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May 25, 2012

Via E-Mail: fsb@bis.org

Secretariat of the Financial Stability Board
c/o Bank for International Settlements
CH-4002, Basel, Switzerland

Re: Comment on Interim Report of the FSB Workstream on Securities Lending and Repos

Dear Sir or Madam:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the Financial Stability Board (the "FSB") Workstream on Securities Lending and Repos' (the "Workstream") Interim Report (the "Report"), published April 27, 2012.

SIFMA represents many different parts of the financial industry that would be impacted by actions taken with respect to the issues identified in the Report. We therefore believe that various groups and committees within SIFMA, including, but not limited to, committees focused on securities lending, funding, broker-dealer regulation and regulatory reporting, can provide industry insight and perspective with respect to the work of the Workstream. SIFMA's committees routinely engage with regulators in dealing with matters that potentially impact the operation of the securities lending and repo markets and the regulations that govern these markets.[2] In submitting this letter, SIFMA seeks to similarly engage with the FSB, by providing additional insight into the operation of the U.S. securities lending and repo markets, and encourage further discussion on, and consideration of, the most effective and efficient ways to address concerns related to these activities and their role in the "shadow banking" system.

1 The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

2 *See, e.g.*, Letter from SIFMA and the Risk Management Association to Ms. Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission (Sept. 25, 2009) (concerning the securities lending, short sale pre-borrowing requirements, and short sale disclosure roundtable hosted by the SEC in 2009), *available at* http://www.sifma.org/uploadedfiles/societies/sifma_securities_lending_section/sifma%20comments%20to%20sec%202009%20roundtable.pdf.

Washington | New York

1101 New York Avenue, 8th Floor | Washington, DC 20005-4269 | P: 202.962.7300 | F: 202.962.7305
www.sifma.org

In this letter, we highlight the importance and benefits of the U.S. securities lending and repo markets to financial markets and market participants, provide an overview of the long-established and well-developed U.S. regulatory schemes in place, and analyze several of the Report's identified financial stability issues, particularly with respect to the U.S. securities lending and repo markets. Given the timing constraints associated with the deadline to submit comments on the Report, this letter should be viewed as only a high-level response to the broad issues raised. SIFMA looks forward to supplementing this letter in the months ahead by engaging in continued dialogue with the FSB.

I. Importance and Benefits of the U.S. Securities Lending and Repo Markets

The U.S. securities lending and repo markets are built on a foundation of well-established legal principles and business practices that have evolved significantly over time. Their growth has been coupled with regulatory and operational enhancements, prompted by regulators and market participants alike, which have helped each of the U.S. securities lending market and repo market develop into one of the largest and most refined in the world.

These markets serve an important role in our financial markets, providing a means by which the cost and risk of borrowing is reduced for both borrowers and lenders. Any specific initiatives/recommendations should be weighed against imposing undue costs and the potential of negative ancillary consequences to the financial markets overall. While some improvements may be helpful, as additional recommendations are currently being reviewed by market participants, over time these markets have proved to be resilient.[3]

The Report raises a number of issues with respect to securities lending and repo that warrant further review. SIFMA, through both its Prime Brokerage and Securities Lending Committee and its Funding Executive Committee, can provide an important perspective on the securities lending and repo markets, respectively, as the FSB's review moves towards putting forth recommendations. SIFMA believes that today's securities lending and repo markets are more structurally sound than they were prior to the financial crisis and that many of the issues noted by the FSB are being, and continue to be, addressed by the market. For example, with respect to repo, the Tri-party Reform Task Force has recommended, and the market has implemented, a number of changes, both structural and with respect to transparency, in the tri-party repo market. While more can be done, the industry looks forward to a continuing dialogue

[3] With respect to the repo markets, we note that the market in the U.S. has implemented a number of the recommendations of the Tri-party Reform Task Force and continues to look at ways to provide additional resiliency. In addition, through SIFMA, market participants are pursuing a complete revision to the Master Repurchase Agreement, the market standard repo document published by SIFMA, to update and incorporate lessons learned from the crisis into standard market practice. As noted below, SIFMA's Funding Executive Committee will review the possibility of developing a more robust and granular survey of the U.S. market.

with all stakeholders, including the regulatory community, to address important risk issues concerning both securities lending and repo.

Securities lending plays an essential role in the efficient operation of the financial markets, providing a critical element of market liquidity. Among other things, securities lending provides the following benefits:

- Allows broker-dealers to satisfy their securities delivery obligations in accordance with U.S. regulations.

- Allows broker-dealers to offer customers margin financing at attractive rates by raising cash through rehypothecation of customer margined securities.

- Facilitates short selling in both equity and fixed income instruments, which contributes to market liquidity and price discovery and enables market makers, particularly in options and futures markets, to hedge their exposures, which generally helps keep spreads narrow and consequently minimizes transaction costs for investors.

- Provides an opportunity for the beneficial owner of the securities (including pension funds and mutual funds) to earn additional income from their securities positions. Over time, the revenues earned from securities lending activities can enhance the returns for these investors.

Similarly, repo plays an essential role in the efficient operations of the financial markets, principally—but not exclusively—in the fixed income markets, and contributes substantially to liquidity in those markets. In particular:

- A robust repo market sustains overall liquidity within the related cash market. Repo in government securities markets allows for a lower cost of funding over time for government issuers.

- Given the demand for a safe, collateralized lending vehicle from cash providers (money market funds in particular), dealers are able to finance their inventories in an efficient way through repo. Cash providers benefit from the safety of a collateralized lending opportunity that uses, in large part, safe and liquid securities.

- As the Report notes, a liquid repo market allows dealers to quote continuous two-way prices in the cash market, prevent chains of delivery failures and hedge exposures from other activities, including government securities auctions. This increases liquidity in the secondary markets, which in turn reduces issuers' cost of funding.

II. Overview of U.S. Regulatory Requirements Related to Securities Lending and Repo

Securities Lending

The securities lending market in the U.S. is regulated by a variety of rules issued by the U.S. Securities and Exchange Commission (the "SEC" or the "Commission"), Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and U.S. self-regulatory organizations, such as the Financial Industry Regulatory Authority, Inc. ("FINRA").

Among the regulations that directly relate to securities lending are the following:

Regulation T

Regulation T of the Federal Reserve Board sets forth certain conditions under which a U.S.-registered broker-dealer may engage in securities lending transactions. For example, under Regulation T, a broker-dealer may generally lend or borrow U.S. securities to or from a non-broker-dealer customer solely for a "permitted purpose," (*i.e.*, "for the purpose of making delivery of the securities in the case of short sales, failure to receive securities required to be delivered, or other similar situations").[4] Therefore, securities lending transactions in the U.S. are predominantly driven by demand by broker-dealers for securities borrowed as opposed to being driven by a lender's desire to finance itself or engage in highly leveraged cash funding transactions.

The Customer Protection Rule - Rule 15c3-3

Rule 15c3-3 under the Securities Exchange Act of 1934 (the "Exchange Act"), the "Customer Protection Rule," among other things, promulgates requirements for U.S.-registered broker-dealers that help ensure sufficient assets are available for distribution to their customers in case of the liquidation of such broker-dealers.[5]

Rule 15c3-3 also sets forth certain documentation and collateral requirements for U.S.-registered broker-dealers who borrow fully-paid securities from a customer. Concerning the documentation requirements, Rule 15c3-3 provides a detailed, extensive list of disclosures

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4 Section 220.10 of Regulation T, 12 C.F.R. § 220.10 (2012), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=31f49068890cbdbb4eb019921a3b8493&rgn=div8&view=text&node=12:3.0.1.1.1.0.1.10&idno=12.

5 Rule 15c3-3 under the Exchange Act, 17 C.F.R. § 240.15c3-3 (2012), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=041b80f81549395e7f7e148d954ec61c&rgn=div8&view=text&node=17:3.0.1.1.1.2.89.306&idno=17.

required to be made by a broker-dealer borrowing securities from customers, including, among other disclosures:

a. a written agreement setting forth the rights and liabilities of the parties;
b. a schedule of compensation;
c. a schedule of the securities to be borrowed;
d. specified forms of collateral;
e. a minimum 100% collateral requirement;
f. daily marking-to-market; and
g. notice that the Securities Investor Protection Act of 1970 ("SIPA") may not protect the lender.

With respect to the collateral requirements, Rule 15c3-3 sets forth what types of collateral are acceptable and the amount of collateral that must be provided.

The Net Capital Rule – Rule 15c3-1

U.S.-registered broker-dealers who borrow and lend securities must also account for such activities in compliance with Exchange Act Rule 15c3-1, the "Net Capital Rule," which provides a complex measurement designed to ensure that broker-dealers will have adequate resources to fund expenses in the event of liquidation.[6] Specifically, certain provisions of Rule 15c3-1 set forth how a broker-dealer must adjust the minimum net capital it is required to maintain based on its securities borrowing and lending activities.

FINRA Rules and Guidance

U.S.-registered broker-dealers who are members of FINRA, the primary U.S. self-regulatory organization, are also subject to various rules and guidance that concern a member firm's securities lending activities.[7] For example, NASD Rule 2330 and incorporated NYSE Rule 402 prohibit member firms from lending securities that are held on margin for a customer and that are eligible to be pledged or loaned without prior written authorization from the customer permitting such lending of those securities.

6 Rule 15c3-1 under the Exchange Act, 17 C.F.R. § 240.15c3-1 (2012), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=041b80f81549395e7f7e148d954ec61c&rgn=div8&view=text&node=17:3.0.1.1.1.2.89.297&idno=17.

7 FINRA rules, including NASD and Incorporated NYSE rules, are available online at http://finra.complinet.com/.

Additionally, in January 2010, FINRA proposed Rule 4330,[8] which would enhance the degree of transparency of securities lending transaction information to member firm customers in fully-paid lending arrangements. Proposed FINRA Rule 4330 would adopt the prior written authorization requirement from NASD Rule 2330 and incorporated NYSE Rule 402. Proposed Rule 4330 would also require member firms to disclose certain risks to customers, including possible loss of SIPA protection, the loss of voting rights on loaned securities, and other implications associated with fully-paid lending arrangements.[9]

Other U.S. regulations have an indirect, but nonetheless substantial, impact on securities lending, such as Rule 204 and the other rules under Regulation SHO.[10] Regulation SHO is the principle U.S. regulation governing short sales, and imposes certain requirements, including the requirement to "locate" securities available for borrowing prior to effecting short sales and taking action to "close-out" fails to deliver by borrowing or buying-in securities.

While these rules primarily have a direct affect on the demand side of the market, there are also regulations, such as the Investment Company Act of 1940 and the Employee Retirement Income Security Act ("ERISA"), which directly impact the supply side by setting conditions on securities lending for investment fiduciaries.

In addition to the foregoing, further U.S. regulations concerning securities lending are expected to be forthcoming. For example, Section 984(b) of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act mandates that the SEC "promulgate rules that are designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities." Furthermore, additional rule-makings are expected as the U.S. regulators interpret and respond to the standards set forth in Basel III.

Repo

Generally speaking, and as noted throughout the Report, participants in the repo market are subject to a variety of rules and regulations. Regulated participants include depository institutions, securities broker-dealers, and institutional investors (such as mutual funds, insurance companies, and corporations). Thus, regulations of the Federal Reserve Board, Federal Deposit

8 *See* FINRA Regulatory Notice 10-03 (Jan. 2010), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120691.pdf.

9 SIFMA commented on proposed FINRA Rule 4330, suggesting certain modifications, including (among other issues) limiting the frequency of the risk disclosures and clarifying certain of the proposed disclosures. *See* SIFMA Comment to FINRA Regulatory Notice 10-03 (Mar. 8, 2010), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/noticecomments/p121087.pdf.

10 Regulation SHO, 17 C.F.R. § 242.200 et seq. (2012), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=49dfb40c442961917259c180dda1649d;rgn=div7;view=text;node=17%3A3.0.1.1.3.0.106;idno=17;cc=ecfr.

Insurance Corporation ("FDIC"), SEC, the U.S. Commodity Futures Trading Commission ("CFTC"), FINRA, and state insurance regulators may govern depending on the type of entity and business.

Among the regulations that directly relate to repo are the following:

<u>The Net Capital Rule – Rule 15c3-1</u>

Rule 15c3-1 provides for net capital requirements for broker-dealers who engage in reverse repurchase agreements.

<u>Rule 2a-7 under the Investment Company Act of 1940</u>

As noted throughout the Report, institutional repo investors that are subject to the SEC's Rule 2a-7 are subject to certain limitations including limitations on counterparty concentration and, in certain circumstances, collateral types.[11] Amendments to Rule 2a-7 were approved by the SEC on January 27, 2010. These amendments revised Rule 2a-7 to strengthen the protections for money market funds by limiting the availability of "look through" treatment for repurchase agreements in money market funds to repurchase agreements collateralized by cash items or government securities. In addition, the creditworthiness of repurchase agreement counterparties must be evaluated by the fund's board or directors or its delegates.

III. Response to Financial Stability Issues

The Workstream identified seven issues related to securities lending and repos in its Report to consider from a financial stability perspective. SIFMA would welcome the opportunity to discuss these identified issues in greater detail with the FSB. Below, we provide high-level comments on a sampling of the identified issues, in an effort to encourage further, more thorough discussion.

Section 5.1 – Lack of transparency

<u>Securities Lending</u>

In Section 5.1 of the Report, the Workstream asks whether transparency could be improved in certain areas of the securities financing markets, including macro-level and micro-level market data and risk reporting by intermediaries to their clients. SIFMA is eager to work

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[11] Rule 2a-7 under the Investment Company Act of 1940, 17 C.F.R. § 270.2a-7 (2012), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=c989038ed3680f71dbe55f1ef7a67076;rgn=div5;view=text;node=17%3A3.0.1.1.15;idno=17;cc=ecfr#17:3.0.1.1.15.0.136.15.

with the FSB and other policy makers to fashion a workable solution that will supply the information required to address financial stability concerns raised in the Report.

Towards that end, SIFMA would appreciate the opportunity to engage in dialogue with the FSB concerning the end goal of increasing transparency of macro-level data. SIFMA believes that the type of data that may be useful depends on the underlying needs and ultimate policy goals. Clarification of the purpose(s) behind disseminating macro-level data will be helpful in determining which data points will be useful in meeting such goals, and then in identifying which of those data points are currently available (*e.g.*, data currently supplied by industry members to vendors and regulators) and those which may need to be made available in the future.

Additionally, SIFMA would like to note that there are currently various ongoing initiatives that provide transparency or are designed to increase the transparency of securities lending information in the U.S. For example, the procedures associated with Agency Lending Disclosure, as articulated in the Agency Lending Disclosure No-Action Request ("ALD No-Action Request")[12] submitted by SIFMA to the SEC in 2007, require agent lenders to provide borrowing broker-dealers with sufficient information to identify the principal, as well as relevant financial information about the principal, and calls for agent lenders to provide borrowing broker-dealers relevant information on the outstanding loans with each principal on a daily basis.[13] U.S. regulators currently examine broker-dealers for compliance with the ALD No-Action Request, and expect broker-dealers to be using the data to monitor and control risk exposure, particularly with respect to counterparties. Furthermore, as discussed in Section II of this letter, FINRA has current and proposed rules designed to enhance transparency of securities lending transaction information to customers in fully-paid lending arrangements, including by requiring a member firm to obtain a customer's written authorization prior to lending the customer's eligible securities and to disclose certain risks to customers, including possible loss of SIPA protection or voting rights and other implications associated with fully-paid lending arrangements.

With respect to transaction-level data specifically, as the Workstream recognizes in the Report, securities loans are not standardized products: the borrowing fee associated with each individual loan may be based on a variety of factors, including but not limited to size of the loan, counterparty type, expected duration, acceptable collateral, supply and demand, and possible

12 Letter from SIFMA to Michael A. Macchiaroli, Associate Director of the SEC Division of Market Regulation, Agency Lending Disclosure Initiative (Mar. 20, 2007), *available at* http://www.sifma.org/uploadedfiles/societies/sifma_securities_lending_section/ald%20initiative%20-%20sifma%20letter%20to%20the%20sec.pdf.

13 Although the ALD No-Action Request remains in draft form, we understand that firms engaging in securities lending activities are currently examined by regulators from the SEC and FINRA for compliance with the terms of the ALD No-Action Request.

corporate actions by the issuer, and will commonly vary over the duration of the loan. Due to the complexity of securities loan data, SIFMA welcomes the opportunity to discuss further the potential benefits and costs associated with micro-level loan-by-loan disclosure.

Finally, with respect to disclosure of rehypothecation activities, SIFMA acknowledges that some rehypothecation practices may have resulted in risks that brokerage customers did not fully appreciate. However, SIFMA believes there are alternate regulatory approaches that can mitigate these risks. For example, U.S.-registered broker-dealers are subject to substantial regulation including, as discussed in Section II of this letter, the Customer Protection Rule and the Net Capital Rule. These rules require U.S.-registered broker-dealers to maintain sufficient assets (securities and cash) in segregation for customers such that the brokers should be in position to meet the customers' net equity claims for their brokerage accounts in the event of the broker-dealers' insolvency. While these rules, among other things, generally limit the amount of securities that can be rehypothecated from any particular customer's account to 140% of the indebtedness of such customer to the broker-dealer, it is important to note that a customer's net equity claim does not take into account whether or not the customer's securities have been hypothecated. Customers' rights to their net equity are not impacted by a broker-dealer's rehypothecation. SIFMA would be happy to meet with the FSB to further discuss these issues concerning rehypothecation and the protections afforded to customers by U.S. regulations.

<u>Repo</u>

SIFMA believes that market data about repo available to the public and to regulators should be robust, useful and indicative of overall market conditions. However, the benefit of additional data collection and dissemination must be balanced against the overall cost. As a result, SIFMA supports robust micro- and macro-level data in repo and encourages the FSB to evaluate enhancements to existing data sources and presentation as it considers the role of other potential sources. As noted above, SIFMA looks forward to working with all stakeholders in enhancing the information that is available and in developing additional sources of information. Also, similar to securities lending data, given the overall complexity of repo transactions and the number of possible data points (amount of collateral, collateral types, term, rate, haircut, and counterparty), macro-level data may be more informative than transaction-by-transaction reporting. Further discussion with the industry would be helpful and will allow the industry to put forth the most efficient and useful data collection proposal to meet regulators' objectives.

SIFMA would support a review of current data sources concerning repo with a view towards revising the collection and its general presentation to not only reflect the current market, but to provide better information to market participants. The Federal Reserve Bank of New York data is a significant source for much information about the repo market. This should be a starting point for what additional information should be made available.

With respect to the creation of additional data sources, SIFMA, through its Funding Executive Committee, is considering the creation of alternatives such as one similar to the International Capital Market Association's ("ICMA") European Repo Market Survey. However, SIFMA believes that such alternatives need to be fully evaluated for their effectiveness.

Section 5.2.2 – Procyclicality of system leverage/interconnectedness – Haircuts

Securities Lending

The Report points to haircuts on collateral as one of the underlying factors that may contribute to the procyclical behavior of securities financing markets. As the Report notes in Section 5.2.2, however, securities lenders have generally kept haircuts relatively stable. Instead of using haircuts to address issues of counterparty exposures, both securities lenders and borrowers have predominantly used credit limits to do so, a process that deals with exposure in a targeted manner that is not provided by adjusting haircuts.

While SIFMA recognizes the relationship between haircuts and procyclicality described in the Report, haircuts are only one factor in a larger system of adjustments for credit quality. SIFMA is concerned that, if mandatory haircuts are set at arbitrary levels by regulators, such haircuts may reduce discretionary securities lending by making such activity uneconomic, and thereby compromise the benefits that securities lending brings to the markets. Furthermore, SIFMA believes mandatory haircuts would remove the distinguishing characteristics between secured financing, such as securities lending, and unsecured financing. As such, before standards and rules concerning a mandated minimum haircut are further considered, we believe it would be appropriate for regulators to conduct a quantitative impact study ("QIS") to look into the levels of haircuts and interaction of haircuts with margin maintenance today and in times of market stress before determining what, if any, restrictions on haircuts may be appropriate.

Repo

The Report expresses concerns that market practices in setting initial margins/haircuts in repos provide the potential to enhance financial market procyclicality. Specifically, the Report notes that when an aggregate shock triggers a downturn, haircuts will be increased. It is argued that this will then result in a reduction of liquidity in the market place, as participants will sell assets in response. These asset sales will in turn reduce the value of existing collateral, therefore contributing to the cycle where haircuts are increased again and assets must be sold.[14]

[14] The source of this concern appears to be work done by economists Gary Gorton and Andrew Metrick around the impact on repos for certain structured securities. Indeed, while there was some impact in this sector of the market, it represents a small portion of the overall market and these impacts were not seen in the broader repo market for more liquid collateral. *See, e.g.*, "Haircuts on repos will jeopardize recovery," Richard Comotto, *Financial Times*, May 2, 2012.

The introduction of minimum margin or haircuts for repo to mitigate pro-cyclicality may, however, be damaging to the marketplace and the overall economy. During the financial crisis, evidence suggests that the haircuts on the majority of the collateral did not significantly change. Therefore, to introduce minimum margin/haircuts under the belief that procyclicality was the principle driver of deleveraging during the financial crisis may have unintended consequences in raising the cost to government borrowing and in making it more difficult to finance positions in non-governmental collateral.

It is important to note that the very nature of repo funding – a collateralized financing – provides safety to the collateral taker and thus a lower cost of financing when compared to unsecured borrowing. Market participants set haircuts based on the nature of the underlying collateral and the credit profile of counterparties. This is an important distinguishing feature of repo and the impact of mandatory minimums on haircuts could distort the relative pricing between secured and unsecured instruments and could reduce liquidity across a range of collateral, hence raising costs to issuers including governments. This might have the unintended effect of making unsecured financing more attractive than secured financing.

In light of the foregoing, SIFMA believes any recommendation for minimum haircuts needs to be considered carefully against the potential significant negative consequences in the broad securities lending and repo markets. The consideration of minimum haircuts should be further assessed through a QIS as an appropriate first step in order to provide the data to enable informed policy making.

Section 5.3 – Other potential financial stability issues associated with collateral re-use, and Section 5.4 – Potential risks arising from fire-sale of collateral assets

Sections 5.3 and 5.4 of the Report address the possible risks associated with the reuse and possible sale of collateral. However, SIFMA notes that, both in securities lending and repo transactions in the U.S., these risks are minimized given that these are secured transactions for each party. We note that every participant in a series of transactions is protected by cash or collateral, notwithstanding re-use/re-hypothecation.

The ability to re-use collateral is an important feature of the repo markets and contributes substantially to the overall liquidity in both the repo and the associated cash markets. Indeed, market participants may seek a particular security in the repo market in order to make a delivery to another counterparty. An important attribute of the repo market is that it is a source of securities and thus contributes to liquidity in the cash market and lowers costs for issuers (including governments). Limiting re-use/re-hypothecation could disrupt liquidity and limit the beneficial effects of a strong repo market. SIFMA urges the FSB to assess possible disruptions to market functioning against any potential benefits before making a recommendation in this area.

With respect to the risks associated with a fire-sale of collateral assets, it may create significant systemic risk to prohibit the repo buyer from exercising its option to sell collateral securities upon the insolvency of the seller, since the ability to generate this liquidity may be necessary to prevent the buyer from becoming insolvent. At the time some bankruptcy safe harbors were adopted in the U.S., permitting repo buyers to sell assets upon the insolvency of their counterparts, it was intended by legislators to "minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries" and to "prevent the insolvency of one commodity [or securities] firm from spreading to other brokers or clearing agencies and possibly threatening the collapse of the market."[15]

In light of the foregoing, SIFMA would appreciate the opportunity to engage the Workstream in further discussion concerning how the re-use and possible sale of collateral present unique issues to the securities lending and repo market, and how they can be addressed.

Section 5.5 – Potential risks arising from agent lender practices, and
Section 5.6 – Shadow banking through cash collateral reinvestment

SIFMA understands that the Committee on Securities Lending of the Risk Management Association ("RMA") and the International Securities Lending Association ("ISLA") will be addressing the issues raised in the Report concerning agent lender practices and cash collateral reinvestment in a joint comment letter to the Report. Because these issues seem more pertinent to agent lenders, SIFMA defers to the analysis of these issues in the joint comment letter submitted by the RMA and ISLA, as the more appropriate groups to evaluate and discuss these issues.

Section 5.7 – Insufficient rigor in collateral valuation and management practices

With respect to the FSB's concerns about insufficient rigor in marking-to-market collateral, SIFMA agrees that it is essential for market participants to employ a rigorous mark-to-market discipline when valuing collateral and to manage the exposures based on this mark-to-market process.

IV. Conclusion

In this letter, SIFMA seeks to present a high-level view of our concerns and responses to the Report, with the hope of encouraging further and more extensive discussions with the FSB. SIFMA would appreciate the opportunity to engage in a dialogue with the FSB, and the Workstream in particular, regarding the Report and our comments outlined above.

15 H.R. Rep. No. 97-420 (1982).

If you have any questions or require additional information, please do not hesitate to contact the undersigned at (202) 962-7400 or via email at kbentsen@sifma.org. Thank you for your attention to this letter.

Very truly yours,

Kenneth E. Bentsen, Jr.
EVP, Public Policy and Advocacy
Securities Industry and Financial Markets Association

cc: Kevin J. Campion, Sidley Austin LLP
Katie Klaben, Sidley Austin LLP