Proposing Release at 9.

10 *See* Proposing Release at 8.

any information to FINRA pursuant to the Proposed Rule. If the beneficial owner is using an intermediary Lending Agent for the securities loan, the Lending Agent would have the obligation to provide information, on behalf of the beneficial owner, to FINRA pursuant to the Proposed Rule. The beneficial owner of the security would only be required to provide information to FINRA pursuant to the Proposed Rule if such beneficial owner does not use an intermediary Lending Agent for the securities loan.

If the beneficial owner or a Lending Agent is obligated, as a Lender, to provide this information to FINRA, such Lender may contract with a broker-dealer as "reporting agent" to provide the information to FINRA on its behalf.[11] The reporting agent would then become responsible for providing this information so long as the Lender provides this information to the reporting agent in sufficient time to allow the reporting agent to provide the information to FINRA within 15 minutes after the loan is effected. Each reporting agent would be required to enter into an agreement with FINRA permitting the filing on behalf of the applicable Lender and providing FINRA with a list of all such Lenders. Each such reporting agent will be required to establish policies and procedures to provide this information to FINRA in a timely manner consistent with the Proposed Rule.

Public Transaction Data

The items required to be reported to FINRA would include: (i) the legal name of the security issuer, (ii) the ticker symbol and other identifiers, if applicable, (iii) the date and time the loan was made, (iv) for a loan executed on a platform or venue, the name of the platform or venue, (v) the amount of the security loaned, (vi) the type of collateral, (vii) for a loan not cash collateralized, the securities lender fee or any other fee or charge, (viii) for a cash collateralized loan, the rebate rate or any other fee or charge, (ix) the percentage of collateral to value of loaned securities, (x) any termination date of the loan and (xi) whether the borrower is a broker, dealer, customer, clearing agency, bank custodian or other person.

These items would be required to be provided to FINRA within 15 minutes after each loan is effected or modified,[12] as applicable. For purposes of the Proposed Rule, a loan would be effected or modified when it is agreed to by the parties. FINRA would be required to make this information publicly available without charge as soon as practicable.

Private Transaction Data

A. Confidential Data. Within 15 minutes after each loan is effected, the Lender would be required to provide to FINRA: (i) the legal name of each party to the transaction, other identifiers as to such party, if applicable, and whether such party is the lender, the borrower or an intermediary, (ii) if the person or entity lending the securities is a broker-dealer and the borrower is its customer, information about whether the security is loaned

[11] Most broker-dealers already have connectivity to FINRA's systems to report equity and fixed income trades. *See* Proposing Release at 27-28.

[12] If the modification results in a change to information provided to FINRA, the Lender is required to provide FINRA with the time of the modification and a description thereof within 15 minutes after the modification is effected.

from the broker-dealer's inventory, and (iii) whether the loan is being used to close out a fail-to-deliver (if the Lender has such information). FINRA would be required to keep this information confidential, subject to the provisions of applicable law, though the information would be shared with the Commission and such other persons as the Commission may designate upon a demonstrated regulatory need.

B. Aggregate Data. If the beneficial owner employs a Lending Agent, such Lending Agent, as Lender, would be required to provide the following to FINRA by the end of each business day on which a securities loan by the beneficial owner was effected or on which the beneficial owner had an open securities loan as to which the Lender was required to provide information to FINRA pursuant to the Proposed Rule (each, an "Aggregate Reporting Day"): (i) the legal name of the issuer, (ii) the ticker symbol and other identifiers, if applicable, (iii) the total amount of the applicable security available to be lent by the Lending Agent, including any securities owned by the Lending Agent, and (iv) the total amount of the applicable security on loan that has been contractually booked and settled, including any such securities owned by the Lending Agent and any such securities as to which the Lending Agent acted as an intermediary. If the Lending Agent is a broker-dealer, items (iii) and (iv) would include any such securities owned by the broker-dealer, any such securities in its margin customer's accounts and any such securities owned by its customers who have agreed to participate in a fully paid lending program.

   If the beneficial owner does not employ a Lending Agent, such beneficial owner, as Lender, would be required to provide to FINRA or to a reporting agent, by the end of each Aggregate Reporting Day, similar information as set forth in items (i)-(iv) above, except that for purposes of items (iii) and (iv), such information would be as to the beneficial owner's holdings.

   FINRA would be required to aggregate any information it receives under items (iii) and (iv) above and to make public aggregate information for that security (except for identifying information about Lending Agents, reporting agents and persons using reporting agents), together with the issuer information received pursuant to items (i) and (ii), no later than the next business day.

Miscellaneous

Public access to the securities lending information would be available on FINRA's website or similar means of electronic distribution and would be free and without use restrictions. Costs for establishing and maintaining this system would be borne by FINRA in the first instance and would be recouped by FINRA from market participants that report securities lending transactions to FINRA.

FINRA would be required to keep this information available to the public for five years after a loan is effected. FINRA also would be required to implement rules regarding the format and manner of administering the collection of information and the distribution of such information as described above.

As noted above, the Proposed Rule does not address repurchase agreements. In the Economic Analysis section of the Proposing Release, the Commission recognized a risk that the benefits that accrue due to the comprehensive nature of the data would be diminished if the Proposed Rule induces market participants to substitute repurchase agreements for securities lending agreements. This substitution might occur to the extent that a cash collateralized securities loan is economically similar to a repurchase agreement. The Proposing Release notes that, in the Commission's view, the migration risk could be minimal for equity securities loan transactions because of the lack of a well-developed repurchase agreement market for equities, while in fixed income it is fairly common for entities wishing to short sell a bond to facilitate that transaction with a repurchase agreement instead of a securities loan.[13]

Comments on the Proposed Rule must be received within 30 days after the Proposing Release is published in the Federal Register.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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[13] *See* Proposing Release at 147-148.