April 11, 2022

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

Re: Modernization of Beneficial Ownership Reporting; File Number S7-06-22; RIN 3235-AM93; 87 Fed. Reg. 13846 (Mar. 10, 2022)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned proposed rule ("Proposal" or "Release"). The Proposal has four major components. It would (1) accelerate the filing deadlines for the beneficial ownership reports (schedules 13D and 13G); (2) expand the scope of beneficial ownership reporting to include certain cash-settled derivatives; (3) clarify when two or more persons have formed a group subject to beneficial ownership reporting obligations; and (4) require Schedules 13D and G to be filed using a structured, machine-readable data language. The collective effect of these reforms would be to increase transparency, fairness, and systemic stability in our markets. Better Markets supports them, subject to the concerns and recommendations set forth below.

SUMMARY OF PROPOSAL

The principal elements of the Proposal fall into three basic categories: (1) shortening the deadlines for filing the various forms disclosing a person's acquisition of more than 5% of a covered class of equity securities (generally, a voting class of securities registered under Section 12 of the Exchange Act); (2) providing that holders of certain cash-settled derivatives will be deemed the beneficial owners of the reference equity securities; and (3) clarifying the circumstances under which two or more persons would be considered to have formed a "group" that would be subject to the beneficial ownership reporting obligations. Specifically:

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

Accelerating reporting deadlines

- For Schedule 13D, the proposed amendments would shorten the initial filing deadline from 10 days to 5 days and require that amendments be filed within 1 business day.

- For certain Schedule 13G filers (i.e., qualified institutional investors and exempt investors), the proposed amendments would shorten the initial filing deadline from 45 days after year-end to five business days after the end of the month in which the investor beneficially owns more than 5 percent of the covered class.

- For other Schedule 13G filers (i.e., passive investors), the proposed amendments would shorten the initial filing deadline from 10 days to five days.

- Finally, for all Schedule 13G filers, the proposed amendments would require that an amendment be filed five business days after the month in which a material change occurred rather than 45 days after the year in which any change occurred.

- The proposed amendments also would accelerate the amendment obligations for certain Schedule 13G filers upon exceeding 10 percent beneficial ownership or a 5 percent increase or decrease in beneficial ownership of a covered class, requiring that qualified institutional investors and passive investors file an amendment within five days and one business day, respectively.

Including cash-settled derivatives under beneficial ownership

- The proposed amendments would provide that holders of certain cash-settled derivatives will be "deemed" beneficial owners of the reference equity securities.

- Specifically, proposed new Rule 13d-3(e) would provide that a holder of a cash-settled derivative security, other than a security-based swap, will be deemed the beneficial owner of the reference equity securities if the derivative is held *with the purpose or effect of changing or influencing the control of the issuer of the reference securities*, or in connection with or as a participant in any transaction having such purpose or effect.

- In addition, the proposed amendments would revise Item 6 of Schedule 13D to clarify that a person is required to disclose interests in all derivative securities (including cash-settled derivative securities) that use the issuer's equity security as a reference security.

Eliminating loopholes in the application of the group reporting obligations

- The proposed amendments would clarify the circumstances under which two or more persons have formed a "group" under Regulation 13D-G and the Exchange Act.

- The proposed amendments would clarify that an "agreement" is not necessary to a finding that two or more persons have formed a group, and that, in accordance with the statutory language, the test is whether they "act" as a group.

- The proposed amendment would also ensure that a group has been formed where, among other things, there is a "tipper-tippee" relationship in which a person shares non-public information about an upcoming Schedule 13D filing with another person who subsequently purchases the issuer's securities based on that information, if the tipper communicates with *the purpose of causing others to purchase shares in the relevant issuer.*

- In addition, the proposed amendments would provide new exemptions to permit investors to communicate and consult with each other, jointly engage with issuers, and execute certain transactions without being subject to regulation as a group. Specifically, those exemptions would address circumstances in which (1) investors communicate with one another or the issuer without the purpose or effect of changing or influencing control of the issuer and (2) investors and financial institutions enter into agreements governing the terms of derivative securities.[2]

<u>COMMENTS</u>

I. <u>ACCELERATING THE REPORTING DEADLINES IS APPROPRIATE.</u>

Under Section 13(d)(1) of the Exchange Act,[3] as implemented by Rule 13d-1(a),[4] any person who acquires beneficial ownership of more than 5% of a covered class of securities must disclose that fact and related information by filing a Schedule 13D with the SEC within 10 days. The requirement dates back to 1968, and although Congress, in the Dodd-Frank Act, authorized the Commission to shorten that 10-day deadline, it has not changed since it was first put in place over 50 years ago.

The Proposal would shorten the reporting period to 5 calendar days. This change is appropriate for a number of reasons. First, simply as a legal matter, shortening the 10-day deadline falls squarely within the legal authority of the SEC and also aligns with Congress's intent. In Section 929R of the Dodd-Frank Act, Congress expressly granted the SEC the discretionary authority to *shorten*—not lengthen—the 10-day reporting deadline by inserting this phrase in Section 13: "or within such shorter time as the Commission may establish by rule." This change in the law not only confirms the SEC's clear authority to shorten the deadline but also evinces Congress's view that such a change is necessary and appropriate, subject to the SEC's discretion in whether, when, and how to effect such a change.

The change in deadline also finds support in one of the primary rationales for the original 10-day reporting deadline. Evidence in the record indicates that the 10-day period was largely set to accommodate the practical challenges associated with gathering the necessary reportable information, compiling it, and delivering it to the SEC.[5] Clearly, technological advances over the

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2 *See* Fact Sheet, *Modernization of Beneficial Ownership Reporting,* SEC (Feb. 25, 2022), https://www.sec.gov/files/33-11030-fact-sheet.pdf.
3 15 U.S.C. § 78m(d).
4 17 C.F.R. § 240.13d–1.
5 *See* Release at 13,849 & n.16.

last 54 years have reduced the need for a 10-day reporting period. By virtue of rapid electronic filing methods, including the EDGAR system, and vastly more efficient data compilation methods, shortening the reporting period from 10 to 5 days is feasible and reasonable. As noted in the Release, many other reporting requirements under the securities laws impose much more stringent deadlines. Moreover, numerous foreign jurisdictions have adopted significantly shorter deadlines for reporting acquisitions of large blocks of an issuer's stock, ranging from "immediately" (Germany) to two days (UK and Australia) to three days (Hong Kong) days.[6]

Perhaps the most important, if controversial, justification for shortening the reporting deadline is advancing the fundamental purposes of the disclosure requirement in Section 13(d), which—in keeping with the core philosophy behind all federal securities regulation—are to enhance transparency and fairness in the securities markets. More specifically, the core purpose of the reporting requirement is to ensure that the investing public has timely information about rapid accumulations of beneficial ownership of companies by persons who have the potential to change or influence control of the company. The legislative history reflects this understanding of the goals behind Section 13(d).[7] The need to disseminate this information is clear. Bids to gain influence or control over companies typically result in significant price rises once the information becomes public. Prior to that point, and during the current 10-day delay in reporting the acquisition of a 5% beneficial ownership stake, those accumulating the beneficial ownership in the target company enjoy an informational advantage and an opportunity to profit at the expense of other investors in the market. As they accumulate additional shares that are likely if not bound to rise at a later point in time, they amass profits at the expense of shareholders not yet aware that the stock price will change. These "stealth" accumulations at artificially low market prices transfer value from countless public investors to those activists engaged in seeking ownership, control, or influence over the target company.[8] It is thus reasonable for the Commission to exercise its authority to adjust the reporting deadline in Section 13(d) and mitigate the opacity and unfairness that comes with the 10-day reporting deadline.

Some advocates challenge this point of view, arguing that shortening the deadline will curtail activism by those who seek to create long-term value in companies for the benefit of *all* shareholders or to advance larger social goods. They claim that reducing the time-period during which activists may continue to accumulate shares without public disclosure will in effect raise the costs of such campaigns and thereby inhibit them.[9] While these are legitimate issues to consider, they do not appear sufficiently persuasive on the current record to overcome the advantages conferred by the increased transparency that attends a shorter reporting deadline. It is true that when it originally adopted the 10-day reporting deadline, Congress acknowledged the benefits derived from activists who seek to challenge incumbent corporate leadership or take outright control of a company. And it apparently sought to strike a balance between the interests

6 Release at 13,852 & n.43.
7 Release at 13,851 n.24.
8 Release at 13,850 & n.19.
9 Release at 13,848 & n. 18.

of investors generally and the interests of the large stakeholders who seek to exert influence or control over issuers.[10]

However, the argument against shortening the filing deadline hinges on two propositions, neither of which appears sufficiently compelling to overcome the benefits of more timely disclosure. The asserted justification for opposing greater transparency depends first on the notion that shareholder activism is always good, and second on the notion that shortening the reporting deadline from 10 to 5 days will significantly inhibit that activism. However, as to the first point, the benefits accruing from those who seek to take over or influence corporate control and policy appear to be decidedly mixed. Along with those who seek to improve corporate governance, enhance long-term value, and foster larger social benefits are other stakeholders who are predatory, acting out of short-term profit motives, not a desire to promote long-term value.[11]

As to the second point, it does not appear that the new 5-day reporting deadline, if adopted, would significantly impair the ability of activists to pursue their agendas. Nothing in Section 13(d) or in the Proposal prevents or limits the ability of any stakeholder to accumulate large ownership shares in public companies, whether for investment purposes or to exert influence over those companies or even to acquire them. Those reporting requirements are designed to increase disclosure and transparency. Moreover, the feared impact on shareholder activism is subject to doubt for other reasons. As the Release notes, many Schedule 13D filers currently do not avail themselves of the full 10-day filing period.[12] In addition, many activists are effective in their campaigns without reaching the 5% beneficial ownership reporting threshold. And to the extent it is desirable to preserve a period of time in which activists may accumulate profits before public disclosure of their goals, enabling them to offset the costs of their activism, the 5-day reporting deadline under the Proposal would preserve that opportunity to a significant degree. For these and all of the foregoing reasons, the Commission should reduce the beneficial ownership reporting deadline from 10 to 5 days.

II. Deeming the holders of certain derivatives to be beneficial owners of the reference securities will further the goals of the beneficial ownership reporting regime, but the Proposal should dispense with the "purpose" test.

Currently, the concept of "beneficial owner" encompasses those who, directly or indirectly, acquire voting rights or "investment power" (the right to dispose of the issuer's securities). It also includes those who have contingent interests in equity securities through derivatives. For example, those who hold the right to acquire shares in the covered class through options or warrants are "deemed" beneficial owners. However, those who hold derivatives, such as cash-settled

[10] Release at 13,862 & n. 35.

[11] *See* Wachtell, Lipton, Rosen & Katz, Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934, 5-7 (Mar. 7, 2011).

[12] Release at 13,851.

derivatives, entitling them only to the *economic exposure* to a covered class, have not been considered beneficial owners. The Proposal would help close this gap.

Concerns have mounted in recent years that this exclusion from the scope of the beneficial ownership reporting framework represents an increasingly significant loophole or gap that should be closed.[13] These concerns are well-founded on legal, conceptual, and practical grounds. The reality is that cash-settled derivatives may confer a form of de facto beneficial ownership by allowing the holder to influence or control an issuer in a number of ways.[14] For example, an investor in cash-settled derivatives may be positioned to acquire any reference securities that the counterparty may hold to hedge the economic risk of the transaction. Similarly, even if the derivative is settled in cash, the investor in the derivative may nevertheless have arrangements outside the terms of the instrument to acquire the reference securities from the counterparty. And setting aside the acquisition of the securities themselves, the holder of the derivative may have sufficient economic power or leverage to exert influence or control over the issuer of the reference security. For example, the counterparty in the derivative transaction may seek to protect its business relationship with the holder by agreeing to cast votes in accordance with the holder's preferences.

Under these scenarios and others, it is appropriate to treat or "deem" the holder of the derivative as a beneficial owner of the reference securities and it is well within the rationale of the reporting regime to do so. This approach is also appropriate from a legal standpoint. The core reporting obligation was written expansively to include any person who "directly or indirectly" acquires beneficial ownership of a registered equity security. Even more fundamentally, treating cash-settled derivatives as conferring beneficial ownership follows the overriding interpretive principle in securities law that economic reality should always control over forms, labels, or other formalities.[15]

By encompassing cash-settled derivatives within the ambit of beneficial ownership, the Proposal would confer an additional benefit by helping to mitigate the systemic risks that come with the accumulation of large but opaque positions in derivatives. The Archegos debacle is often cited in support of this point, and rightly so. In March 2021, the hidden and highly leveraged bets of an obscure trader managing a company called Archegos Capital Management exploded, causing huge losses for banks, driving down the stock prices of several major public companies, and severely rattling markets. The trader was a former manager of a hedge fund who set up a family office, a type of investment adviser that deals with the finances of members of a wealthy family

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13 *See* Comment Letter on the Proposal filed by Healthy Markets Assoc'n, at 3 & n. 12 (Mar. 22, 2022) (explaining that "experts have long warned that some market participants have been able to use derivatives that are outside the reporting requirements to engage in surprise change in control or corporate engagement strategies").

14 *See generally* Release at 13,860-62.

15 *See, e.g., S.E.C. v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946); *see also Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967).

rather than the broader public, enabling it to "take bigger risks" while facing "less regulatory scrutiny."[16] Archegos built up huge positions in a number of stocks, not by buying the stock outright but through "total return swaps," which "allow a user to take on the profits and losses of a portfolio of stocks or other assets in exchange for a fee."[17] Total return swaps provide the economic equivalent of actually owning the stock. However, the regulatory treatment is different—Archegos's holdings were large enough that it would have had to report its positions had it traded in the actual stock, but because the positions were in total return swaps, they were not required to be reported.[18] Moreover, because they were swaps, Archegos could enter into them using a high degree of leverage, i.e. borrowed money, which amplified the gains as well as the losses.

This combination of leverage and anonymity proved devastating. Archegos had large, levered positions in a number of stocks through total return swaps it entered into with a number of banks. When the value of those stocks turned against Archegos, the banks that had helped Archegos amass its positions began unloading huge blocks of shares of the companies underlying Archegos's total return swaps, causing the share prices of those companies to plummet. For example, Discovery closed down 27% on March 19, and ViacomCBS closed down 27% on March 22, 2021. Worse, the panic was not limited to stocks in which Archegos was invested. Because no one knew who was responsible for the massive sell-off, traders were worried that the sell-off reflected sector-wide concerns, causing prices of some peer companies of those held in the Archegos portfolio to experience temporary price declines.[19] Moreover, while some of the banks that had helped Archegos lever up managed to escape unscathed, others were not so lucky. Credit Suisse lost $4.7 billion, and Nomura lost around $2 billion.[20] The increased transparency that will come with including cash-settled derivatives within the ambit of the Section 13(d) reporting framework will help mitigate this type of hidden risk concentration.

Finally, we urge the Commission to improve the Proposal by removing the limiting condition that cash-settled derivatives are to be deemed beneficially owned for reporting purposes only if they are "held with the purpose or effect of changing or influencing the control of the issuer

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16 Emily Cadman, *How a Blowup at Hwang's Archegos Is Rattling the Finance World*, BLOOMBERG (Mar. 29, 2021), https://www.bloomberg.com/news/articles/2021-03-29/goldman-block-trade-what-to-know-about-bill-hwang-viacom-discovery-stock-sale?sref=mtQ4hc2k.

17 Quentin Webb, et al., *What Is a Total Return Swap and How Did Archegos Capital Use It?*, Wall St. J. (Mar. 30, 2021), https://www.wsj.com/articles/what-is-a-total-return-swap-and-how-did-archegos-capital-use-it-11617125839.

18 Quentin Webb, et al., *What Is a Total Return Swap and How Did Archegos Capital Use It?*, Wall St. J. (Mar. 30, 2021), https://www.wsj.com/articles/what-is-a-total-return-swap-and-how-did-archegos-capital-use-it-11617125839.

19 Emily Cadman, *How a Blowup at Hwang's Archegos Is Rattling the Finance World*, BLOOMBERG (Mar. 29, 2021), https://www.bloomberg.com/news/articles/2021-03-29/goldman-block-trade-what-to-know-about-bill-hwang-viacom-discovery-stock-sale?sref=mtQ4hc2k.

20 Erik Schatzker, Sridhar Natarajan, & Katherine Burton, *Bill Hwang Had $20 Billion, Then Lost It All in Two Days*, BLOOMBERG (Apr. 8, 2021), https://www.bloomberg.com/news/features/2021-04-08/how-bill-hwang-of-archegos-capital-lost-20-billion-in-two-days.

of such class of equity security."[21] As the Release itself suggests, this standard is inherently difficult to administer, as it requires evidence of the "purpose or effect" of financial transactions that will often be elusive. And while the "purpose or effect" test does play a role in a number of the other ancillary beneficial reporting obligations, it is not an element of the core trigger for reporting, namely—and simply—the acquisition of more than 5% of the beneficial interest in the issuer. That test was framed in terms of a straightforward quantitative metric without a "purpose" element. The acquisition of cash-settled derivatives, which as demonstrated in the Release deserves to be considered a form of beneficial ownership, should not be treated differently or encumbered with a largely subjective test. At a minimum, the purpose or effect test should be replaced by standards that are more "reasonably" or "objectively" "determinable."

III. <u>The new approach to defining "groups" subject to beneficial reporting will prevent evasion, squarely in keeping with the statute and its rationale.</u>

Section 13(d) of the Exchange Act provides that "[w]hen two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a "person" for the purposes of this subsection." Congress included this provision to prevent evasion of the reporting obligation that arises upon acquisition of a 5% beneficial ownership in a company. It is aimed at preventing groups of persons from seeking to control or influence an issuer by acquiring a collectively large block of shares while maintaining each individual's acquisition below the reporting threshold.

To pin down when a group is formed for purposes of whether and when the reporting obligation under Section 13(d) is triggered, the Commission previously adopted a rule specifying that such a group is formed if an agreement to act together has been reached for purposes of acquiring, holding, or disposing of any securities of the issuer. Although the Commission did not intend the "agreement" test to serve as the sole measure of when a group is formed for purposes of Section 13(d), some courts adopted that approach, holding that a group can only be formed if an agreement exists among its members. This interpretation is inconsistent with the statutory language in Section 13(d), which is framed in terms of those who "act" as a group, not those who enter agreements to act. It is also inconsistent with the purposes underlying the law, as it would needlessly narrow the circumstances under which a group would be obligated to report when their collective beneficial ownership exceeded 5%. And the legislative history confirms that Congress intended the scope of Section 13(d)(3) to be broader, encompassing a wide range of group "understandings" or "relationships."[22]

The Proposal would remedy this situation by removing reference in Rule 13d-5 to the agreement and clearly and simply providing, in accordance with the statute, that two or more persons who *act* as a group for purposes of acquiring, holding, or disposing of securities are treated as a group. These changes would make clear that whether persons are acting as a group is a facts and circumstances test and that concerted action, without any express agreement, can constitute

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[21] Release at 13,862.
[22] Release at 13,868 n.130.

the formation of a group. These changes will conform the rules with the statutory language and intent, and they are clearly appropriate and necessary to address a major loophole in the beneficial ownership reporting framework.

Finally, in a related vein, the Proposal addresses situations where a large blockholder who seeks to effect a change in the corporate governance of an issuer may share its intentions and its plan to file a Schedule 13D with others, in hopes of engendering support for its plan to influence the issuer. That may induce those receiving the information to acquire shares before any filing is made, in hopes of capitalizing on the anticipated rise in the issuer's share price. This scenario presents the basic investor protection concerns discussed above: an informational imbalance results in opportunistic purchases that benefit a few investors at the expense of the vast number of uninformed investors in the market.

To address this concern, the Proposal would amend Rule 13d-5 to provide that where a person shares information about an impending Schedule 13D filing, with the purpose of causing others to make purchases, and the recipient purchases shares of the issuer based on this information, the "tipper" and "tippee" will be deemed to have formed a group within the meaning of Section 13(d)(3) and become subject to the reporting obligations attending group formation. This reform is in keeping with the anti-evasion purposes underlying Section 13(d)(3), and it is necessary and appropriate. Our concern lies with the proviso that the tipper be acting with the purpose or intention of causing others to make purchases in line with the tipper's plan to influence the issuer. This element creates a potential obstacle in the administration and enforcement of the group reporting requirements, as it may be difficult to establish that the tipper acted with precisely that intent. The scenario described in the Release should trigger the group reporting obligations, regardless of whether the tipper can be said to have acted with the specific purpose of inducing others to purchase.

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,

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