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

Submitted electronically via rule-comments@sec.gov

April 11, 2022

Dear Ms. Countryman:

Modernization of Beneficial Ownership Reporting (File Number S7-06-22)

The Alternative Investment Management Association (AIMA)[1] appreciates the opportunity to comment on the U.S. Securities and Exchange Commission's (SEC or Commission) proposed rule to amend certain rules that govern beneficial ownership reporting (the "Proposal").[2] AIMA's members include institutional investment managers and other market participants, many of whom will be negatively impacted by the Proposal.

The Commission has proposed amendments to the rules on beneficial ownership reporting under Section 13(d) and 13(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the reports on Schedules 13D and 13G. The proposed changes address filing deadlines for both Schedules 13D and 13G, the treatment of cash-settled derivatives for the purpose of determining beneficial ownership, when a group is formed and more. We disagree with the proposed

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with around 2,100 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2.5 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council (ACC) to help firms focused in the private credit and direct lending space. The ACC currently represents over 250 members that manage $600 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA's website, www.aima.org.

[2] SEC, Proposing Release, Modernization of Beneficial Ownership Reporting, 87 Fed. Reg. 13846 (Mar. 10, 2022) (the "Proposing Release").

amendments and do not believe the Commission has cited any market event, failure or otherwise to justify the accelerated timelines. The proposed change to include cash-settled derivatives in the beneficial ownership calculus and the revised "group" definition will also add unnecessary complexity and uncertainty to a regime that has proven workable and successful for decades. In particular, we suggest that the Commission:

- preserve the current reporting deadlines for both initial filings and amendments to Schedules 13D and 13G because the justifications provided for accelerating the filing deadlines are misguided, insufficient and would have negative consequences;
- not deem holders of cash-settled derivatives as beneficial owners of the underlying referenced security because these products do not provide any voting rights; and
- maintain the clarity provided by the current "group" definition because the revised definition is vague and would chill shareholder engagement and thus, stifle potential corporate improvements related to strategic direction, climate change, labor standards, management compensation and more.

These suggestions are discussed in further detail below in the attached annex with relevant data points provided. We would be happy to elaborate further on any of the matters raised in this letter. For further information, please contact Daniel Austin, AIMA's Director of U.S. Policy and Regulation, by email at daustin@aima.org or phone at (601) 842-4545.

Yours sincerely,

Jiří Król
Deputy CEO, Global Head of Government Affairs
AIMA

Cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Allison Herren Lee, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
Ms. Renee Jones, Director, Division of Corporation Finance
Mr. Dan Berkovitz, General Counsel, Office of the General Counsel

ANNEX

1. The Commission should maintain the current reporting deadlines because the justifications provided for accelerating both the initial filing and amendment deadlines for Schedules 13D and 13G are misguided and insufficient to justify such significant changes to the beneficial ownership reporting framework.

Section 13(d)(1) of the Exchange Act requires a disclosure statement to be filed "within ten days after [an] acquisition [of more than 5% of a covered class] or within such shorter time as the Commission may establish by rule."[3] SEC Rule 13d-1(a) set forth the requirement that an initial Schedule 13D be filed by the 10-day deadline.[4] Since the passage of the Williams Act in 1968, the 10-day deadline has not been updated, leading some commentators to question whether the 10-day initial filing deadline is still appropriate in light of technological advances, while others disagree that modern technology warrants any change to the deadline.[5]

One of these technological advancements, the Proposal explains, is the ability to file Schedule 13D through the Commission's Electronic Data Gathering, Analysis and Retrieval ("EDGAR") system.[6] This technological innovation has "relieve[d] [Schedule 13D] filers of the need to arrange for delivery in-person or through the U.S. mails."[7] Another technological breakthrough the Commission cites is the modern information technology systems used by market participants.[8] According to the Commission, the 10-day filing deadline also creates "information asymmetries."[9]

The Commission has reassessed whether the current deadline still serves the primary purposes of section 13(d) of the Exchange Act and has concluded, based on technological advances and information asymmetries, to shorten the initial filing deadlines for Schedule 13D to five days.[10]

Based on the same justifications for shortening the initial Schedule 13D filing deadline, the Commission has proposed to revise its rules for persons who initially elect to report beneficial ownership on Schedule 13G, but subsequently lose their eligibility to do so, and so must file a Schedule 13D.[11] Such persons would be required to file an initial Schedule 13D no later than five days after the date on which the person became ineligible to report on Schedule 13G.[12]

Congress enacted section 13(g) of the Exchange Act to address beneficial ownership reporting by persons not required to report under section 13(d).[13] The deadline for the initial Schedule 13G filing

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3 15 U.S.C. 78m(d)(1).
4 17 C.F.R. 240.13d-1(a).
5 Proposing Release, *supra* note 2, at 13849.
6 *Id.* at 13849-50.
7 *Id.* at 13850.
8 *Id.*
9 *Id.*
10 *Id.* at 13851.
11 *Id.* at 13854.
12 *Id.*
13 *Id.* In contrast to section 13(g), section 13(d) applies only to beneficial owners who make non-exempt acquisitions of more than 5% of a covered class. *Id.*

depends on whether the person is a qualified institutional investor (QII), exempt investor or passive investor.[14] QIIs must file an initial Schedule 13G only if such QII beneficially owns more than 5% of a covered class at the end of the calendar year, and it must be filed within 45 days after the end of the calendar year.[15] If the QII beneficially owns more than 10% of a covered class as of the last day of any month, an initial Schedule 13G must be filed within 10 days after the end of that month.[16]

Exempt investors, who may include founders or early investors in an issuer's securities, must likewise file a Schedule 13G within 45 days after the end of the calendar year.[17] Passive investors eligible to report on Schedule 13G in lieu of Schedule 13D must file a Schedule 13G within 10 days after acquiring beneficial ownership of more than 5% of a covered class.[18] A person is eligible to file a Schedule 13G as a "passive investor" only if such person is not seeking to acquire or influence control of an issuer and beneficially owns less than 20% of a covered class.[19]

The Commission believes that the current initial Schedule 13G filing deadlines warrant reassessment.[20] Accordingly, the Commission has proposed to accelerate the filing deadline for the initial Schedule 13G filed by QIIs and exempt investors from 45 days after year end to five business days after the end of the month in which beneficial ownership exceeds 5% of a covered class.[21] The Proposal would also shorten the initial Schedule 13G filing deadline for passive investors from 10 days to five days.[22]

Currently, amendments to Schedule 13D must be filed "promptly," as opposed to a specified deadline.[23] Amendments are made not only for acquisitions or dispositions above a certain size but also for changes in the disclosure narrative that are material and material changes in the level of beneficial ownership caused by an involuntary change in circumstances.[24] For Schedule 13G, QIIs and passive investors currently must file amendments to report beneficial ownership of more than 10% (and, thereafter, for changes of greater than 5%) within 10 days of the end of the month in which such changes occur (for QIIs) and promptly after such change (for passive investors).[25] For any and all other

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[14] *Id.* QIIs include registered broker-dealers, banks, registered investment advisers and more. *Id.* at 13847. An exempt investor may be, for example, persons who acquire all of their securities prior to the issuer registering the subject securities under the Exchange Act. *Id.* Passive investors are beneficial owners of more than 5% but less than 20% of a covered class who certify that the securities are not held for the purpose or effect of influencing the control of the issuer and were not acquired in connection with or as a participant in any transaction have such purpose or effect. *Id.*

[15] 17 CFR 240.13d-1(b).

[16] *Id.*

[17] 17 CFR 240.13d-1(d). Exempt investors, unlike QIIs and passive investors, do not remain subject to section 13(d) and are instead subject to section 13(g) at the time of their initial filing. *Id.*

[18] 17 CFR 240.13d-1(c).

[19] *Id.*

[20] Proposing Release, *supra* note 2, at 13855.

[21] *Id.* The shortened deadline would render unnecessary the current provision in Rule 13d-1(b)(2) that accelerates the filing deadline if beneficial ownership exceed 10% at the end of any month. *Id.* Therefore, the Proposal would delete the language that imposes an initial reporting obligation on QIIs after exceeding 10% of a covered class. *Id.*

[22] *Id.*

[23] *Id.* at 13857.

[24] *Id.* Involuntary changes in circumstances could be, for example, a reduction in the amount of beneficial ownership caused solely by an increase in the number of share outstanding. *Id.*

[25] *Id.*

changes, QIIs and passive investors are required to file amendments only once per year (in a filing no later than 45 days after the end of such year).[26]

The Proposal would require that all amendments to Schedule 13D be filed within one business day after the material change that triggers the amendment obligation (rather than promptly).[27] Also, the Commission is proposing to require all filers of Schedule 13G to file amendments within five business days of the end of the month in which a material change occurs.[28] The Proposal would also require QIIs and passive investors to file amendments to Schedule 13G after exceeding 10% beneficial ownership (and, thereafter, for changes of greater than 5% within 5 days of the end of the month in which such change occurs (for QIIs) and one business day after such change (for passive investors).[29]

We respectfully disagree with the Commission's proposed changes to the initial filing and amendment deadlines for both Schedule 13D and Schedule 13G. The Commission has not cited a market event nor market failure related to the existing beneficial ownership regime to support the proposed amendments. It instead relies upon insufficient justifications regarding Schedule 13D – perceived information asymmetries and technological advances – to amend both the initial filing and amendment deadlines for Schedules 13Ds and Schedule 13Gs. The discussion below therefore focuses on the proposed changes to Schedule 13D.

We believe the Commission falls short of providing any reasonable explanation to warrant such significant changes to its beneficial ownership reporting framework. The Proposal also fails to fully comprehend the practical, negative effects the shortened deadlines will have on activist investing, which is universally viewed (by those other than issuer and their incumbent management themselves) as beneficial for markets and for ensuring the possibility of changes in corporate direction in appropriate instances. Because of these reasons, explained further below, we believe the Commission should maintain the current initial filing and amendment deadlines for both Schedule 13Ds and Schedules 13Gs.

Technological Advances and Information Asymmetries

Throughout the Proposing Release, the Commission repeatedly relies upon the technological advances made since 1968 to help explain its decision to shorten the filing deadlines. In doing so, it cites a select few publications from journalists, academics and law firms that call for revisiting the 10-day filing period for Schedule 13D because of the advent of EDGAR and modern information technology.[30] These writers, however, fail to point to any concrete data, market event or otherwise to support their message, only that technology has advanced since 1968.[31]

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[26] *Id.*

[27] *Id.* To justify this decision, the Commission again cites to technological advances that have occurred since the "promptly" standard was established. *Id.*

[28] *Id.*

[29] *Id.*

[30] *Id.* at 13849, n. 16.

[31] *Id.*

Technological advances over the past five decades simply do not justify the proposed accelerated filing deadlines. Based on the legislative history of the Williams Act, there is no evidence that the current state of technology was a deciding factor in setting the 10-day window. Rather, the 10-day reporting period reflects a careful balance not to tip the scales in favor of either management or the activist investor. According to at least one court, Congress chose the 10-day window because it reflected an "optimal balance" between the operation of a "free and open auction market" and a takeover attempt,[32] not because that was the amount of time it "took to type up, proof, and deliver to Washington the required filing in 1968."[33]

The Commission explains that the current 10-day deadline also contributes to information asymmetries that could harm investors.[34] For example, a shareholder could decide to sell her shares during the 10-day window and potentially miss selling at a higher price after the filing of a Schedule 13D. This shareholder was not forced to sell her shares, she did so voluntarily either seeking liquidity or, perhaps, because she had doubts about the issuer's prospects. Regardless of her reason for selling, she had the same access to disclosures from both the issuer and insider(s) as the filer of Schedule 13D. More importantly, if the effect of the proposed changes is, as we are reasonably certain it would be, to cause at least some activists to pass up activist opportunities they otherwise would have taken, then she and all other holders would be deprived of the opportunity to sell at any increased price resulting from the activism.

Our capital markets are about equal access to issuer and insider information and reaching different conclusions. Any information asymmetry that may exist is because the activist has knowledge of her own intentions, i.e., to accumulate at least 5% of a covered class and file a Schedule 13D. Technically, information asymmetries exist in every stock transaction: a buyer knows why she is buying and a seller knows why she is selling. They do not question the other as to why one is choosing to buy or sell the security when consummating the transaction.

The Proposal's information asymmetry justification misses the forest for the trees. During that 10-day period, buying and selling of an issuer's securities will occur, and, yes, some market participants may miss out on selling at an appreciated price once the Schedule 13D is filed. However, the Commission ignores the benefit that will accrue to the overwhelming majority of shareholders that *did not sell* during the 10-day period. We believe the Commission should focus on the great number of shareholders that will benefit from an appreciated price, not the select few that voluntarily sold.

The Commission notes that its proposal to shorten filing deadlines is consistent with its efforts and Congressional efforts to accelerate public disclosures.[35] These prior efforts, however, relate to filings by issuers and insiders, *not* unrelated, third-party investors.[36] The Proposal incorrectly groups these

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[32] *Hyde Park Partners, L.P. v. Connolly,* 839 F.2d 837, 851 (1st. Cir. 1988).

[33] Proposing Release, *supra* note 2, at 13849, n. 16. We acknowledge, or course, that the emergence of electronic filing facilitates earlier filing, but this is relevant only for issuers at greater physical distance from the Commission, and amounts to only one day at most, since virtually all physical filings were and are made by courier.

[34] *Id.* at 13850.

[35] *Id.* at 13851.

[36] *See id*. at 13851, n. 25.

three types of actors together, seemingly assuming that disclosures made by all three are of equal legal and economic significance – they are not. Again, U.S. capital markets are about making investment decisions from equal access to information from issuers and insiders not, as relevant in this instance, information from other unrelated, third-party investors. Accordingly, the Commission cannot reasonably claim that its proposal to shorten the filing deadlines is "consistent" with prior efforts.[37]

The Practical Effect of Shortened Reporting Windows

We disagree with the Commission's belief that the proposed amendments will lead to the potential benefits it cites throughout the Proposing Release. On the contrary, the practical effect of the shortened reporting window, particularly for Schedule 13D, will have negative ramifications for investors, issuers and the broader market, while also adversely impacting many investors' goals of improving corporate practices – notably, in the current context, including climate-friendly practices. Furthermore, we respectfully question how the Commission can proceed with such a significant change to its beneficial ownership reporting framework when it "cannot provide a reasonable estimate of the effects of the proposed amendments."[38]

First, the Commission assumes that the additional transparency provided by the proposed amendments will "enhance market efficiency and liquidity."[39] If this were the case, one should conclude that market efficiency and liquidity have suffered because of the current reporting deadline. The Commission explains that the current 10-day filing deadline leads to a delay of market moving information being incorporated into the market, thus leading to less efficient pricing and information asymmetries.[40]

We acknowledge that price changes often occur once an initial Schedule 13D is filed, but we question whether any such price changes have necessarily had a negative effect on market efficiency and liquidity. The Commission appears to believe that addressing the information asymmetries that it thinks currently exist in the market will have this effect, yet the Proposal fails to include any meaningful, indicating data that the proposed amendments will enhance market efficiency and liquidity. We do not believe that the Commission can simply rely upon the unsubstantiated belief that addressing perceived information asymmetries will improve market efficiency and liquidity.

We would posit, instead, that because the 10-day deadline is appropriately calibrated to balance the needs of blockholders, other investors and issuers, the current reporting framework ***enhances*** market efficiency and liquidity, rather than detracting from it. Indeed, with an accelerated filing deadline, we believe, that in some instances, markets would become more volatile as a result of limiting the liquidity large purchasers provide. The Proposal could dissuade blockholders from pursuing a particular

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37 *Id.* at 13851.
38 *Id.*
39 *Id.* at 13852.
40 *Id.* at 13881.

strategy and thereby adversely affect liquidity in the securities of that particular issuer, as well as the secondary effects such liquidity provides throughout the equity markets.

Second, the Proposal notes that a shorter reporting deadline may reduce blockholders' incentives to seek or influence a change of control, while also being costly for general shareholders of companies that are potential targets of blockholders.[41] We agree, and we respectfully question whether the desire to address information asymmetries outweighs the benefits that accrue to issuers, shareholders and the broader market from activist investing. We do not believe that it does.[42]

Blockholders spend a great amount of time, resources and capital to develop the necessary research to determine whether it is worthwhile to pursue a meaningful stake in an issuer. Once a decision is made to proceed, blockholders must then expend additional resources to succeed in their bids to replace or influence management, thereby taking on transaction costs, reputational risks and legal and economic liabilities to effect corporate change. Because the proposed amendments would add to those costs in some instances by making it more costly for blockholders to build a sufficient position to effect change, they would also reduce the profitability of, and therefore the incentive to pursue, activist strategies. At the margins, the effect would be to reduce management's accountability to shareholders and corporate governance generally. Furthermore, as the Proposal correctly notes, disincentivizing blockholders could – and we believe almost certainly would – result in worse outcomes for other shareholders who would have shared in the benefits that activist blockholders could have helped them obtain.[43]

We recognize that some purchasers may file within fewer than the required 10 days for Schedule 13D. This reality, however, does not justify accelerating the reporting timeline. Most investors will have a total aggregate investment in mind, based on either a number of outstanding shares, a percentage thereof or financial commitments. When the investor reaches this level and exceeds the 5% threshold, she files her Schedule 13D. If she has not satisfied her aggregate purchasing goal before the 10-day period, she may not file early. This standard market practice in no way suggests that all other holders who are continuing to accumulate shares should be required to file earlier.

It is also important that performance, of course, is not just limited to bottom-line financial performance. Investors are now taking meaningful equity positions with the goal of addressing or improving an issuer's environmental, governance or social (ESG) practices. These investors are motivated beyond just an issuer's financial performance, instead hoping to gain substantial voting power to effect change with benefits that go beyond just the issuer or its investors but accrue to the public as well. The Proposal would, however, hinder this growing group of investors' ability to improve an issuer's ESG practices by reducing the economic incentives associated with pursuing a meaningful equity position because, as explained above, activism comes with great financial costs.

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41 *Id.*

42 As explained above, the Commission's attempt to remedy information asymmetries will ultimately harm the overwhelming majority of investors that do not sell during the 10-day window as well as prevent the potential corporate improvements blockholders may seek.

43 Proposing Release, *supra* note 2, at 13883.

In addition, the revised "group" definition, discussed further below, would stifle investor communications, which are a necessary means of achieving ESG-related improvements. In this sense, the Proposal is also inconsistent with the Commission's new emphasis on climate disclosures.[44] As the Commission seeks to establish new standards of climate disclosures in the hopes of improving public companies' performance in this regard, it has, we believe, simultaneously proposed changes to Regulation 13D-G that would shift the balance of power away from investors and in favor of issuers and thus away from those who can hold management accountable.

Third, although the Commission examines the use of poison pills vis-à-vis the proposed shorter filing deadlines in its Economic Analysis,[45] it does not fully appreciate how the shorter deadlines will affect the relationship between activist investors and management. The Proposal explores whether the accelerated filing deadline for Schedule 13D will provide management with more of an opportunity to quickly deploy its defense mechanisms, i.e., low-threshold poison pills.[46] The Commission ultimately concludes that the shortened reporting deadline is unlikely to trigger low-threshold poison pills because the reported ownership on initial Schedule 13D filings may be even lower than prevalent poison pill triggers.[47]

The Commission's conclusion, however, misses the point. It is plausible that, because of the shortened filing deadline, market participants may be unable to accumulate an equity stake at which some poison pills may be triggered. If that is correct, though, market participants would also be unable to acquire a stake at which change or influence can be achieved, particularly when an issuer also has a staggered board, thereby thwarting potential issuer improvements and benefitting shareholders. The shortened deadline will also further entrench management because they will be given earlier notice of a potential activist's intent before that activist can acquire a sufficient equity position to influence or change management.

One Business Day to File Amendments

We disagree with the proposed change that would revise the filing deadline required for amendments to Schedule 13D from "promptly" to one business after the date on which a material change occurs. We believe there have been very few, if any, abuses associated with the current "promptly" regime and that it has worked well and effectively. Accordingly, the Commission should maintain the requirement that amendments be filed promptly. If, however, the Commission wants a more established deadline for filing amendments, we believe instead that amendments should be filed within at least five business days after the occurrence of the triggering event.

As discussed above, amendments to Schedule 13D are made not only for acquisitions but also for changes in the disclosure narrative that are material, as well as material changes in the level of

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44 SEC, Proposed Rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (April 11, 2022).

45 Proposing Release, *supra* note 2, at 13882-83.

46 *Id.* at 13882.

47 *Id.* at 13882.

beneficial ownership caused by an *involuntary change* in circumstances.[48] An example of an involuntary change cited in the Proposing Release would be a reduction in the amount of beneficial ownership caused solely by an increase in the number of shares outstanding.[49] The converse is also possible, where a reduction in the number of outstanding shares (principally by issuer repurchases, which may not be promptly reported themselves) causes an involuntary increase in a shareholder's beneficial ownership percentage.

The Commission correctly notes that "institutional filers with more complex business organizations, including those with sub-advisory relationships common in the investment management industry, may have difficulty assembling all of the required data within the timeframe that will be necessary in order to comply with the proposed filing deadlines."[50] Indeed, the proposed change from "promptly" to one business day will pose *significant* operational challenges for market participants filing amendments, particularly for the subset of investment managers described above.

The Proposal explains that amendments must be filed not only for acquisitions, but involuntary changes as well, which, clearly, are beyond the market participant's control and have no meaningful signaling value to the issuer or other market participants. In the event of an involuntary change, assuming a market participant is even aware of its occurrence, she will be put in the challenging and unenviable position of trying to gather data across all portfolios in such a brief period to determine even if an amendment needs to be filed. Moreover, if she concludes that an amendment should be filed, because of the incredibly short period to file an amendment, she may be unable to verify whether the amendment is fully accurate, thereby making her susceptible to market disinformation and potential Commission action.

2. The Commission should not deem holders of cash-settled derivatives as beneficial owners of the underlying referenced security because these products do not provide any voting rights.

The Commission is proposing to amend Rule 13d-3 to deem holders of certain cash-settled derivatives to be the beneficial owners of the referenced covered class.[51] Specifically, a holder of a cash-settled derivative security will be deemed the beneficial owner of the equity securities referenced by the derivative if such person "holds the derivative security with the purpose or effect of changing or influencing the control of the issuer."[52] The Proposal explains that issuers and other market participants "should have greater transparency regarding persons with significant interests in an issuer's equity securities and potential control intent."[53] However, it acknowledges that derivatives entitle the holder to nothing more than economic exposure to a covered class and have not historically, referencing Commission precedent, been considered to constitute beneficial ownership.[54]

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48 *Id.* at 13857.
49 *Id.*
50 *Id.* at 13859.
51 *Id.* at 13860.
52 *Id.* at 13862.
53 *Id.* at 13861.
54 *Id.* at 13860.

We respectfully disagree with the Commission's preliminary determination to deem holders of cash-settled derivatives beneficial owners of the underlying referenced security. The Commission's proposed amendment rests on the suggestions of a select few commentators and the Commission's belief that market participants "should have greater transparency regarding persons with significant interests in an issuer's equity securities and potential control intent"[55] The beneficial ownership regime, at its core, is about voting rights and control, not simply economic exposure to an issuer. Moreover, the current regulatory framework already exists for determining which derivatives should be counted towards beneficial ownership,[56] and even if there was an agreement between swap counterparties how shares should be voted, the Commission should rely on its ***existing*** group rules to address such an arrangement rather than proposing a complicated restructure of the beneficial ownership calculus. For these reasons and those explained further below, we encourage the Commission to abandon its preliminary determination to deem holders of cash-settled derivatives as beneficial owners of the underlying referenced securities.

First, the Commission believes that including cash-settled derivatives in the beneficial ownership calculus will improve transparency regarding interest in an issuer and potential control intent thereof. We believe that the alternative is the likely result. Because Schedule 13D is about voting rights and potential control or intent to influence an issuer, market participants, the issuer and the Commission may be left guessing as to who or what actually has true control or influence over the issuer, i.e., voting power.

Even if the filer is holding the cash-settled derivative for the purpose or effect of changing or influencing control of the issuer, it does not follow that the holder has, at the time of filing, enough voting power, i.e., 5% of a covered class of security, to change or influence control of the issuer. The proposed amendments will only muddy the waters in understanding true control of an issuer and make it more challenging for investors and other market participants that utilize Schedule 13D data for their own investing strategies.

Second, holders of cash-settled derivatives would be deemed beneficial owners if they hold the derivative "with the purpose or effect of changing or influencing the control of the issuer."[57] Even if it were possible to hold a derivative with the "purpose" of changing or influencing control, "effect" is vague and indeterminable until after the fact and then is of uncertain application. A holder of a cash-settled derivative has no knowledge as to their institutional counterparty's intent and whether it wishes to "effect" change with the securities it purchased to hedge its position. The holder of the cash-settled derivative would therefore be left guessing as to its institutional counterparty's intent and whether it wishes to "effect" change.[58] This reality will only make the holder's administrative burdens more challenging. The "purpose or effect" formulation, relevant also in the proposed "group" definition discussed below, is particularly difficult. "Purpose" is not an issue; it is a subjective determination, but it is discernible and has worked well. Determining "effect" is often fraught with

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55 *Id.* at 13860-61.

56 *Id.*

57 *Id.* at 13862.

58 The counterparty may not know either. It may later determine that it wishes to "effect" change or influence the issuer – would it therefore be required then to inform all of its counterparties in that referenced security of its intent?

difficulties; it is the essence of the *post hoc ergo propter hoc* fallacy and does not belong in the Commission's rules.

Third, the Proposal seems to believe that a counterparty immediately goes to the market to hedge its derivative position in what would be akin to one-to-one hedging. This assumption is incorrect and does not reflect market realities. A broker-dealer counterparty will aggregate its exposure across all counterparties and hedge only its net position or may not hedge the position at all. Unlike what the Proposal seems to contemplate, just because a position is hedged, does not mean that the broker-dealer can then deliver the referenced securities one-for-one to the derivative holder or even attribute shares that it may hold as a hedge, or the voting of any such shares, to any specific derivative transaction.

Fourth, because holders of cash-settled derivatives will be deemed beneficial owners, the Commission will likely see an influx of Schedule 13D filings as more market participants may, despite not having a true 5% equity position, reach the 5% threshold. As the number of Schedule 13D filings increase, confusion over who or what holds authentic, real voting power will also increase. Market participants and the Commission will be left with a trough of data that cannot be analyzed accurately to determine authentic potential control or influence.

Finally, deeming holders of cash-settled derivatives beneficial owners will likely lead to even earlier disclosure of an activist's position because she will more quickly reach the 5% threshold. The activist's position and potential plan would then be prematurely disclosed thereby hindering her strategy and hopes to improve the issuer.

3. The Commission's revised "group" definition and framework is vague and will chill shareholder engagement, and, accordingly, it should maintain the clarity provided by the current statutory language and regulatory framework.

Commission Rule 13d-5(b) states – and has provided so for more than 40 years – that when two or more persons "agree to act together" for the purpose of acquiring, holding or disposing of securities of an issuer, then a group is formed.[59] If a group is formed, then they are also deemed to be a single person for the purposes of determining beneficial ownership.[60] If, in the aggregate, the amount of beneficial ownership exceeds 5% of a covered class, the group may be required to file a beneficial ownership report.[61]

The Proposal would amend this definition and specify that two or more persons who "act as a group" for the purposes of acquiring, holding or disposing securities will be treated as a group.[62] The Commission explains that the amendment would clarify that group formation does not depend solely on the presence of an express agreement and that concerted actions of two or more persons are

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59 *See* Proposing Release, *supra* note 2, at 13888.

60 *Id.*

61 *Id.* at 13866.

62 *Id.* at 13868.

sufficient to constitute a group.[63] The Proposing Release also provides for a tipper-tippee arrangement vis-à-vis the revised group definition. For example, if a blockholder shares non-public information about its "anticipated obligation to file a Schedule 13D . . . and the person who receives such information subsequently makes a purchase based on that information," then this tipping arrangement falls within the scope of the Commission's proposed group definition.[64]

We believe the Commission's proposed amendments to the group definition violate the plain meaning of Exchange Act section 13(d)(3) and will lead to additional market complexities as shareholders attempt to determine if a group has indeed been formed, chill shareholder engagement with each other and management and further entrench incumbent management. The revised definition is circular on its face. To say that two or more persons are defined as a group if they act as a group does not advance understanding of the group concept. Moreover, if a group is deemed to have been formed, the accelerated reporting deadline will give the group a mere five days to coordinate and gather the necessary data needed to file a Schedule 13D and only one business day to file an amendment.

Section 13(d)(3) of the Exchange Act reads, "When two or more persons act as a partnership, limited partnership, syndicate, or other group for the purposes of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a 'person' for purposes of this subsection."[65] Each of the components described in the statute – partnership, limited partnership and syndicate – all require more than one person and require some form of agreement to act together for a common purpose. When the Commission interpreted this statutory text, it determined, consistent with section 13(d)(3), that a group would be formed when two or more persons "agree to act together" for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer.[66]

Despite providing little firm, or even anecdotal, evidence that the current rule is leading to problems in the securities markets, the Commission ignores the plain meaning of the Exchange Act and decades of industry practice and court decisions with its proposed amendment to Rule 13d-5(b). The revised "act as a group" definition effectively imputes regulatory obligations on persons who have not made any express, implied or even conscious agreement or arrangement to act together, a clear hallmark of section 13(d)(3).

Notwithstanding the clear departure from the statutory text and years of jurisprudence, the practical effect of such an amendment will have significant, negative repercussions. When an activist is considering whether to pursue changes at an issuer – whether they be related to the issuer's strategic direction, response to climate change, labor standards or management compensation – she will often engage with other shareholders and explain her strategy, what changes she would like to make that would benefit shareholders, the issuer and others and try to persuade the other shareholders to support her goals. The current rule would permit her to proceed with this strategy because she and

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63 *Id.* at 13869.
64 *Id.* at 13869-70.
65 15 U.S.C. 78m(d)(3).
66 17 CFR 240.13d-5.

the other shareholders with whom she speaks will not "agree to act together."[67] Although she may only be presenting her strategy and hoping for their support, she must be able to communicate freely with other investors to make her case that change is needed. The revised group definition, however, would discourage this important activity.

The revised definition, where persons who "act as a group" are deemed a group (beyond its definitional circularity), will raise very serious concerns whenever an activist wants to engage with other shareholders because neither the activist nor the other shareholders with whom she engages will want to be deemed to have inadvertently formed a group. As a result, investor communications will suffer and oversight of corporate management will be impeded. The activist will be less likely to meet with other shareholders because, under the revised, vague definition, she will be left questioning whether her actions constitute "acting as a group." She could then be left wondering whether she may have enough shareholder support to pursue her strategy, and, if not, she may abandon it entirely. As a result, the status quo will endure, with the issuer's management and business practices continuing as is and without improvements for the issuer that may accrue to its shareholders and broader market.

Furthermore, the proposed tipper-tippee provision seems to discourage any shareholder with whom the activist engages from buying any shares in the issuer discussed with the activist. This quasi-lock-up period not only discourages other shareholders from meeting with the activist but also, effectively, removes the liquidity these other shareholders may provide to the market in that issuer. Altogether, the Commission's proposed changes will make activism more difficult and deter shareholders from talking to each other, leading to less activism and entrenching management and their business practices.

The Commission is proposing a new paragraph to Rule 13d-6 to avoid chilling shareholder communications or impeding shareholders' engagement with issuers where "those activities are undertaken without the purpose or effect of changing or influencing control of the issuer (and are not made in connection with or as a participant in any transaction having such purpose or effect)."[68] The proposed exemption would be available only if such persons are not directly or indirectly obligated to take such actions.[69]

Again, the addition of "effect" is pernicious. Assume the activist is persuasive, the person with whom she engages votes as the activist desires (and does nothing more in support of the activist) and the shareholder vote affects corporate policy, which is the activist's fundamental goal. It would seem that the person with whom the activist engaged, simply by voting, has acted with the requisite effect. This cannot be what the Commission intends.

We appreciate that the proposed exemption is intended to clarify and avoid chilling shareholders communications with each other and issuers; however, in our view, it only builds upon on the opaqueness of the Commission's revised group definition. For example, several shareholders meet

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67 *Id.* at 13888.
68 *Id.* at 13873.
69 *Id.* at 13874.

to discuss an issuer's climate practices and strategies and how they could be addressed or improved. They adjourn the meeting without any discussion of changing or influencing control of the issuer. In such case, it is clear that the engagement was undertaken without the "purpose" of changing or influencing control of the issuer; however, it is unclear whether such communications might, when viewed subsequently, have had the "effect" of changing or influencing control of the issuer.

Continuing with the above example, one of the shareholders decides within the next week to launch an activist campaign to replace the issuer's management because they have been poor climate stewards. Once this information comes to light, the other shareholders with whom she met may wonder whether their earlier discussion was undertaken with the "effect" of changing or influencing control of the issuer. The other shareholders cannot ascertain, and the activist shareholder may not know, whether their conversation was the tipping point or impetus for the campaign. In short, the "purpose" of the proposed exemption may be not to chill shareholder communications, the "effect" could be to create more confusion regarding when and to what extent one may avail herself of the exemption.

To avoid this uncertainty altogether and the need to carve out an exemption for shareholder communications, the Commission should simply maintain its current "group" definition, including the requirement that there be an agreement to act as a group. The current definition does not: (i) chill shareholder engagement; nor (ii) create the challenge to determine whether a group has indeed been formed or if an exemption may apply; nor (iii) make activist campaigns more difficult to pursue.