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SEC FINALIZES SECURITIES LENDING REPORTING RULE

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SEC FINALIZES SECURITIES LENDING REPORTING RULE

The US Securities and Exchange Commission (SEC) has finalized a rule requiring certain parties to report their securities lending transactions to a registered national securities association (RNSA). The Financial Industry Regulatory Authority, Inc. (FINRA), currently the only RNSA, must now adopt rules implementing the infrastructure for such reporting and dissemination.

The SEC adopted the new rule, Rule 10c-1a, under the Securities Exchange Act of 1934 (the Exchange Act) on October 13, 2023. Rule 10c-1a requires the reporting of securities loans to an RNSA, which in turn has to make publicly available certain information it receives within specified timeframes.

As FINRA is presently the only RNSA, it will be the RNSA that will collect and disseminate this information, and, as such, we will refer to FINRA in place of RNSA throughout. Due to new Rule 10c-1a operating such that FINRA must propose and adopt rules related to reporting and dissemination, persons subject to Rule 10c-1a will have at least two years before reporting obligations begin, assuming FINRA is able to get its rules approved and adopted in such timeframe.

KEY TAKEAWAYS

- **Who Is Impacted?** Persons that will incur reporting obligations include agent-lenders, direct lenders such as funds that operate their own lending programs, and broker-dealers borrowing fully paid or excess margin securities from their customers or lending from inventory. A broker-dealer's customers are excluded to the extent they participate in the broker-dealer's fully paid lending program. Reporting agents can be used so long as they are either broker-dealers or clearing agencies and they meet certain requirements.
- **What Is Reportable?** Any transaction in which one person (directly or through an agent-lender) lends a "reportable security" (i.e., CAT, TRACE, RTRS reportable) to another person, subject to certain exclusions.
- **What Information Is Reported and What Is Disseminated?** Reportable information includes issuer name, symbol, rate, transaction date and time, amount loaned, rate information, collateral, termination, and borrower type. Modifications to any of that information is also reportable. FINRA will disseminate this information the next day after reporting except for amount loaned, which will be disseminated 20 days later. Certain confidential information also has to be reported such as the legal names of the counterparties, whether a broker-dealer loaned securities to a customer from inventory, and whether a loan is being used to close out a fail to deliver. This information will not be disseminated.
- **What Are the Reporting Timelines?** Information must be reported to FINRA by end of day. That phrase is presently undefined.
- **What Has Changed from the Proposal?** The final rule does not require a 15-minute reporting window but does require end-of-day reporting. In a change from the proposal, "securities available to loan" and "securities on loan" (i.e., the total amount of each security on loan that has been contractually booked and settled) will not be reportable.
- **What's Next?** FINRA must propose and adopt rules to implement the reporting and dissemination infrastructure.

BACKGROUND

Section 984 of the Dodd-Frank Act added Section 10(c) to the Exchange Act to provide the SEC with authority over securities lending and require the SEC to increase the transparency of information available to brokers, dealers, and investors. More than 10 years after the adoption of the Dodd-Frank Act, the SEC proposed Rule 10c-1a in late 2021 (as discussed in our previous LawFlash).

In proposing and now adopting Rule 10c-1a, the SEC expressed its belief that the rule is designed to provide investors and other market participants with access to pricing and other material information regarding securities lending transactions in a timely manner. In addition, the SEC stated that Rule 10c-1a would improve price discovery, reduce information asymmetries, close securities lending data gaps, and increase market efficiency and competition.

OVERVIEW OF RULE 10C-1A

Rule 10c-1a requires that (1) Covered Persons (as defined below) (2) provide securities loan information (3) regarding reportable securities (4) to FINRA (5) within certain timeframes. The rule permits a Covered Person to use a broker-dealer or registered clearing agency to report information to FINRA on behalf of the Covered Person subject to certain conditions.

Three broad types of data must be reported by the end of the day: the material terms of a securities loan transaction, modifications to securities loans, and certain confidential information. FINRA is then required to make certain aggregate information available the next day and more specific loan and modification information available 20 days later. Rule 10c-1a requires that FINRA adopt a framework to implement the rule and address issues related to data retention and fees that FINRA can charge.

Who Must Report – Covered Persons

Rule 10c-1a(j)(1) defines a "Covered Person" to mean

- any person that agrees to a covered securities loan on behalf of a lender ("intermediary") other than a clearing agency when providing only the functions of a central counterparty or central securities depository;
- any person that agrees to a covered securities loan as a lender when an intermediary is not used, unless the borrower is a broker-dealer borrowing fully paid or excess margin securities; or
- a broker or dealer when borrowing fully paid or excess margin securities.

This definition generally captures agent-lenders, including banks that facilitate securities lending transactions for their custodial customers under the exception from broker status for custody activities in Section 3(a)(4)(B)(viii) of the Exchange Act.

It also captures direct lenders that run their own lending programs, such as funds. However, broker-dealer customers that participate in a broker-dealer's fully paid securities lending program would not be Covered Persons under the rule.

The SEC further clarified that the designation of a business unit as a branch, office, or otherwise is not dispositive of whether such business unit has an obligation to report Rule 10c-1a information since the obligation would fall on the entity.

Use of Reporting Agents and Vendors

Rule 10c-1a(a)(2) permits a Covered Person to use a "Reporting Agent" to submit Rule 10c-1a information to FINRA. A Reporting Agent is a broker-dealer or registered clearing agency that enters into a written agreement with a Covered Person under Rule 10c-1a(a)(2). In order to use a Reporting Agent, a Covered Person must

- enter into a written agreement with the Reporting Agent; and
- provide the Reporting Agent with *timely access* to the required Rule 10c-1a information.

Timely Access and Liability

As explained in the adopting release, "timely access" for these purposes means that the Reporting Agent has access to the Rule 10c-1a information with sufficient time to provide such information to FINRA in the manner, format, and time required by it. One benefit of using a Reporting Agent is that liability can appear to shift if a Covered Person meets the timely access requirements and other requirements of the Reporting Agent provisions.

As explained in the adopting release, the final rule provides that a Reporting Agent will be required to provide the Rule 10c-1a information to FINRA (i.e., "assume[] the reporting obligation") under the new reporting regime only when the Covered Person has both (1) entered into the required written agreement with the Reporting Agent and (2) provided the Reporting Agent with timely access to the Rule 10c-1a information.

As further explained, if a Reporting Agent is unable to provide the Rule 10c-1a information to FINRA because it lacks timely access to it, the Covered Person that enters into the written agreement with the Reporting Agent remains fully responsible for providing the Rule 10c-1a information to FINRA.

Use of Vendors

The SEC also clarified that the Reporting Agent provisions do not prohibit the use of third-party vendors by Covered Persons. As explained in the adopting release, the difference between a Covered Person relying on a Reporting Agent and using a third-party vendor is solely with respect to liability and responsibility under final Rule 10c-1a.

A Covered Person using a Reporting Agent may rely on the Reporting Agent to fulfill its reporting obligations, whereas the use of other third-party vendors would not relieve a Covered Person of its obligation to report Rule 10c-1a information to FINRA.

Reporting Agent Policies and Procedures; Recordkeeping

Rule 10c-1a(b)(2) requires a Reporting Agent to establish, maintain, and enforce written policies and procedures that are reasonably designed to provide Rule 10c-1a information to FINRA. The Final Rule also requires that the Reporting Agent enter into a written agreement with FINRA that permits the Reporting Agent to provide the required Rule 10c-1a information to FINRA (i.e., connectivity).

Further, a Reporting Agent is required to provide FINRA with a list naming each Covered Person on whose behalf the Reporting Agent is providing Rule 10c-1a information and provide FINRA with any updates by the end of the day.

A Reporting Agent would be required to retain (1) the data that it submitted to FINRA (including time of transmission), (2) the data it received from the Covered Person (including time of receipt) to demonstrate compliance with the timely access requirements discussed above, and (3) the written agreements required in order to be eligible as a Reporting Agent. These records would have to be preserved for a period of not less than three years (the first two years in an easily accessible place).

Rule 10c-1a(j)(2) and (3): Scope of Securities and Transactions to Report

The final rule uses two newly defined terms to identify the types of transactions that are within scope: (1) a "reportable security" and (2) a "covered securities loan."

Reportable Security

A "reportable security" is defined as "any security or class of an issuer's securities for which information is reported or required to be reported to the consolidated audit trail as required by § 242.613 ('Rule 613') of the Exchange Act and the CAT NMS Plan ('CAT'), [FINRA's Trade] Reporting and Compliance Engine ('TRACE'), or the Municipal Securities Rulemaking Board's Real Time Reporting System ('RTRS'), or any reporting system that replaces one of these systems."

The final rule recognizes that some securities are outside of these reporting regimes and specifically excluded the following per reporting system:

- TRACE: Fixed-income transactions in securities with a maturity of one calendar year or less, such as money market instruments, and non-US dollar–denominated debt
- CAT: Equity transactions in Rule 144 "restricted securities" that are generally not reportable to the CAT because they are not subject to prompt last-sale reporting rules
- RTRS: Municipal securities transactions excepted under MSRB Rule G-14, including a small number of transactions for securities without assigned Committee on Uniform Securities Identification Procedures (CUSIP) numbers, municipal fund securities (e.g., 529 plans, ABLE programs, local government investment pools), and inter-dealer transactions ineligible for comparison of trade settlement date at a clearing agency

With respect to crypto assets, the adopting release simply states that some digital assets may meet the definition of a "security," and that if a crypto asset is a security for which transactions are reported to the CAT, TRACE, and RTRS, then the crypto asset is a reportable security.

Covered Securities Loan

A "covered securities loan" is defined as a "transaction in which any person[,] on behalf of itself or one or more other persons, lends a reportable security to another person."

It excludes a position at a clearing agency that results from central counterparty services pursuant to Rule 17Ad-22(a)(2) of the Exchange Act or central securities depository services pursuant to Rule 17Ad-22(a)(3) of the Exchange Act. It also excludes the use of margin securities, as defined in Rule 15c3-3(a)(4) of the Exchange Act, unless the broker-dealer lends such margin securities to another person.

As discussed in the adopting release, the SEC refused to provide carveouts for inter-affiliate loans (including arranged financing programs), arrangements that were not subject to a written agreement (e.g., a master securities lending agreement), uncollateralized loans, or loans that do not include an explicit fee.

That said, the SEC did clarify that short sales would not have to be reported per se, but loans that are used in connection with short sales will be required to be reported as a confidential data element.

In addition, the SEC provided clarity on lending programs where a lending agent pools together an available supply of a given security across multiple lenders in their lending program to satisfy a large loan of securities and reallocates such loan among the lenders in the program, as the inventory of individual lenders changes, to avoid recalling a loan.

The SEC clarified that where a lending program as an individual entity is the party that is the lender of the covered securities loan, changes to the underlying participants, inventory providers, or customers of

that lending program will not constitute a change to the parties of the covered securities loan and, as such, the individual participants will not be lenders.

If, however, the multiple, individual participants are all parties identified as lenders to a loan, with no lending program or other entity interposed between them and the borrower, then each will have to be identified as a lender.

Information Reported to FINRA

Rule 10c-1a(c): Loan Data Elements

The loan data elements that must be reported to FINRA remain largely unchanged from the proposal. These data elements include

- the legal name of the security issuer and the Legal Entity Identifier (LEI) of the issuer, if the issuer has a non-lapsed LEI;
- the ticker symbol, International Securities Identification Number (ISIN), CUSIP number, or Financial Instrument Global Identifier (FIGI) of the security, or other security identifier;
- the date the covered securities loan was effected;
- the time the covered securities loan was effected;
- the name of the platform or venue where the covered securities loan was effected;
- the amount, such as size, volume, or both, of the reportable securities loaned;
- the type of collateral used to secure the covered securities loan;
- for a covered securities loan collateralized by cash, the rebate rate or any other fee or charges;
- for a covered securities loan not collateralized by cash, the securities lending fee or rate or any other fee or charges;
- the percentage of collateral to value of reportable securities loaned required to secure such covered securities loan;
- the termination date of the covered securities loan; and
- whether the borrower is a broker or dealer, customer (if the person lending securities is a broker or dealer), clearing agency, bank, custodian, or other person.

Rule 10c-1a(d): Loan Modification Data Elements

The SEC also adopted the loan modification data elements substantially as proposed. Under the final rule, for a securities loan that was subject to initial reporting, the following must be reported with respect to a modification:

- The date and time of the modification;
- The specific modification and the specific data element being modified (as identified above); and
- The unique identifier assigned to the original covered securities loan.

If a securities loan is being modified that was not initially subject to reporting, then the data elements that would have to be reported for a new loan (as identified above) would have to be reported as of the date of modification and the date and time of the modification.

Rule 10c-1a(d): Confidential Data Elements

Under the final rule, a Covered Person is required to report the following confidential data elements to FINRA:

- If known, the legal name of each party to the covered securities loan (other than a broker-dealer's fully paid securities lending customer); the Central Registration Depository or Investment Adviser Registration Depository Number, the market participant identification (MPID), and the LEI of each party to the covered securities loan; and whether each such person is the lender, the borrower, or an agent-lender;
- If the person lending securities is a broker-dealer and the borrower is its customer, whether the security is loaned from the broker-dealer's securities inventory to the customer of such broker-dealer; and
- If known, whether the covered securities loan is being used to close out a fail to deliver pursuant to Rule 204 of Regulation SHO or to close out a fail to deliver outside of Regulation SHO.

To address commenter concerns regarding the "if known" language, the SEC stated that the information is required to be reported only to the extent the Covered Person knew that piece of information. Finally, these confidential data elements are not to be publicly disseminated by FINRA but will be subject to security safeguards as discussed below.

Timing of Reports to FINRA and Public Dissemination

End-of-Day Reporting

The proposal would have required reporting to FINRA within 15 minutes of the loan being effected or modified (including the confidential data elements), after which FINRA would assign the loan a unique transaction identifier and make such information publicly available as soon as practicable.

The final rule ultimately adopts an end-of-day reporting framework so that loans, modifications, and confidential data elements are subject to reporting to FINRA by the end of the day in which the loan is effected or modified.

Public Dissemination

Certain information will be disseminated to the public by FINRA "as soon as practicable, and not later than the morning of the [next] business day," while some other information will be disseminated 20 business days later. More specifically, after a covered securities loan is effected and reported to FINRA (and FINRA assigns it a unique identifier) FINRA will disseminate by the next morning

- the unique identifier assigned by FINRA;
- all the data elements it receives except for the amount, such as size, volume, or both, of the reportable securities loaned; and
- the identity of the reportable security based as FINRA determines is appropriate.

For a loan modification, FINRA will disseminate by the next morning the unique identifier for the loan and information about the data element that was modified (except for the amount, such as size, volume, or both, of the reportable securities loaned).

However, if the modification is to a loan that had yet to be reported, all data elements would be disseminated as if it were a new loan, as described above (except for the amount, such as size, volume, or both, of the reportable securities loaned), along with the modifications.

Dissemination of information about the amount, such as size, volume, or both, of the reportable securities loaned will be delayed for 20 business days. Confidential data elements would not be publicly disseminated.

FINRA Data Retention, Security, and Fees

Under the final rule, FINRA will be required to do the following:

- Retain information in a convenient and usable standard electronic data format that is machine readable and text searchable without any manual intervention for a period of five years;
- Make information collected available to the SEC or other persons as the SEC may designate by order upon a demonstrated regulatory need;
- Make the information collected regarding loans and modifications that it publicly disseminates available to the public on its website or similar means of electronic distribution, without use restrictions, for a period of at least five years; and
- Establish, maintain, and enforce reasonably designed written policies and procedures to maintain the security and confidentiality of confidential information that is reported to it.

The final rule also permits FINRA to establish and collect reasonable fees under rules that are promulgated pursuant to Section 19(b) and Rule 19b-4 of the Exchange Act. Notably, the final rule does not limit FINRA's fee collection efforts to only those persons that are required to report information.

Cross-Border Application

During the comment period, a number of commenters expressed concern about the cross-border application of the final rule. In response, the SEC noted that it was taking a territorial approach to the application of the final rule, under which Rule 10c-1a will generally be triggered whenever a Covered Person effects, accepts, or facilitates (in whole or in part) in the United States a lending or borrowing transaction.

Effective and Reporting Dates

Finally, although Rule 10c-1a will be effective 60 days after publication in the *Federal Register*, the actual reporting requirement will not begin for at least two years. More specifically, the implementation timetable for the final rule is set forth below:

Timeframe	Requirement
Within four months after effective date of final rule (i.e., 60 days after publication in the *Federal Register*)	FINRA proposes rules for public comment
Within 12 months after effective date of final rule	FINRA rules become effective
Within 24 months after effective date of final rule	Covered Persons to begin reporting to FINRA
Within 90 days after Covered Persons commence reporting	Public dissemination by FINRA

IMPLICATIONS AND OBSERVATIONS

Although the SEC modified the final rule from the proposal, Covered Persons will still have significant data collection and connectivity issues to tackle, in addition to the litany of other outstanding issues as they wait for FINRA to propose rules.

Operational and Back Office Considerations

Although FINRA has yet to propose rules, Covered Persons may want to consider developing an inventory of transactions and arrangements that could be implicated by Rule 10c-1a. As noted by the SEC in the adopting release, it does not intend for the rule to be limited to those transactions for which there is a master securities lending agreement in place, or even to transactions that include fees.

In addition, to the extent that order management systems, whether developed internally or sourced from third-party vendors, do not already track securities loans and the data elements required by Rule 10c-1a, Covered Persons may want to consider enhancing their systems to do so.

Short-Selling Position Reconstruction

While the SEC is not specifically requiring FINRA to disclose whether a loan is connected to a short sale—and suggested that the end-of-day reporting, next-day dissemination, and 20-day delay in size and volume information is meant to alleviate concerns about traders being able to decipher short positions—the SEC's actions may not be enough. The data elements that are being disclosed, particularly the issuer identity and the type of borrower, may be enough information to allow market participants to determine which CUSIPs are being shorted based on securities lending activity.

In many ways, this is at direct odds with the approach the SEC took when it adopted Rule 13f-2, which governs reporting of short position and short activity data for equity securities by institutional money managers. Under that rule, reporting is generally required within 14 days after the end of each *calendar quarter*, after which time the SEC would publish aggregate data.

Authority to Require That FINRA Engage in Rulemaking

While FINRA is the only RNSA, its willingness to adopt rules to implement Rule 10c-1a would appear to be entirely voluntarily. In this respect we note that, in adopting the rule, the SEC cited to the statutory authority in Sections 3, 10(b), 10(c), 15(c), 15(h), 15A, 17(a), and 23(a) of the Exchange Act—however, none of those provisions give the SEC the authority to require or direct that FINRA or any other RNSA adopt rules.

Notably, the only sections that are directly on point in this regard are Section 10B of the Exchange Act, which gives the SEC the authority to direct that a self-regulatory organization (SRO) adopt rules around position limits in security-based swaps, and Section 19(c) of the Exchange Act, which gives the SEC authority to itself amend SRO rules subject to certain conditions, including a notice and comment period.

Moreover, it is unclear whether and to what extent FINRA would have the authority to enforce its own rules or Rule 10c-1a against a non–broker-dealer since the disciplinary and enforcement provisions of Sections 15A and 19 of the Exchange Act appear to speak about such processes with respect to members and participants.

Finally, if FINRA does not adopt, or in the more likely scenario FINRA simply is not able to meet, the deadlines imposed by the SEC, it is unclear what mechanism the SEC would have to force FINRA to act. To this end, if, for example, FINRA chose through its rulemaking to impose fees in an unreasonable manner, or on persons that have no reporting obligation, such actions could be challenged and subject to SEC or judicial review, potentially causing significant delays to the SEC's target dates.

First Mover Advantages on Data

One issue that the final rule does not address is whether Reporting Agents or third-party vendors would be prohibited from using data that they are collecting to generate, for example, indicative rate information before FINRA has had an opportunity to disseminate its own data.

While we certainly would expect market data providers to scrape data once FINRA disseminates it to provide market color and more sophisticated rate information, there does not appear to be a prohibition on Reporting Agents or third-party vendors doing so before FINRA publishes its data set. Given that Rule 10c-1a is prescriptive in terms of what FINRA must adopt, it is unclear whether any such prohibitions can be imposed.

CONTACTS

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