September 25, 2009

Ms. Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. 4-590 (Securities Lending and Short Sale Roundtable),
File No. S7-30-08 (Temporary Interim Final Rule 204T), and
File No. S7-08-09 (Amendments to Regulation SHO)

Dear Ms. Murphy:

The Securities Lending Division ("SLD") of the Securities Industry and Financial Markets Association ("SIFMA") and the Committee on Securities Lending of the Risk Management Association ("RMA") are submitting this comment letter in connection with the roundtable hosted by the U.S. Securities and Exchange Commission ("Commission") on September 29 and 30, 2009 (the "Roundtable") focusing on securities lending, short sale pre-borrowing requirements, and short sale disclosure. We are also writing to address comment letters previously submitted by Quadriserv, Inc., ("Quadriserv") in response to the short sale proposals referenced above as well as the document it submitted entitled "Quadriserv Proposal to Modernize the Market for Securities Lending" ("Quadriserv Proposal"). In this letter, we are providing brief comments on the current state of the U.S. securities lending markets, notions of a centralized marketplace for securities lending as well as a securities lending central counterparty ("CCP"). Our specific comments relative to the Quadriserv Proposal appear in Appendix I.

About SIFMA and the RMA

SIFMA brings together the shared interests of more than 600 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington, D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

Founded in 1914, the RMA is a not-for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk principles in the financial services industry. RMA has over 2,600 institutional members that include banks of all sizes as well as nonbank financial institutions throughout North America, Europe, and

Asia/Pacific. RMA's Committee on Securities Lending ("CSL") was formed in 1983. The objective of the CSL is to promote sound securities lending practices within its members and the industry. In the securities lending context, the members of RMA primarily act as "agent lenders", loaning securities on behalf of underlying principal lenders.

The U.S. Securities Lending Market

The U.S. securities lending market operates on a well-established base of legal principles and business practices which is supported by an infrastructure that has evolved significantly over time through a combination of industry efforts and commercial technology developments. The securities lending process in its simplest form involves a securities lender and a securities borrower. Each business day, a broker-dealer determines its need to borrow securities then contacts potential securities lenders searching for the desired securities. Once a lender is found, the financial terms of the securities loan/borrow are agreed upon, including: the amount of collateral to be given to the securities lender to secure the loan (including the daily percentage of over-collateralization of the loan); the form of collateral (typically cash); the interest 'rebate' rate the securities borrower will receive from the lender on any cash collateral given by the securities borrower:[1] or the fee paid by the borrower in the case of non-cash collateralized transactions. Loans of U.S. securities are typically transacted on a 'same-day' basis, meaning the borrower will contact and borrow the securities from the lender all within the same business day.

Technological advances have allowed broker-dealers and lending agents to automate securities lending transactions. This automation has been critical in allowing the borrowers and lenders of securities to keep pace with the growth and expansion that has taken place in the capital markets over the past 40 years. Much of what is described above now happens electronically and without human intervention. It is only for a relatively small portion of the daily securities borrows/loans that borrowers and lenders will actually speak to one another to find needed securities and negotiate terms.

The soundness of this market has been exemplified in both routine and non-routine situations. With respect to the routine, every day millions of transactional events (*e.g.*, new loans, marks-to-market, rate changes, partial and full loan returns) occur in the securities lending market in a highly automated, efficient manner. Exemplifying the non-routine is last year's bankruptcy of Lehman Brothers, an entity that had a significant presence in the securities lending market. As Lehman Brothers moved toward bankruptcy, the participants in the U.S. securities lending market began the process of reducing their business and unwinding transactions with them in an orderly manner, supported by the sound legal and contractual elements of the business coupled with the market's infrastructure.

The securities lending market in the U.S. is almost entirely a bilateral market (*i.e.*, the parties to a securities lending transaction deal directly with each other and not, for

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[1] If the rebate rate is negative, the securities borrower will owe interest payments to the securities lender.

example, through the processes of a centralized market center such as an exchange or an ATS, or a CCP such as National Securities Clearing Corporation ("NSCC") or the Options Clearing Corporation ("OCC") for clearance and settlement). This difference is not the result of the securities lending market not keeping pace with developments in the U.S. market for purchases/sales of equities and listed options (the "cash markets"); rather, it is because the U.S. securities lending market is fundamentally different from the cash markets. The cash markets feature irrevocable purchases and sales of fungible securities where there is no on-going relationship between purchaser and seller after completion of the transaction.

By contrast, securities lending transactions are revocable transactions where the identity of the counterparty is essential in determining whether to effect a transaction, and if a transaction is effected, the terms of the transaction (such as rate and collateral). The identity of the counterparty is relevant considering that each securities lending transaction is an on-going relationship (unlike a purchase or sale) that does not end with the initiation of the borrow/loan. Securities lending transactions are ultimately intended to be unwound, the termination is at the discretion of either the lender or the borrower, and rates are subject to change on a daily basis. It is in this context that counterparty traits such as creditworthiness, historical behavior in other securities lending transactions, and the nature of the lender's portfolio need to be considered.[2]

These differences between the securities lending market and the cash markets are among the issues that should be considered in determining whether a centralized marketplace or a CCP for securities lending would add material value. We do not point out these fundamental differences to discourage efforts by the Commission to foster a securities lending CCP or centralized marketplace; however, we do believe these differences must be taken into account as the Commission contemplates a centralized marketplace and/or a CCP for securities lending.

Comments regarding a Securities Lending CCP

While the opinions of the members of both the SLD and the CSL may vary in certain respects relative to a securities lending CCP, there are several areas where there is consensus. While we are not opposed to the operation of a CCP for securities lending transactions, as noted above we do believe there are significant issues that an effective CCP would need to address that do not exist in the cash markets where CCPs (such as NSCC with respect to equities and the OCC relative to listed options) have been so successful. In fact, the OCC's securities lending CCP has been in operation for more than a decade, yet it is not involved in a significant percentage of securities lending transactions today. We believe the relative lack of participation in the OCC's CCP demonstrates that most participants in the U.S. securities lending market have confidence in the current bilateral system and have not found the credit enhancement offered by the OCC's CCP to be necessary or of material added value.

[2] As an example of the relevance of the nature of a lender's portfolio, securities borrowed from an index fund are considered more stable (and less likely to be subject to recall) than securities borrowed from an actively managed fund.

While we understand that CCPs are being used or considered in cash and other OTC markets, we believe the Commission should analyze the differences between securities lending and those markets in connection with any consideration of a securities lending CCP. Further, any such consideration by the Commission should include a review of the following additional issues and factors, among others:

- participant criteria of a CCP, including credit and capital requirements and appropriate regulatory oversight;
- the most effective manner to address rate changes, recall risk, and other counterparty behavior with respect to the on-going maintenance of the loan;
- whether there should be only one or multiple CCPs;
- ownership, control, and operational issues (*e.g.*, should a securities lending CCP be owned, controlled, and operated by the participants);
- whether a CCP should be a not-for-profit enterprise; and
- interoperability (*i.e.*, the ability to participate in a securities lending CCP using a variety of securities transaction platforms).

We believe that fostering a successful securities lending CCP, if it is desirable, will require successfully addressing these issues. We also believe that any regulatory action by the Commission in this area should be taken in consultation with the industry after much more detailed analysis. Representatives of the RMA and SLD would like to continue to be involved in any further discussions the Commission may have regarding structural issues relating to the U.S. securities lending industry.

Please see the attached Appendix I for our further comments regarding a securities lending CCP in the context of our discussion of the Quadriserv Proposal.

If you have any questions or require additional information, please do not hesitate to contact the undersigned or Amal Aly, SIFMA Managing Director and Associate General Counsel, at (212) 313-1268, or Curtis Knight, Director, RMA Securities Lending and Market Risk, at (215) 446-4082. Thank you for your attention to our comments.

Sincerely,

/s/ Irving Klubeck
President, Securities Lending Division, Securities Industry and Financial Markets Association

/s/ Michael P. McAuley
Chairman, Committee on Securities Lending, Risk Management Association

cc: The Hon. Mary Schapiro, Chairman
The Hon. Kathleen Casey, Commissioner

The Hon. Troy Paredes, Commissioner
The Hon. Elisse Walter, Commissioner
The Hon. Luis Aguilar, Commissioner
James A. Brigagliano, Co-Acting Director, Division of Trading and Markets
Daniel Gallagher, Co-Acting Director, Division of Trading and Markets
Brian Bussey, Associate Director, Division of Trading and Markets
Josephine Tao, Assistant Director, Division of Trading and Markets
Jerry Carpenter, Assistant Director, Division of Trading and Markets
Elizabeth Sandoe, Branch Chief, Division of Trading and Markets

APPENDIX I

The Quadriserv comment letters and the accompanying Quadriserv Proposal assert that there are fundamental, systemic deficiencies in the securities lending market that would be addressed by "encouraging automation of the securities lending process to bring lenders and borrowers together in a regulated, electronic market backed by a strong central counterparty." Not surprisingly, the letter advocates the movement toward the product that Quadriserv is attempting to launch through its wholly-owned subsidiary, Automated Equity Finance Markets, Inc, operating as "AQS." Perhaps the most problematic aspect of the Quadriserv Proposal is that it blurs the distinction between a securities lending CCP and Quadriserv's centralized securities lending market. We hope that our comments will help the Commission differentiate between the two.

Quadriserv makes broad statements regarding securities lending that do not square with reality. For example, it asserts that the structural framework of securities lending "has not kept pace with its growth" and that "throughout the dramatic increase in size and importance of securities lending over the last 30 years, the market has changed little to correct its significant deficiencies." As noted in our letter, the U.S. securities lending market is a sound market that operates on a well-established base of legal principles and business practices which is supported by an infrastructure that has evolved significantly over time through a combination of industry efforts and commercial technology developments.

Quadriserv's documents suggest that the securities lending market has the same need for a CCP that the OTC markets for various derivatives have, and that the securities lending market would function the same as the cash markets if only a CCP were implemented. Quadriserv's submission asserts that numerous benefits would accrue to the securities lending market by adopting a CCP structure along with the AQS model. We have reviewed these claims and find that in a number of cases, the information presented is inaccurate, incomplete, or otherwise in need of clarification. Quadriserv's assertions and our observations are summarized below:

Assertion 1: **Reduced Fails to Deliver and Concomitant Naked Short Selling**

Observations: We agree with Quadriserv's assertions that a CCP will not address the problem of persons shorting a stock without any intention of borrowing to make delivery. A naked short seller does not comply with the locate requirement nor seek to make delivery when it is due, and the existence of a CCP would not change that behavior. We also do not believe a CCP will impact unintentional failures to deliver as the CCP model merely relates to the clearance, settlement and counterparty risk of agreed-upon securities lending transactions, not the ability of short sellers to borrow securities to cover their

short sales. A securities lending CCP model has nothing to do with short sale compliance nor is it clear how it would impact naked short selling or fails to deliver.

Quadriserv also equates unintentional fails to deliver with naked short selling - a point with which we disagree - and asserts that a centralized securities lending marketplace (such as AQS) would reduce such unintentional failures by enhancing the ability of borrowers to find willing lenders. We believe that unintentional failures to deliver are not typically the result of the inability of borrowers to find lenders. Unintentional failures to deliver are usually the result of processing delays which would not be improved by a centralized securities lending marketplace. Furthermore, where an unintentional failure to deliver is the result of a lack of supply, there is no evidence that this would be remedied by a centralized securities lending marketplace; U.S. securities lending desks already form an efficient network that routinely enables participants to find sources of borrowable securities if such exist.

In any event, there appears to be little if any negative impact that results from unintentional failures to deliver because of the Commission's steps to crack-down on failures to deliver. Regulation SHO, especially Rule 204, has driven what were already small fail levels down even further. For example, according to information provided by DTCC, CNS fails in July 2008 (before Rule 204 was adopted) averaged 1.09% of the total value processed in CNS, whereas this figure dropped to 0.16% in July 2009. 21.3% of the July 2008 failures related to ETFs (where failures are due primarily to latency in the creation/redemption process) whereas 42.5% of the July 2009 fails, already a small number, related to ETFs.

The steep drop in failures to deliver can also be seen in the decrease in the number of "threshold" securities. According to the Commission's Office of Economic Analysis ("OEA"), between the imposition of Rule 204T in September 2008 through the end of March 2009, the average daily number of threshold securities declined 77.5% from 480 securities to 108 securities[1] - declines that have only continued since the time of OEA's analysis (as of September 23, 2009, there were only 78 threshold securities).

Regardless of the reason for failures to deliver (*i.e.*, whether intentional naked shorting or otherwise), the inability of short sellers to find a counterparty from whom to borrow a security causes little or no harm because even if there is a brief fail, Rule 204 requires such fails to be closed-out before the start of trading after the failure to deliver.

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[1] Memorandum from the Commission's Office of Economic Analysis Re: Impact of Recent SHO Rule Changes on Fails to Deliver, April 16, 2009 at http://www.sec.gov/comments/s7-30-08/s73008-121.pdf.

Assertion 2: Reduced Systemic Risk

Observations: A CCP reduces systemic risk by backstopping the failure of a borrower or lender with a guaranty fund and mutualizing the risk. The risk related to such mutualization will depend on the exact model of a given CCP, including its capital and margin requirements. In the current securities lending market, each participant makes a conscious, measured decision to transact with each of its counterparts, typically following detailed credit analysis. Each participant understands that it bears the counterparty risk that results from these decisions.

Assertion 3: Increased Transparency

Observations: The Quadriserv Proposal notes that "[t]ransparency has become a much-obscured concept in recent years…" yet does not itself provide any clarification. The Quadriserv Proposal blurs the distinction between the transparency to be provided by a CCP versus that to be provided by its centralized marketplace, and then it does not clearly define the elements where transparency would be improved nor how the CCP and/or centralized lending marketplace would provide increased transparency.

There is considerable transparency already in the securities lending market. For example, today there are a variety of systems from multiple vendors that provide various forms of transparency from the perspective of pricing and activity levels in specific securities. Further, in response to the concerns raised by the Commission in 2003 regarding the level of information disclosure in agency lending transactions and the impact on credit and capital monitoring, the industry worked for several years to develop and implement Agency Lending Disclosure, an operating model that has dramatically improved the degree of principal lender transparency to broker-dealer borrowers. Among the benefits of Agency Lending Disclosure is that it enables participants to make informed decisions regarding the parties with whom they may deal.

As noted in our accompanying letter, much of the important information relative to a securities loan is information regarding the counterparty, and not all lenders and borrowers are equal; therefore, the value of securities borrowed/loaned depends on the borrower/lender. Unlike, for example, the equities trading markets where fungible shares are worth the same amount regardless of the seller and purchaser, in the securities lending market, pricing is not merely a function of supply and demand - the value of a security loan is intrinsically linked to the identity of the borrowers and lenders. Relevant factors regarding a lender include, as examples, the collateral accepted and the likelihood of recall or a change in rate. As a more specific example, the stability value associated with borrowing a security from a passively managed index fund is significantly greater than an actively traded fund, as the potential for a recall is significantly less. We

fail to see how either Quadriserv's AQS or its associated CCP would provide transparency regarding these key elements.

Blind trading platforms such as Quadriserv's would eliminate the opportunity to discern differences such as this and efficiently price securities lending transactions. In fact, the blind trading model runs directly counter to the regulatory concerns that ultimately led to the development and implementation of Agency Lending Disclosure.

Assertion 4: Greatly Improved Regulatory Oversight

Observations: The Quadriserv Proposal again blurs the distinctions between a securities lending CCP and a centralized securities lending market such as AQS and is unclear how either would improve regulatory oversight of short sale issues. Securities lending in the brokerage industry has been subject to intense regulatory scrutiny for years, especially since the advent of Regulation SHO in 2005 and the implementation of Rule 204 in September 2008. Both the Commission and FINRA (and its predecessor NYSE and NASD regulatory groups) have conducted innumerable reviews of broker-dealers' compliance with Regulation SHO and Rule 204. In its May 2009 report on Regulation SHO, the Government Accountability Office ("GAO") highlights the many regulatory reviews, including sweep examinations in early 2005 following the implementation of Regulation SHO and then on an ongoing basis through both routine examinations and electronic surveillance.

Each broker-dealer is required to comply with strict possession and control and delivery requirements. Neither a securities lending CCP nor centralized marketplace would substitute for these requirements nor alleviate the necessity of regulators' review of individual broker-dealer's activities and records. While a CCP structure would permit a regulator to go to one source to see all borrowing and lending activity, this information is of little or no value without having the trading and position detail that exists only within the records of each broker-dealer, as well as other information solely in the hands of individual broker-dealers such as settlement obligations and customer protection segregation requirements. It is therefore unclear how a CCP in securities lending would improve on an examination structure that results in the direct scrutiny of the activities and the books and records of broker-dealers with respect to locates, borrowing, possession and control, and delivery.

Assertion 5: Capital and Balance Sheet Efficiency

Observations: The details behind Quadriserv's suggestion that a securities lending CCP would improve capital and balance sheet efficiency are set out in Appendix C of the Quadriserv Proposal. It suggests that their model would

positively impact net capital charges under Rule 15c3-1 and could impact Rule 15c3-3 customer reserve computations. Without commenting on whether the analysis provided in the Quadriserv Proposal is accurate, we fail to see the relation between the potential benefits to broker-dealers in the form of reduced net capital and customer protection requirements, if they were to be derived from a CCP, and an overall benefit to the securities lending market.

The benefits outlined in the Quadriserv Proposal are extremely technical and premised on a number of broad assumptions and presumptions. These claims need to be examined in detail and we see considerable hurdles, not the least of which is that they would appear to require changes in both regulation and accounting principles.

Assertion 6: Reduced Trading Costs

Observations: Quadriserv cites the automation of trading in NYSE and NASDAQ securities as predictive of the impact that would result from bringing lenders and borrowers into a centralized trading platform. It is important to note that, in this context, Quadriserv is not talking about a securities lending CCP, but rather its trading system. Quadriserv's assertions regarding the impact of their trading system on the economics of the securities lending market are very broad and speculative.

Something that is noticeably absent is any reference to the specific costs of the Quadriserv service. As a commercial enterprise, we would expect it to impose costs that do not currently exist. In addition, the OCC charges a fee per transaction novated through its CCP program.

Assertion 7: Improved Operational and Technology Efficiencies

Observations: Securities lending is a transactionally intensive business that is serviced by a variety of technology platforms and vendors (*e.g.*, EquiLend, SunGard, Pirum) that already provide for highly efficient transaction execution and operational processing. Securities lending participants have invested in the interfaces and integrated the functionality of these systems into their own processes. Quadriserv is suggesting that it would centralize loan maintenance activities with the potential to reduce overhead and the CCP would reduce the risks associated with corporate actions, rebate payments, marks-to-market, settlements and buy-ins. Without the detail regarding how this processing would function, it is impossible to assess what, if any, cost savings could be realized as compared to what are already highly efficient industry processes.

Assertion 8: Reduction in Operational Losses and Fraud

Observations: The Quadriserv Proposal cites the MJK Clearing ("MJK") liquidation and Lehman's bankruptcy with regard to operational losses and fraud that a CCP could have impacted. The primary factors behind the MJK failure appear to have been failure to collect mark-to-market payments and fraudulently using customer securities to generate cash to meet MJK's own mark-to-market obligations. While a CCP might have prevented MJK's failure to collect such payments, it could not have addressed the widespread fraud. The real problem at MJK appears to have been a lack of supervision and poor management. While we recognize the potential benefits of a securities lending CCP, it should not be portrayed as a cure-all for problems that might arise in the securities lending context. Any reference by Quadriserv to Lehman's bankruptcy in support of a CCP is misplaced given, as noted in our letter, it was handled in an orderly manner in the U.S. by the securities lending market without a CCP.

Assertion 9: Increased Liquidity

Observations: Quadriserv maintains that its proposal increases liquidity in three ways. First, Quadriserv asserts that having the OCC as a CCP "removes trade flow bottlenecks by normalizing the credit relationship between its members." However, as discussed above, any normalization of credit relationships needs to be viewed in light of the significance of the characteristics of a potential counterparty when assessing whether to enter into a securities lending transaction, and if so, the terms of such loan. As the blind transactional model proposed by Quadriserv does not provide the necessary transparency, we question the benefit of normalized credit relationships.

Secondly, Quadriserv asserts that balance sheet relief allows firms to do more business. Aside from the fact that balance sheet relief is not a certain benefit to accrue from a CCP, even if broker-dealers would have lower net capital requirements as a result of a CCP, it is speculative to claim that such excess capital would manifest itself in the form of increased securities lending and borrowing.

The third point suggests that public access to the market for borrowers, lenders, and market makers would provide more liquidity for securities lending transactions. It should be noted that this claim relates to a centralized securities lending marketplace such as AQS and not a CCP. In fact, we believe that a centralized securities lending marketplace would do little to increase liquidity because the primary factor behind such liquidity, the availability of securities to be loaned, is not increased simply by virtue of the existence of a centralized market. As to whether a centralized marketplace would increase liquidity, it should be noted that a there are already a variety of ways and multiple routes to market for entities that want to participate in the market today if they so choose.

For example, a lender can choose to lend through either a custodial or non-custodial agent lender, could agree to lend directly on an exclusive basis to a broker-dealer, or could establish its own lending desk.

More important than the specifics of Quadriserv's assertions regarding liquidity, it does not appear to us that the CCP model offered by the OCC would bring new supply to the securities lending market.

Assertion 10: Trading Compatibility and Redundancy

Observations: Quadriserv's main thesis here appears to be that its model (AQS coupled with the OCC's CCP) brings standardization of relationships that allows transactions to be maintained even if a party to a transaction fails. The example used is that party A lends to party B, B lends to C, and there is no lending contract in place between A and C. Quadriserv's claim is that if B fails, business between A and C would not disrupted if a CCP were in place. Again, this raises the issue we have raised above in several places - the very traits of the participants are key aspects of a transaction, and it is perhaps because of such traits that A and/or C chose not to do business with one another.