



January 7th, 2022

VIA Email: rule-comments@sec.gov

Vanessa A. Countryman, Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

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

Dear Ms. Countryman,

Provable Markets LLC (“PML” or the “Firm”) appreciates the opportunity to comment on proposed Securities and Exchange Commission (the “SEC” or the “Commission”) Rule 10c-1 (“10c-1” or the “Proposal”). PML is a Financial Industry Regulatory Authority (“FINRA”) broker-dealer operating an Alternative Trading System (“ATS”) for the securities finance markets. The Firm’s ATS, Aurora, seeks to provide broader access points, increased liquidity, efficiency, and ultimately transparency through improvements in workflows and market structure to the financing markets.¹

The term market structure is of utmost importance to PML. The Firm was established on the principle that we could use our collective talents as a team of highly accomplished computer scientists coupled with increasingly broad experience in the capital markets to fundamentally grow markets. Broadly, we view the Proposal as a step in the right direction of executing on the goals of Section 984(b) of Dodd-Frank² to

¹Aurora is a cloud-based ATS for the matching of CCP-based and bilateral securities lending, security based swaps, and financing based options trades. Provable Markets was founded in 2021 and seeks to utilize prior research and expertise in secrecy-preserving computation (“SPC”) such as homomorphic encryption (“HE”) and multi-party computation (“MPC”) where applicable. These cryptographic techniques, in the view of the Firm, provide functionality beyond the promises of blockchain and DLT, allowing market participants full control of their data at rest and in transit, while allowing for the running of user-controlled processes on that encrypted data to produce desired results (e.g., an algorithm, credit matching, risk management). PML believes that, over time, SPC will provide participants and regulators a better understanding of trust and sharing of information and data that will support a stronger and more secure market structure.

² See generally, Dodd-Frank Wall Street Reform and Consumer Protection Act, 06-29-2010: <https://www.govinfo.gov/content/pkg/CRPT-111hrpt517/pdf/CRPT-111hrpt517.pdf> [hereinafter Dodd-Frank].

“promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan and borrowing of securities^{3,4} .

The Firm’s ethos believes whether it is identifying improvements to the market structure or deploying technology, changes should always be deployed with pragmatism. As it pertains to increasing transparency, while highly supportive, we take caution that the Proposal’s implementation and demands may unintentionally increase the burden of such compliance both in outright cost for each individual participant old and new, and most importantly; the long-term impacts for the growth or unintended mitigation therein of the market as a whole.

We have watched both in our short tenure as a FINRA member firm, and as individuals in our prior professional lives, the steady and thoughtful implementation of regulation tied to the goals of Dodd-Frank that have significantly improved market conditions, and systemic stability. As is more pertinent to this proposal, PML supports the success of pre Dodd-Frank regulatory developments, stated more specifically in a prior policy letter:

“Regulation SHO⁵ and FINRA Rule 4560⁶... have curtailed a lot of the ‘headline’ activity that is often attributed to disruptive and volatile market events. The Firm explicitly applauds the efforts of both FINRA and the SEC in essentially ridding the market of what is deemed Naked Short Selling (“NSS”) that was a large contributor to the negative stigma around short selling leading into, during, and after the Financial Crisis of 2008 also known as the Global Financial Crisis (the “GFC”). To wit, during the House Financial Services Committee’s hearings around GameStop (“GME”), the topic of NSS was frequently raised as a major component to the events surrounding GME’s volatility. PML believes that while the practice of NSS has certainly not been eradicated, through rule implementations and enforcement, the SEC and FINRA have significantly reduced the occurrence of this activity to a level where its impact to the broader market is de minimis.”⁷

However, based on a casual review of comments received for FINRA RN 21-19⁸, and commentary for the underlying proposal herein, the stigma around short-selling and its underlying market structure remains in need of improvement. PML believes it is important to differentiate between negative stigma and legitimate problems in the underlying market structure as being two very different hurdles. Yes, generally

³ For clarification, in its capacity as a broker-dealer approved for the operation of an ATS that focuses initially on equity markets, comments herein should be presumed to pertain to equity securities. The Firm is aware, and notes that the potential scope of the Proposal has implications for markets well beyond equities, including, but not limited to cryptocurrency.

⁴ *Id.* at pg. 567.

⁵ See generally, <https://www.sec.gov/investor/pubs/regsho.htm>.

⁶ See generally, <https://www.finra.org/rules-guidance/rulebooks/finra-rules/4560>.

⁷ See, Provable Markets Markets LLC (PML) Comments on SR 21-19, 09-30-2021 at pg. 1: https://www.finra.org/sites/default/files/NoticeComment/Provable%20Markets_Matthew%20R.%20Cohen_21-19_9_30_2021%20-%20FINRA%2021-19%20-%20Provable%20Markets%20LLC.pdf.

⁸ See generally, <https://www.finra.org/rules-guidance/notices/21-19#comments>.

speaking we agree that “the securities lending market is opaque,”⁹ but PML believes significant nuance is required to properly expound on that assessment. Opacity has reigned supreme for those that are not main participants in SL (or close enough to them to be apprised of the information that exists within the current SL ecosystem) but the looking glass becomes much clearer for those who have access to some or all parts of the market structure to derive more accurate information. As such, we would like to promote an alternative assessment:

The securities lending market is highly nuanced, complex, and its transparency, or lack thereof, has a direct cause and effect relationship to a participant’s ability to directly participate in the transacting of underlying borrows and loans.

It is the last part of that statement that the Firm requests the SEC consider when implementing the final form of 10c-1, and how we will seek to address and approach our comments in this letter. As noted in our recent request for additional time for comment¹⁰, “[w]ith the publication of proposed rule 10c-1 for SL, along with new proposals for SBS via file no. S7-32-10¹¹ and file no. S7-19-21¹², the Commission has introduced nearly 500 pages of material for participants to digest, discuss, and comment on.” As others have also stated, there are 97 specific comments requests in the proposal alone. Looking deeper, these comment requests introduce a total of 248 individual questions proposed by the Commission throughout. We do not believe it is in the interest of the Commission, other commenters, and the overall market for the Firm to individually expound on and engage with each of these questions. Rather, our approach is to dissect high level points regarding market structure and offer support or alternative suggestions where appropriate to help the Commission succeed on its mission in an efficient manner.

I. The creation of a “consolidated tape” for SL transactions

The Firm resoundingly supports the carefully and eloquently chosen words in comments provided by Dr. James J. Angel stating succinctly transparency goals of the 10c-1 proposal:

“RIGHT ON!!!!!!!!!!!!!!!!!!!!!!”¹³

In our view a consolidated tape (“CT”), or similar reproduction of data would indeed provide valuable information and transparency to the *securities lending* market. However, the context in which the Commission presents it in the rule we believe can and will create confusion as to its ultimate goals. The Proposal states in relation to the House Financial Services Committee’s March 17, 2021 hearing, “Game Stopped? Who Wins and Loses When Short Sellers Collide, Part II, that:

“As Michael Blaugrund stated during the hearing, ‘[a] system that anonymously published the material terms for each stock loan would provide the necessary data to

⁹ See, Proposed rule: Reporting of Securities Loans: 17 CFR 240.10c-1 at pg. 7: <https://www.sec.gov/rules/proposed/2021/34-93613.pdf>.

¹⁰ See generally, <https://www.sec.gov/comments/s7-18-21/s71821-20110864-264695.pdf>.

¹¹ See generally, <https://www.sec.gov/rules/proposed/2021/34-93784.pdf>.

¹² See generally, <https://www.sec.gov/rules/proposed/2021/34-93614.pdf>.

¹³ See, Re: Reporting of Securities Loans, James J. Angel, Ph. D., CFP, CFA, 01-04-2022 at pg. 2: <https://www.sec.gov/comments/s7-18-21/s71821-20111123-264777.pdf>.

understand shifts in short-selling activity while protecting the intellectual property of individual market participants.”¹⁴

While we welcome the concept of more transparency through consolidated and “clean” data reporting by a registered national securities association (“RNSA”) (i.e. FINRA), we once again wish to ensure that the market does not conflate short selling with stock borrow and loan. While they are more often than not intertwined (especially in the context of hearings around GME) we as a Firm feel it is important to reiterate the work flows that result in a short sale, and that borrow and loan information is at best the equivalent of a delayed stock quote. Furthermore, PML counts eight (8) mentions of “signals”¹⁵ in the Proposal, and specifically that “[p]rofessional traders, might seek to profit by developing trading strategies based on signals.”¹⁶

As a point of emphasis for the Commission and readers of comments in the letter and others, PML presents the following to describe the nuance between the SL market and, more generally, short selling that it supports.

SL functions to *settle* previously enacted short sales by market participants. We believe it is incorrect, and in some instances possibly harmful for market participants to assume an SL-related CT would provide insight into short selling activity in real time.

For example: If Apple Inc. (“AAPL”) were trading at \$100, and real-time market data pertaining to options showed significant call buying of \$120 strike calls, it is feasible a participants may deduce or derive “a signal” that the market perceives a sharp increase in the price of AAPL stock. Conversely, if the proposed CT were to show a significant increase in reported loans on the same day for AAPL, one cannot similarly make the argument that this shows a similarly offsetting “signal” that the market perceives AAPL stock will see a sharp decline. While not to the contrary, the answer is that the SL data provided by the CT is part of a larger (and two day old) transaction.

The perception that short sales must always imply a bet that the market is going down is equally as fallible that significant purchases in options (and perhaps more accurately the buy or sale of the underlying volatility of a security) imply a bet that a stock is going up (or down in the instance of significant put buying). What the borrow activity, and a transparent CT *can* provide is clarity on current rates for participants who may directly be involved in the SL market to better price their supply or demand, beneficial owners to understand the potential opportunities they may have in providing liquidity to the SL market, and retail investors understanding of what may currently be hard to borrow and potentially a source of income among other things.

The Firm requests that the Commission carefully consider and describe the context of the information provided publicly to the market, and the underlying benefits of each category published to the proposed CT.

¹⁴ See *supra* note 8, *fn. 11 at 9*.

¹⁵ See *supra* note 6, at *pgs. 11,25,42,46,47,133, and 154*.

¹⁶ *Id.* at *pg. 154*.

To the extent the commission is interested in more technical suggestions to improve market structure of the short sale process, we respectfully resubmit our opinion expressed previously in our comments for FINRA SR 21-19 that:

“PML believes this area [locates] in particular can assist in reducing the amount of fails to deliver in the market, by employing newer technology and encouraging those providing locates to use more dynamic systems and logic when providing “good” locates.”¹⁷

As such, we once again request that the Commission explore ways to strengthen the “reasonable grounds” rule under the current Regulation SHO framework.

In this context, while we do not believe the underlying data of requiring lenders to submit total lendable assets as prescribed under 10c-1(e)(1)(iii) can serve an investment related purpose; PML does view this as a logical this is a suitable starting point for refining the locate process both from a participant basis, and for the Commission and other SROs to monitor activity. As such, we are supportive of this proposed rule Proposal. Furthermore, we note that there are already participants that operate in this fashion with the ability to provide real-time availability intraday. The Firm believes that there is little reason with the assistance of technology that this market cannot and should not have a goal of moving in this direction long term.

II. Market Structure

PML believes that the Commission is correct in its assessment of the participants in the SL market as it stands today. Additionally, in our view, the Commission appropriately summarizes the *current* state of affairs in underlying market structure and transaction types. The SL market is and has long been primarily a bilateral market for transacting. But it has seen an increase in terms of offerings and volume¹⁸ that is being traded through new platforms and CCP solutions.

There are many new solutions arising within this market to solve problems large and small. Core among them are the introduction of the Aurora ATS for SL, which acts as partner in its role as an Approved Submitter to the also newly proposed Depository Trust & Clearing Corporation’s Securities Finance Transaction (“SFT” or “SFT Service”) run by its subsidiary the National Securities Clearing Corporation (“NSCC”).¹⁹ The Firm believes that the growth of alternative platforms for transacting in conjunction with solutions that strengthen market structure remain at an early stage, akin to the evolution of cash equity trading in the early days of ECN’s and the first ATS’s, to its current state.

¹⁷ See *supra* note 8 at pp. 8-9 for further detail.

¹⁸ See, OCC securities lending average daily loan value hits new high during December, Securities Finance Times, 01-04-2022:

https://www.securitiesfinancetimes.com/securitieslendingnews/industryarticle.php?article_id=225252&navigationaction=industrynews&newssection=industry

¹⁹ See generally, <https://www.sec.gov/rules/sro/nscc.htm#SR-NSCC-2021-010>

As such, the Firm requests that when considering the costs of implementing the final rule 10c-1, the Commission include an analysis on the impact of other market structure developments that may have equal or perhaps even further benefits to providing transparency and more accurate pricing: these have historically been the beneficial results of more participants and easier and increased access to points of liquidity. To wit, in its analysis, the Commission calculates 409 participants²⁰ in scope for reporting.

If and when the Commission provides approval for the SFT Service, the available participants to a borrow and loan transaction expand dramatically to any eligible NSCC member or Sponsored Member. While not a direct corollary, the Fixed Income Clearing Corporations (“FICC”) Sponsored Repo service now boasts nearly 2000 participants²¹. Its underlying “sponsored repos are surging.”²²

While it would serve in the interest of PML and Aurora to see similar success, we objectively believe that a similar growth trajectory for the SFT Service, continued growth for the OCC, and new digital platforms and workflow solutions will continue to bring more point-of-trade efficiency to this market. Furthermore, we believe statements by Chair Gary Gensler in comments surrounding the U.S. Treasury Market, is equally applicable to SL and other financing markets that, “[w]hile central clearing does not eliminate all risk, it does lower it. It *levels the playing field across counterparties, allowing for greater competition and resilience* by bringing in additional capital during times of stress.”[emphasis added]²³

In February of 2021, Eurex announced the closure of its CCP for Securities Lending after approximately eight years of operation.²⁴ Upon conversations with members of Eurex and participants, while one single event was not the direct cause of the need to close, it was made clear that the slew of reporting and other regulatory initiatives underway in the EU, including but not limited to SFTR, CSDR, MiFID II, initial phases of UMR, and Brexit all placed a burden on firms to ration resources away from working to grow adoption of the CCP for SL. In an article published in Finadium the situation was summarized by stating:

“Although closing the Lending CCP is a disappointment, there is a lot to be learnt from this case. Regulatory mandates have driven client priorities in the last decade; cleared SFT have not benefited from that priority. In order to drive adoption in that business line, the economic incentives must be strong for all stakeholders.”²⁵

PML believes that the current changes under way (it is of note that OCC has announced plans for a blockchain based solution for SL and Aurora has plans to seek to be a connection point to the OCC in the future as well), along with new offerings such as the SFT Service, the cost analysis requires a more

²⁰ See *supra* note 8 at pp. 143-146.

²¹ See generally, <https://www.dtcc.com/client-center/ficc-gov-directories>.

²² See generally,

<https://www.bnymellon.com/us/en/insights/aerial-view-magazine/sponsored-repos-are-surging.html>.

²³ See, Prepared Remarks at U.S. Treasury Market Conference, Chair Gary Gensler, 11-17-2021, <https://www.sec.gov/news/speech/gensler-us-treasury-market-conference-20211117>.

²⁴ See, https://www.securitiesfinancetimes.com/securitieslendingnews/industryarticle.php?article_id=224545&navigat ionaction=industrynews&newssection=industry

²⁵ See, Eurex to close Lending CCP as buy-side repo growth accelerates (Premium), Josh Galper, 02-07-2021: <https://finadium.com/sfm-interview-eurex-to-close-lending-ccp-as-buy-side-repo-growth-accelerates-premium/>

holistic approach to what may serve to benefit the SL market in the medium and long term while supporting the goals of Dodd-Frank.

As a quick exercise, PML would like to emphasize the following:

In the current market structure a new broker-dealer looking to enter the bilateral SL market requires significant upfront costs, but they are not insurmountable. These costs and infrastructure requirements include:

- A books and records system, OMS, and reconciliation engine (e.g., FIS Securities Lending Processing Platform - formerly Loanet)²⁶ and technology support to onboard and integrate said system
- An SL trader
- An FTE operations professional (minimum) covering daily reconciliation, receives and delivers, billing, and other operational necessities
- A credit and risk monitor
- Legal services to execute individual Master Securities Lending Agreements (“MSLA”) with each counterpart for bilateral trading
- An NSCC Membership and clearing account or clearing partner

In comparison, if approved, the SFT Service would require the following²⁷:

- A books and records system, OMS, and reconciliation engine (e.g., FIS Securities Lending Processing Platform - formerly Loanet)²⁸ and technology support to onboard and integrate said system
- Access to an Approved SFT Submitter (that may or may not offer integration with the aforementioned software)
- An SL Trader
- An FTE operations professional (managing more streamlined process with the NSCC’s involvement)
- Part time credit and risk monitor (as the exposures are managed by DTCC/NSCC)
- An NSCC Membership and or Sponsor for access to the CCP

In other words, the cost of “going live” upfront may be relatively comparable, but ongoing needs to run the business require approximately 50% fewer FTE and significantly less legal documentation to both begin trading and get access to a broad array of participants.

While PML believes that there is a need for both CCP and bilateral based trading in different circumstances, that barrier to entry for any new participant should not be overlooked. If a new entrant is

²⁶See, <https://www.fisglobal.com/en/capital-markets-solutions/investment-banking-and-brokerage/securities-finance/fis-securities-lending-processing-platform>

²⁷ PML further notes that for some participants, there are significant balance sheet cost savings to be derived from the central clearing of stock borrow and loans that are not included in this analysis.

²⁸*Id.*

looking at costs associated with extra reporting (and eventually T+1 changes operationally firmwide) the market at best may remain stagnant to slightly smaller. As staff notes:

“The Commission also preliminarily believes that given the significant fixed costs of implementing the systems required by the proposed Rule for lending programs to report to an RNSA, smaller lending programs and broker-dealers may be forced to consolidate or exit the lending market. The Commission preliminarily believes that a mitigating factor leading to less consolidation is that the current relationship and network structure of lending programs and broker dealers already favors larger lending programs and broker-dealers who have the resources to maintain relationships with more and larger securities lending counterparties. Consequently, the Commission preliminarily believes that the market for lending programs and broker-dealer security borrowing services is already likely dominated by larger lending programs and broker-dealers that the Commission does not believe would cease operating as a result of these fixed costs.”²⁹

Once again, PML expresses concern that whether or not current market conditions do in fact allow for larger lending programs and broker-dealers to “dominate”, it would be counterproductive to dismiss the benefits that a greater number of participants (large and small), operating with the same information, can do to similarly promote stability, transparency, and better pricing for all users.

As such, this creates somewhat of a conundrum as to how to weigh market structure developments, the promise of future technologies, and necessary reporting requirements to both increase transparency and provide regulators the proper tools to manage systemic risk.

While PML has concerns around potential ambiguity in the Proposal as also raised by others in terms of who may or may not be under scope, where potential free-riders may exist, and potential conflicts of interest (especially in the case of a non broker-dealer lender outsourcing reporting to a broker-dealer customer who borrows from them) - we will summarize with constructive bullet points to address our concerns. We also highlight existing market structure dynamics that may serve to make integration of proposed 10c-1 more palatable.

1. The SL market has retained high barriers to entry for some time. As noted earlier, while not insurmountable, PML believes that improvements that mirror that evolution of the cash equity markets can go a long way in fostering growth and transparency by increased participation. As such, we support:
 - a. an open and standard FIX protocol for the SL market³⁰.
 - b. incorporating more technological advancements and/or test POC’s to reduce bottlenecks in the existing workflow. (e.g. smart contracts, encrypted data sharing for risk and credit management using SPC, automation tools, etc.).

²⁹ See *supra* note 8 at pp. 150-151.

³⁰ PML is currently developing such a protocol, and welcomes any input from participants that are in support of similar goals.

2. Phase in 10c-1 requirements and who is in scope over time, similar to the phase in of UMR. Allow smaller participants to benefit from the experience of larger incumbents who have either already built systems to comply today (as there are many examples) and/or find alternatives that best suit the needs of each individual firm in scope.
3. Form working groups to better understand the data currently retained and housed by existing infrastructure (e.g., books and records systems) to allow for a relatively seamless transition from third party reporting to the RNSA.
4. Complete a thorough cost benefit analysis on the impact of new developments in the SL ecosystem, and how they may defray costs through new efficiencies while providing transparency organically.
5. Treat the SL market similar to SBS and Swaps (as defined by the CFTC). For traditional bilateral transactions, those in scope for reporting can opt to report directly or through a (registered or unregistered) third-party solution. For transactions reported on a platform (i.e., traded on an ATS or other regulated platform), allow participants to defer reporting of the transaction data to the marketplace operator directly.

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Provable Markets thanks the commission for their consideration and time in reviewing our comments, and the comments of others. If you have any questions about the information provided herein, or require additional information or documentation, please feel free to contact the undersigned at matt@provablemarkets.com.

Respectfully,

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