

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

**Re: File No. S7-06-22: Modernization of Beneficial Ownership Reporting**

Dear Ms. Countryman:

I am writing in response to the SEC's proposed Rule 13d-3(e), and specifically the requests for comment in ¶¶ 42-44. In short, the limitation of Rule 13d-3(e) applicability—to those acquiring or holding cash-settled derivative securities with the purpose or effect of changing or influencing control of the issuer—creates an unnecessary evidentiary burden to prove intent. Intent to effect or influence control should be presumed, for the following two reasons.

First, in the U.S., cash-settled, equity-linked swaps implicating the 5% reporting threshold are held to avoid disclosure. There are four primary reasons to own a swap in lieu of direct equity share or call option ownership: (1) exposure to non-deliverable markets; (2) jurisdictional tax arbitrage; (3) leverage; and (4) avoidance of 13d-3 Beneficial Ownership. Reason (1) does not implicate the onshore U.S. market. Reason (2) is not likely applicable to the onshore U.S. market, subsequent to implementation of withholding tax on dividend-equivalent amounts, under I.R.C. § 871(m) (moreover, this paper takes the uncontroversial position that tax avoidance is not a valid reason to allow TRS to evade beneficial ownership disclosure requirements). Reason (3) is not distinguishable from margin-financed share ownership, other than for passive institutional investors who by mandate do not have access to leveraged financing. Rather, it is Reason (4)—avoidance of 13d-3 Beneficial Ownership—which is the primary use of TRS implicating the 5% reporting threshold.

Second, the settlement terms of ISDA-standard, cash-settled, equity linked swaps provide a contractual option—unilaterally exercisable by the long counterparty—to convert their cash-settled swap to physical shares at a pre-determined price, with minimal price friction. The CSX court and previous SEC guidance contemplated the possibility that long and short parties to a swap might *bilaterally* agree to an exchange of shares underlying a swap. However, they did not appear to contemplate the following: even if the short party does not agree to a *bilateral* exchange, the long party may *unilaterally* effect an exchange to physical shares. This is because the final price at which a swap settles is a market-reference price—typically VWAP or market-close—against which the long counterparty can execute a purchase order with minimal tracking error. Said otherwise, cash-settled, equity-linked swaps create a *de facto* contractual call option, out of which the long party cannot contract.

Consequently, the SEC should expand Rule 13d-3 Beneficial Ownership to the delta-adjusted notional of any instrument—whether cash or physically settled—which references a security subject to Rule 13d-3. Conferral of Beneficial Ownership should not be conditioned on intent to influence control.

I have attached a copy of a letter dated February 4, 2022, which I previously submitted in response to Rule 10B-1. The analysis demonstrates – through illustrative examples – the *de facto* contractual call option embedded in cash-settled, equity-linked swaps. A more detailed analysis—addressing the applicability of Rule 13d-3(a)-(b) to swaps—is available upon request.

Sincerely,

/s/ Wm. Robertson Dorsett  
Wm. Robertson Dorsett

CC:  
The Honorable Gary Gensler, Chair  
The Honorable Hester M. Peirce, Commissioner  
The Honorable Allison Herren Lee, Commissioner  
The Honorable Caroline A. Crenshaw, Commissioner

.....  
Via Electronic Mail

February 4<sup>th</sup>, 2022

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

**Re: File No. S7-32-10: Proposed Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions; Release No. 34-93784**

Dear Ms. Countryman:

Attached please find a comment in response to Release No. 34-93784, and in particular Proposed Rule 10B-1. My comment proposes that the SEC expand Rule 13d-3 Beneficial Ownership to the delta-adjusted notional of any instrument – whether cash or physically settled – which references a security subject to Rule 13d-3. Doing so would address what I perceive to be inadequacies in both the applicability and breadth of disclosure under Proposed Rule 10B-1.

This result is contemplated by Dodd-Frank § 766(e), which purports to provide the SEC authority to expand the scope of Rule 13d-3 Beneficial Ownership applicability, with specific regard to security-based swaps. This result is also achievable under the existing language of Rule 13d-3(d) – a provision that went unanalyzed in both previous written SEC guidance and the CSX case law. As my comment explains, the settlement terms of ISDA-standard, cash-settled total return swaps (TRS) provide a contractual option – unilaterally exercisable by the long counterparty – to convert their cash-settled TRS to physical shares at a pre-determined price. This right to obtain shares at a pre-determined price – a right inhering in any instrument with delta sensitivity to a 13d-3 reportable security – should trigger Rule 13d-3(d) for the same reason a physically-settled call option does.

Additionally, the conversion right inhering in TRS would enable an activist investor to rapidly obtain a significant block of voting rights ahead of a record date, (1) without filing a Schedule 13D; (2) without alerting the market to the full scope of buying interest; and therefore (3) at a lower cost than would be incurred through an outright purchase of shares in the open market.

Consequently, TRS should confer Rule 13d-3 Beneficial Ownership, because the contractual conversion right both (1) satisfies Rule 13d-3(d); and (2) implicates the original concern of Rule 13d-3 and the 1968 Williams Act – rapid acquisition of voting rights without adequate public disclosure of interest.

Sincerely,  
/s/ Wm. Robertson Dorsett  
Wm. Robertson Dorsett

\_\_\_\_\_

cc:  
The Honorable Gary Gensler, Chair  
The Honorable Elad L. Roisman, Commissioner  
The Honorable Hester M. Peirce, Commissioner  
The Honorable Allison Herren Lee, Commissioner  
The Honorable Caroline A. Crenshaw, Commissioner

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*This comment proposes that the SEC expand Rule 13d-3 Beneficial Ownership to the delta-adjusted notional of any instrument – whether cash or physically settled – which references a security subject to Rule 13d-3. This would impact cash-settled, equity-linked total return swaps (TRS) in particular, as well as any instrument with a first-order delta sensitivity to reportable securities (including, for example, synthetic forwards). An expansion of Rule 13d-3 would address inadequacies in both the applicability and breadth of disclosure under Proposed Rule 10B-1.*

*Upon request, a more detailed version of this analysis is available, covering (1) the legislative history of Rule 13d-3, from the Williams Act through Dodd-Frank; (2) the relevant CSX case law and SEC guidance; (3) an argument that Rule 13d-3(a) is satisfied by the guaranteed hedging activity of the short counterparty; (4) an argument that the mental intent element of Rule 13d-3(b) consists of a reckless knowledge standard – met by prevalent TRS usage; and (5) an argument that TRS in fact implicate Rule 13d-3(d) to a greater extent than physically-settled call options, as demonstrated through an explanation of option pricing parameters and the “greeks,” and illustrative examples.*

*The author is a current J.D. candidate at Columbia Law School. From 2012 to 2017, he worked in equity derivative, convertible debt, and credit sales at Credit Suisse in Hong Kong, and Goldman Sachs in Tokyo. From 2017 to 2020, he was the country finance director for Japan and Korea operations at The Kraft Heinz Company. The author would like to thank the following individuals for their contributions and feedback: Professors Jeffrey N. Gordon and Joshua Mitts of Columbia Law School, Kenju Watanabe, Arjun Srinivas, Robertson “Mac” McAnulty; Matthew Huster, and several current and former market participants.*

## I. [Author’s Response to 10B-1 and Proposal to the SEC](#)

Proposed Rule 10B-1 would mandate regulatory disclosure and public dissemination of, *inter alia*, cash-settled, equity-linked total return swaps (TRS). The rule may both overshoot the scope and undershoot the aims of its authorizing statute – the Dodd-Frank Act – in several ways.

First, Rule 10B-1 would require disclosure of individual market participant identity,<sup>1</sup> which would “not be confidential and would be publicly available.”<sup>2</sup> This public disclosure of swap participant identity appears to contradict the confidentiality mandate of Dodd-Frank § 763(i).<sup>3</sup> Second, public dissemination would apply only to those swap participants required to report under Rule 908 of Regulation SBSR<sup>4</sup> – a group which by the SEC’s own admission would not implicate some non-U.S. investors.<sup>5</sup> This inapplicability to certain offshore transactions may prevent full public disclosure of the systemic risk at which Dodd-Frank was aimed. Third, 10B-1 does not require swap participants to disclose the “purpose” of their transaction, and requires only a “brief

<sup>1</sup> Securities and Exchange Commission, Release No. 34-93784 (Dec. 15, 2021) at 83 (*available at <https://www.sec.gov/rules/proposed/2021/34-93784.pdf>*) (“2021 SEC Swap Release”).

<sup>2</sup> 2021 SEC Swap Release at 111.

<sup>3</sup> 15 U.S.C. § 78m(m)(1)(C);(E).

<sup>4</sup> 17 C.F.R. § 242.908; 2021 SEC Swap Release at 88.

<sup>5</sup> 2021 SEC Swap Release at 148. *See also* “Regulation SBSR: The Compliance Guide to Reporting Security-based Swaps,” Latham & Watkins Client Alert (Mar. 24, 2015) at 4–5, 12.

description” of third-party arrangements with regard to the swap and/or related securities.<sup>6</sup> This minimal disclosure may not achieve the SEC’s goal of market transparency.

The SEC might better meet its Dodd-Frank mandate, and achieve the goals of 10B-1, by either (1) amending Rule 13d-3 to explicitly encompass security-based swaps – as contemplated by Dodd-Frank § 766(e);<sup>7</sup> or (2) providing clarification that the option embedded in the settlement terms of TRS – and equity-linked instruments generally (whether cash or physically settled) – confers Beneficial Ownership pursuant to Rule 13d-3(d).

Unlike 10B-1, Rule 13d was promulgated under a statute which permits disclosure of individualized participant identity and transactional purpose.<sup>8</sup> Accordingly, Schedule 13D could be used to elicit and disseminate the information with which the SEC appears concerned in proposing Rule 10B-1. First, Rule 13d allows for public dissemination<sup>9</sup> of individualized participant identity.<sup>10</sup> Second, Rule 13d applies to both onshore and offshore transactions. Non-U.S. investors may avoid Rule 13d only if a transaction does not implicate corporate control, and even in such case, they remain subject to year-end<sup>11</sup> 13g filing requirements.<sup>12</sup> Third, Rule 13d requires detailed, qualitative descriptions of both the “Purpose of Transaction,”<sup>13</sup> as well as “Contracts, Arrangements, Understandings, or Relationships with Respect to Securities of the Issuer.”<sup>14</sup>

Consequently, this comment proposes that the SEC expand Rule 13d-3 “Beneficial Ownership” to TRS in particular – and equity-linked instruments in general – by expressly amending Rule 13d to encompass the delta-adjusted notional<sup>15</sup> of any instrument (whether cash or physically settled) referencing underlying securities that are themselves subject to Rule 13d-3. Such a rule would achieve the aims of Dodd-Frank without exceeding its scope, and ensure that instruments with delta-sensitivity<sup>16</sup> to 13d reportable equity securities do not evade disclosure.<sup>17</sup>

Alternatively, this comment proposes the SEC to provide clarification that these instruments confer Beneficial Ownership under the existing language of Rule 13d-3(d). As illustrated in the section below, the settlement terms of ISDA-standard TRS provide a contractual option – unilaterally exercisable by the long counterparty – to convert their TRS to physical shares at a pre-determined price. Moreover, this conversion right implicates the original concern of Rule 13d-3 and the Williams Act – rapid acquisition of voting rights without adequate public disclosure of interest.<sup>18</sup> Specifically, the conversion right inhering in TRS would enable an activist investor to rapidly obtain a significant block of voting rights ahead of a record date, (1) without filing a Schedule 13D; (2) without alerting the market to the full scope of buying interest; and therefore (3) at a lower cost than would be incurred through an outright purchase of shares in the open market.

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<sup>6</sup> 2021 SEC Swap Release at 86–87.

<sup>7</sup> 15 U.S.C. § 78m(o).

<sup>8</sup> This contrast is consistent with the respective aims of Dodd-Frank and the Williams Act, as revealed through their legislative histories. The author’s view is that the 2010 Dodd-Frank Act was enacted to reduce systemic, market-wide risk posed by undisclosed securities leverage, while the 1968 Williams Act – which authorized 13d – was enacted to reduce idiosyncratic, security-specific risk posed by undisclosed securities ownership.

<sup>9</sup> 17 C.F.R. § 240.13d-101.

<sup>10</sup> 17 C.F.R. § 240.13d-1(d)

<sup>11</sup> 17 C.F.R. § 240.13d-1(b)(1).

<sup>12</sup> 17 C.F.R. § 240.13d-1(b)(1).

<sup>13</sup> Item 4, 17 C.F.R. § 240.13d-101.

<sup>14</sup> Item 6, 17 C.F.R. § 240.13d-101.

<sup>15</sup> Mirroring the broad definition proposed in Rule 10B-1(b)(6). See 2021 SEC Swap Release at 78, Fn. 136.

<sup>16</sup> The first-order derivative of an instrument with respect to the underlying share price.

<sup>17</sup> For example, such a rule would require disclosure of a short put position.

<sup>18</sup> The Williams Act was originally proposed to combat “[Federal Securities law’s] fail[ure] to take proper cognizance of the activities of corporate raiders,” as well as the “inadequate disclosure system in regard to cash tender offers,” in contrast to stringent disclosure requirements preceding either an exchange offer or proxy contest. 111 Cong. Rec. 28257-58 (1965) (remarks of Senator Williams, “Protection Against Corporate Raiders”). The author’s detailed analysis of the legislative history is available upon request.

## II. [Rule 13d-3\(d\) Applicability to TRS](#)

Expansion of Rule 13d-3 “Beneficial Ownership” to TRS has been controversial. In the 2008 CSX case,<sup>19</sup> Judge Kaplan approached – but ultimately declined – the conclusion that TRS *per se* confer Beneficial Ownership pursuant to Rule 13d-3(a) [voting and/or investment power]. Rather, he concluded the TRS at issue – based on the facts presented – conferred Beneficial Ownership pursuant to Rule 13d-3(b) [plan or scheme to evade]. In his concurrence to the 2011 appeal,<sup>20</sup> Judge Winter argued that TRS do not *per se* confer Rule 13d-3(a) Beneficial Ownership. He also argued for a higher threshold<sup>21</sup> to establish Rule 13d-3(b) Beneficial Ownership – one not met, in his view, by the particular TRS at issue. The SEC Division of Corporation Finance was more equivocal in its 2008 CSX amicus letter, leaving open the possibility that a fact-based inquiry could satisfy 13d-3(a), and providing only a limited explanation of the mental intent element necessary to satisfy 13d-3(b).<sup>22</sup>

However, the courts in CSX 2008 and CSX 2011, and the SEC in their amici curiae, did not address Rule 13d-3(d). In particular, the previous analysis did not recognize that Rule 13d-3(d) inherently applies to TRS and other equity-linked instruments – whether cash or physically settled – for the same reason it applies to physically-settled call options exercisable within sixty days.<sup>23</sup>

The CSX courts and SEC did contemplate the possibility that long and short parties to a TRS might *bilaterally* agree to an exchange of shares underlying a TRS, wherein the short party agrees to sell their hedge shares to the long party at the market reference price<sup>24</sup> by which the TRS terminates. What they did not appear to contemplate, however, is that even if the short counterparty does not agree to a *bilateral* exchange, the long party may *unilaterally* effect a conversion of their TRS to physical shareholdings<sup>25</sup> at a pre-determined price.<sup>26</sup> This is because the final price at which a TRS settles is a market reference price – typically, VWAP<sup>27</sup> or market-close – against which the long counterparty can execute a purchase order with minimal tracking error. By doing so, the long party enters their physical shareholding at the same price their TRS swap terminates. This is best illustrated through a hypothetical TRS transaction, as provided below.

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<sup>19</sup> *CSX Corp. v. Child.’s Inv. Fund. Mgmt. (UK) LLP et al.*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008) (“CSX 2008”).

<sup>20</sup> *CSX Corp. v. Child.’s Inv. Fund. Mgmt. (UK) LLP et al.*, 654 F.3d 276 (2d Cir. 2011) (“CSX 2011”).

<sup>21</sup> *E.g.*, an agreement between the short and long counterparties to transfer share ownership or voting power.

<sup>22</sup> The author’s detailed analysis of the CSX case law and SEC guidance is available upon request.

<sup>23</sup> “A person shall be deemed to be the beneficial owner of a security . . . if that person has the right to acquire beneficial ownership of such security . . . within sixty day, including but not limited to the right to acquire: (A) Through the exercise of any option, warrant, or right . . . provided, however, any person who acquires a security or power specified [above] with the purpose or effect of changing or influencing the control of the issuer . . . immediately upon acquisition shall be deemed to be the beneficial owner of the securities.” 17 C.F.R. § 240.13d-3(d)(1)(i).

<sup>24</sup> *E.g.*, market close, or volume-weighted-average-price (VWAP).

<sup>25</sup> For a discrete TRS with a fixed termination date, this right is exercisable at the termination date, but also at any time the short counterparty is reasonably obligated to agree to an unwind of the TRS. For a TRS terminable at the short counterparty’s contractual election (*see infra*, note 35), this right is exercisable at any time. Consequently, this right should be seen as exercisable – with reasonable notice – at any time by the long counterparty.

<sup>26</sup> And at no additional cost, excluding brokerage commission, and allowing for small tracking error.

<sup>27</sup> Volume-weighted-average-price.

## II(a). Hypothetical TRS Transaction.

First, note that any investment bank, as short counterparty to a TRS – particularly one implicating the 5% reporting threshold<sup>28</sup> – will undoubtedly hedge their directional exposure,<sup>29</sup> both for practical<sup>30</sup> and regulatory<sup>31</sup> reasons. From the investment bank’s perspective, TRS are fundamentally financing transactions – not directional trades. Structurally, TRS are an agreement between the long counterparty and short counterparty, wherein (1) the long party receives and the short party makes payment equivalent to any increase in the notional value of equity shares referenced, as well as dividends; (2) the long party pays and the short party receives payment equivalent to any decrease in the notional value of equity shares referenced; and (3) the long party pays and the short party receives interest on the notional value of the shares referenced. Consequently, the short party will hedge its directional and dividend exposure by purchasing the number of shares referenced by the TRS, ensuring the amount they pay/receive to/from the long counterparty is equivalent to performance accrued and dividends received from ownership of physical shares.

To establish that the long counterparty investor always retains a right to acquire Beneficial Ownership of the shares underlying a TRS, we need only examine the long counterparty’s acquisition rights when the investment bank – as the short counterparty – refuses to exchange<sup>32</sup> their hedge shares. More specifically, we need only examine two sub-situations: (1) where the short counterparty agrees to an early termination but not to a share exchange; and (2) where the short counterparty agrees to neither an early termination nor a share exchange.

Sub-situation (2) is unlikely – with sufficient notice, there are few valid reasons for an investment bank to refuse an early unwind request. Sub-situation (1) is more likely. While the investment bank will have hedged their full directional exposure, they may have done so through a combination of share ownership and third-party TRS agreements. Additionally, the investment bank may have loaned out its hedge shares, and need several business days to recall them.

Regardless, someone in the market – whether (1) the short counterparty investment bank with whom the long counterparty investor originally contracted; or (2) the third-party investment bank with whom the short counterparty investment bank contracted – will be selling hedge shares in the market. Moreover, they will be selling shares at the terms governing the TRS settlement, to match their profit/loss on hedge shares against their loss/profit on the equity leg of the TRS, netting out to leave the investment bank with only the financing leg of the transaction. Even were the short counterparty – implausibly<sup>33</sup> – to not hedge their directional exposure, the TRS would nonetheless terminate at a value determined by a market reference price, executable

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<sup>28</sup> 17 C.F.R. § 240.13d-1(a).

<sup>29</sup> In his CSX 2011 Concurrence, Judge Winter noted that the short counterparty was free to direct their own hedging activity, noting the existence of a hypothetical transaction wherein the short counterparty would opt not to hedge the directional exposure of their hedge shares. “Had the banks chosen, for whatever reason, not to hedge their short swap positions with a purchase of shares, not to sell all their hedge shares once the swaps had terminated, to alter their hedging methods and sell the hedge shares before the swaps were unwound, or to sell those shares to a competing would-be acquirer of CSX, the Funds would have lacked any means, legal or moral, to compel the bank to alter that choice or even to inform the Funds of their actions.” CSX 2011 (Winter, J., concurring) at 299 (internal citation omitted). While it is true the short counterparty is not contractually obligated to purchase hedge shares, it is implausible they would not – particularly in a transaction implicating the 5% reporting threshold.

<sup>30</sup> The exception would be situations wherein the TRS references a basket of stocks, and the notional exposure of one particular stock is small enough that the investment bank opts to hedge that exposure with index futures. This exception is not relevant to TRS implicating the 5% reporting threshold.

<sup>31</sup> While analysis of the Volcker rule is beyond the scope of this comment, a naked share position large enough to implicate the 5% reporting threshold would almost certainly violate the rule’s general prohibition on proprietary trading.

<sup>32</sup> Through a block sale or otherwise.

<sup>33</sup> See *supra*, note 25.

by the long counterparty. Consequently, the long counterparty always retains “the right to acquire beneficial ownership of” the underlying shares at a pre-determined price, and generally retains the right to do so “within sixty days.”<sup>34</sup>

II(a)(1). Hypothetical TRS Term Sheet.

The truncated term sheet below includes only those terms relevant to the analysis of Rule 13d-3(d) applicability; namely, the “General Terms” and sub-definitions of “Equity Amount Payable.” The terms used are those appearing in the “Confirmations for use with the 2002 ISDA Equity Derivatives Definitions”<sup>35</sup> and accompanying “2002 ISDA Equity Derivatives Definitions,”<sup>36</sup> both of which are produced by the International Swap Dealers Association (ISDA) and serve as a proxy for market-standard terms. A glossary of relevant ISDA terms is included in the Appendix.

Cash-Settled Share Swap Transaction	
<b>General Terms</b>	
Trade Date:	Day T+0
Termination Date:	Day T+90 <sup>37</sup>
Shares:	"Public Company"
Exchange:	"Public Exchange"
<b>Equity Amounts Payable:</b>	
Equity Amount Payer:	"Investment Bank" – the Short Counterparty
Equity Amount Receiver:	"Hedge Fund" – the Long Counterparty
Number of Shares:	1,200,000
Equity Notional Amount:	USD \$120,000,000
Type of Return:	Total
Initial Price:	\$100
Final Price:	The arithmetic mean of the VWAP observed on the three (3) Exchange Trading Days immediately prior to the Valuation Date"
Valuation Time:	3:00 p.m.
Valuation Date:	Day T+90

<sup>34</sup> See 17 C.F.R. § 240.13d-3(d)(1)(i).

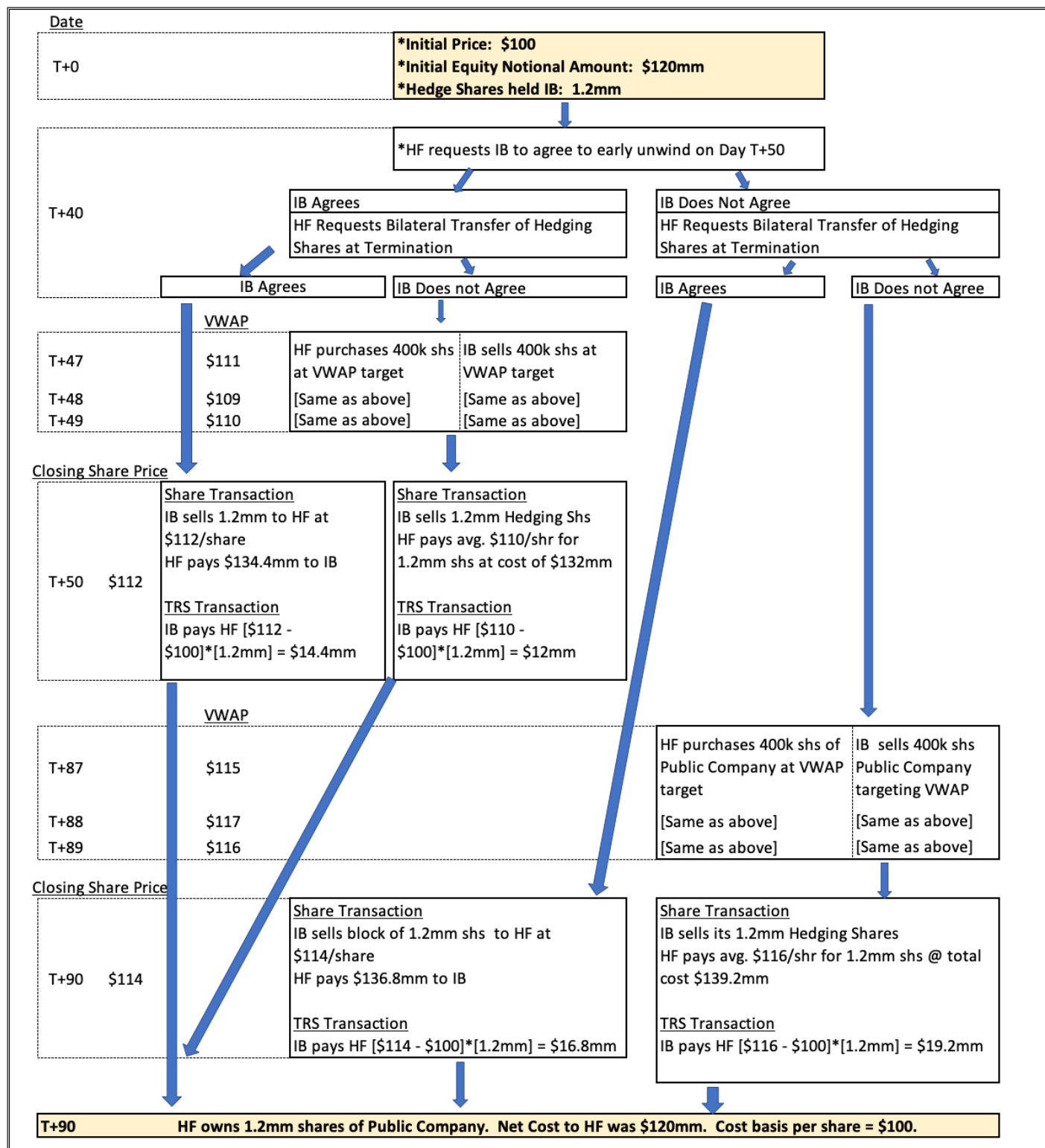
<sup>35</sup> International Swaps and Derivatives Association, Inc. (ISDA), *Confirmations for use with the 2002 ISDA Equity Derivatives Definitions (2002)* (“ISDA Confirmations”).

<sup>36</sup> International Swaps and Derivatives Association, Inc. (ISDA), *2002 ISDA Equity Derivatives Definitions (2002)* (“ISDA Definitions”).

<sup>37</sup> Termination Date may or may not be “subject to adjustment in accordance with the [ ] Business Day Convention.” ISDA *Confirmations* at 84.

II(a)(2). Hypothetical TRS Settlement.

The below flowchart demonstrates that, regardless of Investment Bank (IB) hedging activity, Hedge Fund (HF) is able to convert its TRS to physical shares at the pre-determined, Initial Price of the TRS.





## II(a)(3). Summary of Hypothetical TRS Transaction.

As these hypothetical transactions demonstrate, Hedge Fund has a contractual right to acquire 1.2mm physical shares at \$100 per share – the Number of Shares and Initial Price, respectively, of the TRS. This should implicate Rule 13d-3(d) for the same reason a call option to purchase 1.2mm shares at \$100 per share would implicate Rule 13d-3(d).

This analysis could be expanded to any instrument with delta-sensitivity to a 13d reportable security. The short counterparty to a trade large enough for its delta-adjusted notional to implicate the 5% reporting threshold will hedge their delta exposure. At expiry, the long counterparty will be able to purchase physical shares in an amount equivalent to the instrument's delta, in-line with its settlement terms.

## II(b). Rapid Acquisition of Voting Rights – Illustrative Example.

From a broader policy perspective, TRS should trigger Rule 13d because they implicate the original concern of the 1968 Williams Act – rapid acquisition of voting rights without adequate public disclosure of interest.<sup>38</sup> Specifically, the conversion right embedded in TRS would enable an activist investor to obtain a significant block of voting rights ahead of a record date, (1) without filing a Schedule 13D; (2) without alerting the market to the full scope of buying interest; and therefore (3) at a lower cost than would be incurred through an outright purchase of shares in the open market. The below hypothetical is illustrative:

Suppose the Record Voting Date for Public Company is Day T+100. On T+0, Hedge Fund knows it wants to obtain 10% of the voting rights for Public Company by T+100, but also wants to avoid disclosing its ownership and/or ongoing interest to the broader market. One option is for Hedge Fund to purchase the shares in the open market, beginning no earlier than T+91.<sup>39</sup> However, purchasing an average of 1% of Public Company shares each day would likely impact the market's supply/demand balance, and therefore increase the cost of acquisition. Additionally, while Hedge Fund would not be required to publicly disclose their holdings prior to the Record Voting Date, the market would nonetheless be alerted to significant buying interest in Public Company shares. Accordingly, the market offer price would increase.

Alternatively, Hedge Fund could instruct Investment Bank to purchase 10% of Public Company Shares over a longer period, and then exercise their TRS conversion right on T+100. For example, Hedge Fund could instruct Investment Bank to purchase Public Company Shares equivalent to 0.1% of shares outstanding and write a TRS, each day from T+0 to T+99. Each TRS could have an Initial Price equal to the price at which Investment Bank is able to purchase shares, an expiry of Day T+100, and Final Price equal to VWAP on Day T+100. By the end of Day T+100, Hedge Fund will own TRS referencing 10% of Public Company Shares, and Investment Bank will own 10% of Public Company as Hedge Shares.

On Day T+100, Investment Bank could agree to terminate all the TRS at a market price, and sell its Hedge Shares to Hedge Fund at that same price. If, for some reason, Investment Bank does not agree to the bilateral hedge share transfer (ignoring practical<sup>40</sup> and regulatory<sup>41</sup> restraints), Hedge Fund can purchase shares with a VWAP instruction over the day, equivalent to 10% of Public Company shares outstanding, confident that Investment Bank will have an equivalent amount of Hedge Shares to sell in order to close out and make payment on the TRS.<sup>42</sup>

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<sup>38</sup> See *supra*, note 17.

<sup>39</sup> So that all purchases will fall within the 10d reporting window [17 C.F.R. § 240.13d-1(a)], and there will be no need to file a Schedule 13D until after the Voting Record Date.

<sup>40</sup> See *supra*, notes 29-30.

<sup>41</sup> See *supra*, note 31.

<sup>42</sup> Suppose that Investment Bank did not sell hedge shares. First, note that Hedge Fund's significant demand would push VWAP up over the day, increasing the VWAP price and therefore, increasing the payment due by Investment Bank to Hedge Fund pursuant to the TRS. Second, note that this would leave the Investment Bank with delta exposure – a highly concentrated directional bet on a

Thus, Hedge Fund will have obtained 10% of Public Company voting rights, without the price impact of either (a) public disclosure of ownership through a Schedule 13D; or (b) creation of a supply/demand imbalance in the market through high-volume daily purchases.

### III. [Summary and Proposal to the SEC](#)

Proposed Rule 10B-1 may both exceed the scope and fall short of the aim of its authorizing statute, the Dodd-Frank Act. First, the public disclosure of participant identity may contradict Sec. 763(i). Second, the exemption from public disclosure of certain offshore transactions may prevent full disclosure of the systemic risk at which Dodd-Frank was aimed. Third, the limited qualitative description of transactional purpose and third-party arrangements may frustrate the SEC's goal of market transparency.

The SEC's goals could be better achieved through Rule 13D, which – unlike Rule 10B-1 – was promulgated under a statute better suited to disclosure of individualized participant identity and transactional purpose. As such, Schedule 13D could be used to elicit and disseminate the information with which the SEC appears concerned in proposing Rule 10B-1. This result was contemplated by Dodd-Frank Sec. 766(e).

Additionally, while expansion of Rule 13d-3 Beneficial Ownership has been controversial, much of that controversy stemmed from a mischaracterization and misunderstanding of cash-settled, equity-linked instruments, and in particular TRS. Most importantly, previous analysis failed to recognize that settlement terms of ISDA-standard TRS provide a contractual option – unilaterally exercisable by the long counterparty – to convert their TRS to physical shares at a pre-determined price. This right to obtain 13d reportable securities at a pre-determined price – a right inhering in any instrument (whether cash or physically settled) with first-order delta sensitivity to 13d reportable securities – should trigger Rule 13d-3(d) for the same reason a call option triggers Rule 13d-3(d). Additionally, TRS should trigger Rule 13d-3 because the contractual conversion right implicates the original concern of the 1968 Williams Act – rapid acquisition of voting rights without adequate public disclosure of interest. The contractual conversion right inhering in TRS would enable an activist investor to rapidly obtain a significant block of voting rights ahead of a record date, (1) without filing a Schedule 13D; (2) without alerting the market to the full scope of buying interest; and therefore (3) at a lower cost than would be incurred through an outright purchase of shares in the open market.

Consequently, the SEC should amend Rule 13d-3 Beneficial Ownership to encompass the delta-adjusted notional of any instrument – whether cash or physically settled – referencing underlying securities that are themselves subject to Rule 13d-3. Alternatively, the SEC should provide clarification that these instruments confer Beneficial Ownership under the existing language of Rule 13d-3(d).

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significant percentage of a single company's shares outstanding. Investment Bank would be left to sell those shares, which, absent the large Hedge Fund buyer in the market in subsequent days, will likely decline in price. Moreover, as mentioned above, from the perspective of an investment bank, the TRS is fundamentally a financing transaction. It would not be within the mandate of the executing desk to take a directional bet on the underlying shares. Even supposing the executing desk had *some* directional discretion, that discretion would not be large enough to encompass a directional bet implicating the 5% reporting threshold. Moreover, as mentioned *supra*, note 31, a naked share position of such size would almost certainly violate the Volcker Rule's general prohibition on proprietary trading.

## Appendix: ISDA TRS Glossary

- (1) **Trade Date** “means . . . the date specified.”<sup>43</sup>
- (2) **Termination Date** is either “subject to adjustment in accordance with the [ ] Business Day Convention;”<sup>44</sup> or; if not specified; subject to adjustment only upon agreement of both parties.<sup>45</sup>
- (3) **Shares** “means . . . the shares specified.”<sup>46</sup>
- (4) **Exchange** “means . . . each exchange or quotation system specified.”<sup>47</sup>
- (5) **Equity Amount Payer** means the long counterparty – the party paying positive performance, and receiving the absolute value of negative performance, on the underlying shares.
- (6) **Equity Amount Receiver** means the Short Counterparty – the party receiving positive performance, and paying the absolute value of negative performance, on the underlying shares.
- (7) **Number of Shares** “means . . . the number of Shares specified.”<sup>48</sup>
- (8) **Equity Notional Amount** means “the Number of Shares multiplied by the Initial Price.”<sup>49</sup>
- (9) **Rate of Return** means  $[Final\ Price - Initial\ Price] / [Initial\ Price]$ <sup>50</sup>
- (10) **Equity Amount** “means . . . an amount . . . equal to the product of the Equity Notional Amount and the Rate of Return.”<sup>51</sup>
- (11) **Type of Return** means either
  - a. **Price Return**
    - i. “[I]f the Equity Amount . . . is a positive number, then [the] Equity Amount Payer will pay . . . to the Equity Amount Receiver the Equity Amount.”<sup>52</sup>
    - ii. “[I]f the Equity Amount . . . is a negative number, then the Equity Amount Receiver will pay . . . to the Equity Amount Payer the absolute value of the Equity Amount.”<sup>53</sup>
  - b. **Total Return**
    - i. Provides for additional provision of dividend, either through cash payment or increase in Equity Amount.
- (12) **Initial Price** “means, in respect of the first Valuation Date . . . the price specified . . . and in respect of each subsequent Valuation Date, the Final Price for the Valuation Date immediately preceding such Valuation Date.”<sup>54</sup>
- (13) **Final Price** “means, in respect of each Valuation Date . . . the price per Share determined . . . as provided in the related Confirmation as of the Valuation Time on the Valuation Date or, if no means for determining the Final Price are so provided: (i) in respect of any Share for which the Exchange is an auction or ‘open outcry’ exchange that has a price as of the Valuation Time at which any trade can be submitted for execution, Final Price shall be the price per Share as of the Valuation Time on the Valuation Date, as reported in the official real-time price dissemination mechanism for the Exchange.”<sup>55</sup>
- (14) **Valuation Time** “means the time on the relevant Valuation Date or Averaging Date . . . specified . . . or, if no such time is specified, the [scheduled or actual closing time].”<sup>56</sup>
- (15) **Valuation Date(s)** “means . . . each date specified . . . (or, if such date is not a Scheduled Trading Day, the next followed Scheduled Trading Day;”<sup>57</sup> where “‘Scheduled Trading Day’ means any day on which each Exchange . . . [is] scheduled to be open.”<sup>58</sup>

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<sup>43</sup> ISDA *Definitions* at 2.

<sup>44</sup> ISDA *Confirmations* at 84.

<sup>45</sup> “Termination Date” means the date specified as such for a Swap Transaction, which date is the last day of the Term of the Swap Transaction. The Termination Date shall not be subject to adjustment in accordance with any Business Day Convention unless the parties specify in a Confirmation that the Termination Date will be adjusted in accordance with a specified Business Day Convention.” International Swaps and Derivatives Association, Inc. (ISDA), *2000 ISDA Definitions* (2000).

<sup>46</sup> ISDA *Definitions* at 2.

<sup>47</sup> ISDA *Definitions* at 3.

<sup>48</sup> ISDA *Definitions* at 2.

<sup>49</sup> ISDA *Confirmations* at 85.

<sup>50</sup> ISDA *Definitions* at 15.

<sup>51</sup> ISDA *Definitions* at 25.

<sup>52</sup> ISDA *Definitions* at 25.

<sup>53</sup> ISDA *Definitions* at 25.

<sup>54</sup> ISDA *Definitions* at 15.

<sup>55</sup> ISDA *Definitions* at 15. This comment does not consider shares on a “dealer exchange or dealer quotation system,” wherein the mid-point of the prevailing highest bid and lowest ask constitutes the Final Price.

<sup>56</sup> ISDA *Definitions* at 16.

<sup>57</sup> ISDA *Definitions* at 16.

<sup>58</sup> ISDA *Definitions* at 4.