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April 11, 2022

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **File No. S7-06-22** – Modernization of Beneficial Ownership Reporting - Release 33-11030; 34-94211

Ladies and Gentlemen:

This letter is submitted as to the proposed modernization of beneficial ownership reporting rules (including Schedules 13D and 13G) ("Proposed Beneficial Ownership Rules") voted on by the Securities and Exchange Commission ("SEC") in February 2022 per Release Nos. 33-11030; 34-94211.(the "Beneficial Ownership Release"). I appreciate this opportunity to comment.

On March 21, 2022, I also submitted a comment letter (the "March Letter," attached as Exhibit 1) on Release 34-93784 (the "Swaps Release") that proposed Rules 9j-1 and 10B-1 ("Proposed Swaps Rules") voted on by the SEC in December 2021. The Proposed Beneficial Ownership Rules and the Proposed Swaps Release overlap as to closely-related "decoupling" issues (collectively, the "Proposed Ownership & Swaps Releases"). I hope that the SEC can consider this and the March Letter together.

I hold the Allan Shivers Chair in the Law of Banking and Finance at the University of Texas Law School and was the inaugural Director of the SEC's Division of Economic and Risk Analysis (2009-2011). My scholarship (SEC service) centers (centered) on the law and finance of capital markets and corporate governance, with a special focus on financial innovation.

Over the past 15 years, I was the lead or sole author of ten academic articles on: (1) the kinds of share ownership disclosure now addressed by both the Beneficial Ownership Release and the Swaps Release; and (2) other disclosure and substantive decoupling issues related to such Releases (such as "empty creditors with negative economic interest" (and other CDS abuses) and "empty voters").

Most directly relevant to the Beneficial Ownership Release, a 2006 law review article was the first to analyze the use of cash-settled equity swaps to try to avoid Schedule 13D disclosure (coining the term "hidden (morphable) ownership" to refer to the phenomenon), to situate this phenomenon in an overarching analytical framework for "decoupling," and to propose associated reforms of Schedules 13D and 13G. The analysis was extended and refined in, among others, two 2008 articles and a 2015 article; in later articles, the analysis was extended to positions in CDS and other debt derivatives.

At the SEC, I also considered "decoupling" issues, including those relating to Sections 13(d) and 13(g). As one example, the July 2010 SEC "Concept Release on the U.S. Proxy System" included a section--"'Empty Voting' and Related 'Decoupling' Issues" (pages 137-150)--that discusses a variety of disclosure and substantive aspects of equity, hybrid, and debt decoupling, and cites the two 2008 articles and used their analytic framework.[1]

A partial listing of my writings on decoupling matters is set out below.[2]

The March Letter applauded the SEC's decision in the Proposed Ownership & Swaps Releases to try to address public disclosure of certain DS, equity, and other derivative positions, substantive CDS abuses, and certain other decoupling-related matters. I expressed appreciation for those Releases citing some of the decoupling articles. However, I also suggested that certain modifications to the rules proposed in those Releases be considered and suggested some ways in which the associated cost-benefit analysis could be enhanced.

In the interests of brevity, this comment letter has a narrower focus, and will avoid simply repeating related portions of the March Letter. This letter focuses on one core question pertinent to both the Beneficial Ownership Release and the Swaps Release: whether "synthetic" share ownership that carry no formal voting rights should be treated symmetrically with traditional share ownership for the purposes of triggering block holder disclosure obligations.

First, as a polestar, such synthetic share ownership and traditional share ownership should be treated symmetrically under block holder disclosure rules. "Hidden (morphable) ownership" involves efforts to avoid disclosure of large equity ownership stakes by a person who obtains economic interest greater than their (formal) voting rights (zero such voting rights, in the case of cash-settled equity swaps) but, in some circumstances, effectively having the ability to "morph" that economic-only ownership to full (economic and voting) ownership of shares at any time. To the extent that the proposed Rule 13d and the proposed Rule 10B-1 treat such synthetic share ownership symmetrically, this is to be commended.

Thc case for using this regulatory symmetry as a polestar with respect to share ownership was introduced in the initial 2006 article and reiterated with additional legal and financial analysis (and

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[1] Exchange Act Release No. 82495, Concept Release on the U.S. Proxy System (July 14, 2010).

[2] The three 2006 articles focused on "equity decoupling." *See* Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) ("Hu & Black,-*Decoupling I*"); Henry T. C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011 (2006); Henry T. C. Hu & Bernard Black, *Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership*, 13 J. CORP. FIN. 343 (2007). Subsequent articles extended the analysis to "debt and hybrid decoupling." *See, e.g.*, Henry T. C. Hu & Jay L. Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321 (2007); Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625 (2008) ("Hu & Black, *Decoupling II (Penn)*"); Henry T. C. Hu & Bernard Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 EUR. FIN. MGMT 663 (2008) ("Hu & Black, *Decoupling II (EFM)*"); Henry T. C. Hu, *Financial Innovation and Governance Mechanisms: The Evolution of Decoupling and Transparency*, 70 BUS. LAW. 347 (2015) ("Hu, *Innovation and Governance*"); Henry T. C. Hu, *Corporate Distress, Credit Default Swaps, and Defaults: Information and Traditional, Contingent, and Empty Creditors*, 12 BROOK. J. OF CORP. FIN. & COM. L. 5 (2018) ("Hu, *CDS Abuses*"). *See also* Henry T. C. Hu, *'Empty Creditors' and the Crisis*, Wall St. J., Apr. 10, 2009, at A13 ("Hu, *Empty Creditors and the Crisis*"); Henry T. C. Hu, *Reform the credit default swap market to rein in abuses*, FIN. TIMES, Feb. 24, 2019 ("Hu, *Reign in CDS Abuses*")

additional actual and possible real world examples) in subsequent articles.[3] Importantly, as was noted from the start, Rule 13d-3(b) has long discouraged the gaming of Schedule 13D by providing that any person who uses any "contract, arrangement, or device" to evade the reporting requirements is nonetheless deemed to be a beneficial owner.

Second, corporate activism, by hedge funds and others, can often be privately and socially valuable but the implications of this for the symmetry polestar may be a bit different from what some activists may suggest. I believe that departures from the symmetry polestar on the sole basis that non-disclosure of synthetic positions would provide more incentives for activism is insufficient. If, *arguendo*, the current ten-day filing window for Schedule 13D (or the proposed five-day filing window for filing Schedule 13D) or the setting of the trigger for Schedule 13D disclosure at 5% do not provide enough incentives for activism (considered from the standpoint of individual firms or society as a whole), such filing dates and trigger levels deserve to be re-visited by the SEC, Congress, and others in a systematic, holistic, way. An essential part of any such analysis would be to properly balance how activism could be promoted through market opacity against how price integrity and level playing field, and other interests could be promoted by market transparency. (Indeed, as the SEC recognized, this balancing issue is a key aspect of the costs and benefits of the Beneficial Ownership Release's proposed move to shorten the initial Schedule 13D filing date from 10 days to five days.) Continuing to allow *ad hoc*, "self-help" avoidance of 13D disclosure by activists who elect to use hidden (morphable) ownership tactics would not necessarily lead to the optimal amount of activism or the proper balancing of the respective benefits of opacity and transparency.

Third, in certain respects, the SEC's Proposed Ownership & Swaps Releases themselves depart from the polestar of symmetry in respect of shareholdings. This needs re-consideration, if not remediation. Disclosures pertaining to cash-settled equity swap positions, the traditional vehicle for the hidden (morphable) ownership strategy, are covered by proposed Rule 10B-1, not by proposed Schedule 13D (apart from the requirements of proposed Item 6 to Schedule 13D, in case the filing of the proposed Schedule 13D is otherwise triggered). Under proposed Rule 10B-1, a cash-settled equity swap holding in the amount of as little as $300 million would trigger reporting. In contrast, under both the existing and proposed Schedule 13D, an equivalent sized traditional shareholding in such a modest amount would, in most corporations, not meet the 5% trigger for disclosure

As another example, proposed Rule 13d contemplates shortening the filing deadline from 10 days to five days and an amendment deadline of one business day after a material change (rather than "promptly" as is the case today). In contrast, Proposed Rule 10B-1 contemplates a very abbreviated filing date: one business day from the time the threshold is exceeded or a material change occurs.

Fourth, the curious architecture of how synthetic share ownership is handled and associated substantive artifacts may need re-consideration. The SEC's departures from the symmetry polestar stem in part from an architecture that flows from Section 766 of the Dodd-Frank Act and in part from the differences in emphasis in the Beneficial Ownership Release and the Swaps Release. At least in the past, the hedging (morphable) ownership strategy to game Schedule 13D generally relied on using cash-settled

[3] These articles include: Hu & Black, *Decoupling I*, *supra* note 2 (2006); Hu & Black, *Decoupling II (Penn)*, *supra* note 2 (2008); Hu & Black, *Decoupling II (EFM), supra* note 2 (2008); Hu, *Innovation and Governance*, *supra* note (2015).

equity swaps. The most straightforward way of observing the symmetry polestar would be to treat both traditional ownership and cash-settled equity swap-based synthetic ownership within a revised Schedule 13D. The considerations associated with beneficial ownership disclosure with respect to both traditional and synthetic ownership are similar.

However, in 2010, Section 766 of the Dodd-Frank Act amended Section 13 of the Securities Exchange of 1934 to provide that, with respect to "security-based swaps"—i.e., a category that includes cash-settled equity swaps—persons will be deemed to have acquired beneficial ownership *only* if the SEC determines by rule "after consultation with the [bank] prudential regulators and the Secretary of the Treasury" that : (a) the swap "provides incidents of ownership comparable to direct ownership of the equity security and (b) the determination is necessary to achive the purpose of Section 13. Faced with the such Section 766 hurdles, the SEC did not try to count holdings of cash-settled equity swaps toward the 5% trigger of proposed Schedule 13D.

Instead, the SEC turned to proposed Rule 10B-1 in order to count cash-settled equity swaps toward a public disclosure obligation of large positions. But Rule 10B-1 may be driven more by a focus on such matters as the demise of Archegos Capital in 2021 than on the usual considerations relating to the beneficial ownership of shares. There is a "two masters" issue, as mentioned in the March Letter.

Consideration should be given to a more straightforward regulatory architecture of including cash-settled equity swap positions towards the trigger for Schedule 13D disclosure if there proves possible to navigate the Section 766 obstacles. If that proves impractical and we are left with proposed Rule 10B-1 and proposed Schedule 13D sharing responsibility in the disclosure of synthetic share positions, there may still be room for moving closer to regulatory symmetry.

Fifth, the cost-benefit analysis as to the Proposed 13D and Proposed Rule 10B-1 could be enhanced. The March Letter offers some ideas, primarily in respect of the Swaps Release as a whole. In respect of the specific matter of disclosure of synthetic ownership of shares, the initial 2006 decoupling article, the two 2008 articles, and the 2015 article (as well as certain of the other decoupling articles that extended consideration to CDS and debt derivatives) offer ideas on costs and benefits as well as actual and possible real world examples. In examples involving litigation, to the extent they are public, sworn testimony and other court records may offer highly granular data. The broader issue of the proposed shortening of the initial Schedule 13D filing date from 10 days to five days deserves fuller cost-benefit analysis as well.

* * *

In sum, the SEC's increased recognition of the importance of public disclosure of such synthetic share ownership stakes is welcome. The particular implementation and the associated cost-benefit analysis do merit additional work.

If I can be helpful in any way to the Commission or the staff, please do not hesitate to contact me. My email is hhu@law.utexas.edu.

Thank you.

Sincerely,

/s/ Henry T. C. Hu

Henry T. C. Hu
Allan Shivers Chair in the Law of Banking and Finance
University of Texas School of Law

Exhibit 1: Marh 21, 2022 Comment Letter
Cc (with Exhibit 1):
The Hon. Gary Gensler, Chair
The Hon. Carolyn A. Crenshaw, Commissioner
The Hon. Allison Herren Lee, Commissioner
The Hon. Hester M. Peirce, Commissioner
Renee Jones, Esq., Director, Division of Corporation Finance
Dr. Jessica Wachter, Director, Division of Economic and Risk Analysis
Dr. Haoxiang Zhu, Director, Division of Trading and Markets
Carol McGee, Esq., Division of Trading and Markets
Nicholas Panos, Esq. Division of Corporation Finance
Valian Afshar, Esq. Division of Corporation Finance

EXHIBIT 1

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BY E-MAIL: RULE-COMMENTS@SEC.GOV

March 21, 2022

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 Positions - Release 34-93784

Ladies and Gentlemen:

This letter is submitted as to proposed Rules 9j-1 and 10B-1 ("Proposed Swaps Rules") voted on by the Securities and Exchange Commission ("SEC") in December 2021 per Release 34-93784 (the "Swaps Release"). I am responding to the invitation for public comment. I appreciate this opportunity. This letter also addresses certain related matters in the proposed changes to Rule 13d ("Proposed 13d Rule") voted on in February 2022 per Release 33-11030 / 34-94211 (the "13d Release"). (Collectively, the "Proposed Rules.")

I hold the Allan Shivers Chair in the Law of Banking and Finance at the University of Texas Law School and was the inaugural Director of the SEC's Division of Economic and Risk Analysis (2009-2011). My scholarship (SEC service) centers (centered) on the law and finance of capital markets and corporate governance, with a special focus on financial innovation.

Over the past 15 years, I was the lead or sole author of ten academic articles on: (1) ownership disclosure gaming targeted by Proposed Rule 10B-1 and Proposed Rule 13d; (2) CDS abuses targeted by Proposed Rules 9j-1 and 10B-1; and (3) other "decoupling"-related issues. The articles were the first to identify and analyze such disclosure gaming, CDS abuses, and related decoupling issues, and to urge the SEC respond. This research situated the issues in its analytic framework for "decoupling." An 2006 articcoined the term "hidden (morphable) ownership" to refer to such disclosure gaming. Articles in 2007-2008 coined the terms "empty creditor" and "empty creditor with negative economic ownership" in their analysis of CDS abuses.

At the SEC, I was also involved on "decoupling" matters. On October 7, 2009, I testified for the SEC before the House Financial Services Committee on derivatives legislation, including its CDS abuse language, and answered questions posed on empty creditors and empty creditors with negative economic interest.[1] (On the same panel, Chairman Gensler, then Chairman of the CFTC, testified for the CFTC on the legislation.)

[1] *Reform of the Over-the-Counter Derivatives Market: Limiting Risk ad Ensuring Fairness*, Hearing before the House Comm. Fin. Serv., 111th Cong. - 1st Sess. (Oct. 7, 2019) at 19-43, 147-156.

In July 2010, the SEC's "Concept Release on the U.S. Proxy System" included a section--"'Empty Voting' and Related 'Decoupling' Issues" (pages 137-150)—that cited two 2008 articles and used their analytic framework for decoupling and associated terminology.[2]

A partial listing of my writings on decoupling matters is set out below.[3]

I applaud the SEC's decision to propose rules to try to address disclosure gaming, CDS abuses, and certain other decoupling-related matters. CDS abuses such as empty creditors with negative economic ownership and, in the United States, hidden (morphable) ownership have gone on too long. This decision is seminal. I much appreciate the Proposed Releases citing certain of the decoupling articles.

I do believe that the SEC should, *first*, re-examine certain elements of Proposed Rule 10B-1 and the subsequently-proposed Proposed Rule 13d in a way that systematically considers these proposed rules as a whole; and, *second*, supplement the cost-benefit analysis set out for both Proposed Rule 10B-1 and Proposed Rule 9j-1 in their respective Releases:

> (1) Such re-examination and possible substantive changes to Proposed Rule 10B-1 and/or Proposed Rule 13d that may result could enhance SEC's efforts not only with respect to disclosure gaming and CDS abuses but other decoupling-related matters. Proposed Rule 10B-1 and Proposed Rule 13d overlap in material ways with respect to disclosure of equity positions. There is a welcome symmetry in how Proposed Rule 10B-1 and Proposed Rule 13d treat "traditional" equity ownership and "synthetic" equity ownership. There are also asymmetries that make much sense: notably, for instance, Proposed Rule 10B-1 (unlike Proposed Rule 13d) has provisions directly calling for disclosure of CDS positions. However, there are certain asymmetries in the disclosure of equity stakes--including as to thresholds and filing deadlines---that deserve systematic scrutiny. (The somewhat-artificial architecture of these two proposed rules taken as a whole—and some of these latter asymmetries--stem from an obscure provision of the Dodd-Frank Act over which the SEC has no control.) The possible substantive changes to such Proposed Rules that may result from such a re-examination may enhance their robustness to court and other challenges on cost-benefit grounds. At the extreme, consideration might even be given to altering the overall architecture if the obstacles posed by that Dodd-Frank provision could be navigated. (*See* "I. Disclosure Symmetry and Asymmetry in Proposed Rules 10B-1 and Proposed Rule 13d" *infra*.)

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[2] Exchange Act Release NO. 82495, Concept Release on the U.S. Proxy System (July 14, 2010).

[3] The three 2006 articles focused on "equity decoupling." *See* Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) ("Hu & Black,-*Decoupling I*"); Henry T. C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011 (2006); Henry T. C. Hu & Bernard Black, *Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership*, 13 J. CORP. FIN. 343 (2007). Subsequent articles extended the analysis to "debt and hybrid decoupling." *See, e.g.*, Henry T. C. Hu & Jay L. Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321 (2007); Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625 (2008) ("Hu & Black, *Decoupling II (Penn)*"); Henry T. C. Hu & Bernard Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 EUR. FIN. MGMT 663 (2008) ("Hu & Black, *Decoupling II (EFM)*"); Henry T. C. Hu, *Financial Innovation and Governance Mechanisms: The Evolution of Decoupling and Transparency*, 70 BUS. LAW. 347 (2015) ("Hu, *Innovation and Governance*"); Henry T. C. Hu, *Corporate Distress, Credit Default Swaps, and Defaults: Information and Traditional, Contingent, and Empty Creditors*, 12 BROOK. J. OF CORP. FIN. & COM. L. 5 (2018) ("Hu, *CDS Abuses*"). *See also* Henry T. C. Hu, *'Empty Creditors' and the Crisis*, Wall St. J., Apr. 10, 2009, at A13 ("Hu, *Empty Creditors and the Crisis*"); Henry T. C. Hu, *Reform the credit default swap market to rein in abuses*, FIN. TIMES, Feb. 24, 2019 ("Hu, *Reign in CDS Abuses*")

(2) The cost-benefit analysis to help justify Proposed Rule 10B-1 and Proposed Rule 9j-1 should be supplemented. This may help address court and other challenges on cost-benefit grounds. *First*, certain important benefits are not identified. For example, on the "debt governance" side, among the key benefits from the Proposed Rules pointed out in the Swaps Release are those associated with empty creditors with negative economic ownership (aka "net short activism"). However, the Swaps Release nowhere mentions the benefits relating to the far more common situation of empty creditors *without* negative economic ownership. As an example on the corporate governance side, the Swaps Release does not consider the benefits from the Proposed Rules relating to empty *voters* with negative economic ownership. *Second*, more real world evidence, including detailed U.S. evidence, is available as to possible examples of the decoupling problems sought to be addressed and should be referred to. (*See* "II. Enhancing the Cost-Benefit Analysis as to the Proposed Rule 9j-1 and Proposed Rule 10B-1" *infra.*)

Thie letter does not address many matters in the Proposed Rules, and my refraining from doing so is not meant to be in any way indicative of my position on such matters.

Given the SEC's general familiarity with the analytical framework for decoupling and associated terminology, I will here only lightly touch on essential aspects that may help clarify this letter.[4] From the standpoint of the decoupling framework, the Proposed Rules focus have the most impact on three matters. *First*, Proposed Rule 10B-1 and Proposed Rule 13d deal with **"hidden (morphable) ownership"**—essentially, efforts to avoid disclosure of large equity ownership stakes by a person who obtains economic interest greater than their (formal) voting rights but, in some circumstances, effectively having the ability to "morph" that economic-only stake to outright ownership of shares at any time.. Historically, this strategy has generally deployed cash-settled equity swaps in efforts to avoid Section 13(d) disclosure. *Second*, Proposed 9j-1 focuses on an extreme type of **"empty creditor"** and other abuses related to credit default swaps ("CDS) (such as "manufactured events"). An **"empty creditor"** is a creditor who holds the control rights that their loan agreements or bond indentures give them even though they may have bought instruments such as CDS to hedge away at least a portion of their economic interest. In extreme cases, creditors may stand to make more money on CDS if a company defaults than they would if it repaid tis debts. These are **"empty creditors with negative economic exposure."** *Third*, there are equity decoupling analogues. An **"empty voter"** is any person whose voting rights substantially exceeds its economic ownership: that is, its votes have been "emptied" of a corresponding economic interest. In extreme cases, the empty voter will be motivated to vote with a view to destroying, not enhancing, shareholder wealth, Such an "**empty voter with negative economic ownership**" situation could occur, for instance, if it held 10,000 shares but either bought a large number of put options on the shares or sold short 15,000 shares.

I, Disclosure Symmetry and Asymmetry in Proposed Rules 10B-1 and Proposed Rule 13d

A. "Traditional" versus "Synthetic" Ownership: A Welcome Symmetry at the 10,000 Foot Level in Both Proposed Rule 10B-1 and Proposed Rule 13d

The classic hidden (morbable) ownership strategy has involved the use of cash-settled equity swaps to try to avoid Section 13(d) disclosure requirements that would be applicable to traditional equity ownership in corresponding size. Given the possible "morphability" of such "synthetic" equity ownership into

[4] For a brief overview of the framework and associated terminology *see* Hu, *Innovation and Governance, supra* note 2, at 350-51, 354-81, 405.

traditional ownership—i.e., if the swap dealer is willing to cooperate with its customer—treating synthetic equity ownership differently from traditional equity ownership makes little sense.

The general case for symmetric treatment is strong. The integrity of the stock market is undermined, important information is not reflected in the share price, and an unlevel playing field is created in circumstances that Section 13(d) would normally address.

Considered at the 10,000 foot level, both Proposed Rule 10B-1 and Proposed Rule 13d take the welcome, important step of moving towards such symmetry in the treatment of traditional and synthetic ownership. In particular, pursuant to Section 10B(d), Proposed Rule 10B-1 would require any person or group that owns as "security-based swap" position exceeding a threshold amount to promptly file a publicly available statement on Schedule 10B. By reason of the "security-based swap" definition (Rule 10B-1(b)(3)), Schedule 10B-1 would require information, for instance, both on positions in cash-settled equity swaps often used in hidden (morphable) ownership strategies as well as on shares that are traditionally held.

Similarly, pursuant to Section 13(d), the subsequently-Proposed Rule 13d contemplates that "beneficial ownership" for the purposes of the 5% disclosure threshold would be extended from traditional equity holdings to include holdings of cash-settled derivative securities held with the purpose or effect of changing or influencing control of the issuer—*other than* holdings of security-based swaps. Thus, ironically, the Proposed 13D Rule does not deal with the classic hidden (morphable) ownership strategy of trying to avoid Section 13(d) through the use of cash-settled equity swaps.

Instead of dealing symmetrically with such cash-settled equity swap-based hidden (morphable) ownership and traditional share ownership directly, within Proposed Rule 13d, the regulatory architecture delegates the task to Proposed Rule 10B-1.

I next turn to how this curious division of labor. This regulatory architecture presumably stems from an obscure provision of the Dodd-Frank Act that will be briefly described.

B. Need for Re-Examination of Some of the Asymmetries Between Proposed Rule 10B-1 and Proposed Rule 13d and Consideration of a More Straightforward Architecture

(1) Overview

In 2010, Section 766 of the Dodd-Frank Act amended Section 13 of the Securities Exchange Act of 1934 to provide that, with respect to "security-based swaps"—i.e.., a category that includes cash-settled equity swaps--persons will be deemed to have acquired beneficial ownership *only if* the Commission determines by rule "after consultation with the [bank] prudential regulators and the Secretary of The Treasury" that: (a) the swap "provides incidents of ownership comparable to direct ownership of the equity security" and (b) the determination is necessary to achieve the purposes of Section 13.

This amendment, especially the "incidents comparable to direct ownership" requirement, makes it difficult to revise Rule 13d-3 to directly comprehend hidden (morphable) ownership through the use of cash-settled equity swaps. Such swaps do not, after all, directly convey voting rights as a formal matter. The amendment also nullified the effect of the 2008 district court opinion in *CSX Corp. v. Children's Investment*

Fund Management (UK), LLP).[5] The district court opinion relied on the "anti-gaming" provisions of Rule 13d to find that the synthetic ownership in the circumstances of the case in effect did count towards the 5%. (The case was appealed, and three years later, a divided court in the Second Circuit rendered its opinion but declined to reach the hidden (moprahble) onwerhship issue at the core of the case and remanded on other grounds.[6])

Proposed Rule 10B-1 is directed at a variety of important purposes that extend well beyond those related to hidden (morphable) ownership. Some of the asymmetries are to be applauded. For instance, Proposed Rule 10B-1 takes the welcome step of directly requiring disclosure of certain CDS positions and Proposed Rule 13d does not.

However, in the area of disclosures relating to equity positions, some of the asymmetries may suffer from a "two masters" problem. Consideration of Rule 10B-1's entire range of purposes may mandate disclosure rules in the equity derivatives area different than would be the case if the sole purpose related to the hidden (morphable) ownership problem. For instance, concerns over the impact of the 2021 collapse of Archegos Captial, its large positions in various companies via security-based swaps, the large losses for major banks, and other matters would drive different rules than if the SEC were concerned solely about cash-settled equity swap-based hidden (morphable) ownership strategies.

The Swaps Release was issued three months before the 13d Release. The SEC should re-examine certain of the asymmetries between the Proposed Rules in the area of equity derivatives Given the integrally-related equity ownership disclosure changes being proposed in the two Releases, such a systematic consideration could be helpful. Harmonization is not an end in and of itself. However, perhaps some changes in one or both of the proposed rules might ensue from such a systematic analysis.

If, whether because of the "two masters" problem or for other reasons, the asymmetries which are troublesome cannot be successfully navigated, perhaps the SEC should at least consider moving to a more straightforward regulatory architecture. If there turn out to be ways of navigating the obstacles posed by Dodd-Frank Section Section 766, the classic cash-settled equity swap-based hidden (morphable) ownership strategy to try to avoid Section 13(d) would be handled within a modified Rule 13d.

(2) Asymmetry as to Thresholds

As with existing Rule 13d, the trigger for beneficia ownership disclosure under Proposed Rule 13d is 5% of a covered class of equity securities.

Proposed Rule 10B-1 casts a far broader net. The reporting threshold amount would be the lesser of two amounts, one of which is focused on notional amounts. As to the latter notional amount threshold, proposed Rule 10B-1(b)(iii) would, roughly speaking, require disclosure if: (a) the gross notional amount of a security-based swap position is at least $300 million; or (b) if such gross notional amount is at least $150 million, the calculation must also include, among other things, the value off all of the underlying equity securities owned by the issuer. Under this notional amount threshold, there is no requirement of a 5% stake.

[5] 562 F. Supp. 2d 511 (S.D.N.Y. 2008). The author was engaged in this matter by Cravath, Swaine & Moore, counsel for CSX Corporation.

[6] See CSX Corp. v. Children's Inv. Fund Mgmt., LLP, 654 F.3d 276 (2 Cir. 2011).

As a result, the use of simple cash-settled equity swaps in circumstances which, either alone or in combination with traditional shareholdings would fall far short of 5% would trigger Schedule 10B disclosure. This would be far different, for instance, the existing Rule 13d were straightforwardly revised to count cash-settled equity swap ownership and traditional ownership in a symmetric way.

(3) Asymmetry as to Filing Dates

Proposed Rule 13d contemplates shortening the filing deadline from 10 days to five days and an amendment deadline of one business day after a material change (rather than "promptly" as is the case today). In proposing the shortening from 10 days to five days, the SEC recognized (as it always has) the need to strike an appropriate balance between, on the one hand, providing adequate disclosures to investors (and the furtherance of manifold other purposes by quick disclosure) and, on the other hand, not unduly burdening activists engaged in change of control transactions (and manifold other disadvantages to quick disclosure).

Proposed Rule 10B-1 contemplates a strikingly abbreviated filing date: one business day from the time the threshold is exceeded or a material change occurs. The result of this is that use of cash settled equity swap positions (with or without traditional share ownership) could sometimes trigger almost immediate public disclosure.

If either the existing 10 day or the proposed five day requirement makes sense for Section 13(d) purposes given the competing considerations, a one business day requirement that would be triggered by the use of such synthetic ownership would not. The one business day requirement set out in Proposed Rule 13B-1 is driven by purposes altogether separate from the purposes of Section 13(d): Archegos is different.

Ii. Enhancing the Cost-Benefit Analysis as to the Proposed Rule 9j-1 and Proposed Rule 10B-1

CDS have many privately and socially valuable uses. There is, however, there is a dark side. These involve, for instance, the CDS abuses addressed substantively by Proposed Rule 9j-1 and the CDS abuses and the systemic risks and other market-wide issues that, both directly and directly, would be affected by the CDS-related disclosure provisions of Proposed Rule 10B-1.

Naturally, the private and social importance of a vital market in CDS and other derivatives will lead to intense scrutiny of new substantive and disclosure requirements, including the possibility of court challenges on cost-benefit grounds. Certain benefits that flow from requirements are not, but I believe should be, included in the cost-benefit analysis supporting these proposed rules. Moreover, more real world evidence suggesting the possibility of decoupling problems could be referred to.

On the "debt governance" side, as one example, one key set of benefits focused on in the Swaps Release are those flowing from how the proposed rules may help with respect to empty creditors with *negative* economic ownership. One of the types of CDS abuses I have written about is a prominent *possible* example involving the hedge fund Aurelius with respect to Windstream Services. No one really knows for sure if it's an *actual* example because of the lack of transparency.

In fact, however, the far more common situation of empty creditors is that of empty creditors who do **not** have negative economic ownership. As discussed in both of the 2008 decoupling articles, there are benefits to transparency even with respect to empty creditors that do *not* have negative economic ownership—i.e., empty creditors that are *not* "net short." Indeed, as perhaps illustrated by the behavior of a major investment bank vis-à-vis American International Group (AIG) at the height of the global financial crisis, the behavior of empty creditors *without* negative economic ownership might depart markedly from traditional, (non-hedged) creditors in circumstances that touch on systemic risk.[7]

On the corporate governance side, as one example, the Swaps Release does not discuss how increased transparency of CDS and other derivatives-related positions could improve governance by shining a light on "empty voting with negative economic ownership" and "empty voting with negative economic interest." In the extreme case, through the purchase of CDS, simple short selling, and other strategies, an investor could literally have the most voting power at a company and yet have an interest in the share price decrease. This type of extreme empty voter would use its voting power not to see that the firm have good directors or make good acquisitisn, but precisely the reverse.

Speaking on the virtues of enhanced transparency in the face of empty voting with negative economic stakes, hidden (morphable) ownership, and other decoupling strategies, Hu and Black, *Decoupling II (Penn)* stated at pages 683-84:

> We discuss the policy factors bearing on the optimal level of shareholder disclosure in [Hu & Black, *Decoupling I]* and do not repeat that analysis here. These requirements are rooted in the belief that investors, as well as society at large, should know who a company's major shareholders are. Investors should also know whether those shareholders are buying and selling and should have an opportunity to respond. From an economic standpoint, share pricing will be more efficient if investors know what major investors are doing and have advance notice of possible changes in control. The integrity of, and confidence in, the stock market will be enhanced. We also identified reasons more directly related to equity decoupling. Disclosure can provide information on the frequency of empty voting and hidden (morphable) ownership. Disclosure may also deter some new vote buying: not everyone will do in the sunshine what they will do in the dark. Moreover, some empty voting strategies may be less effective if disclosed.

The cost-benefit analysis could also be supplemented by additional real world evidence of possible examples of the decoupling that the Proposed Rules try to deal with. For instance, in the district court opinion in the *CSX* case, the judge exhaustively discussed the details of the hedge funds attempt to avoid Section 13(d) disclosure through the use of derivatives.

* * *

I am delighted that the SEC is addressing decoupling issues in the Proposed Releases and elsewhere. The decoupling phenomenon has private and social benefits but also presents complexities for debt governance, corporate governance, market integrity, and systemic risk.

Again, I appreciate the opportunity to comment. I would be happy to discuss any questions the Commissioners or the staff may have. My email is [redacted].

Thank you.

Sincerely,

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[7] A plain English version of this story is set out in Hu, *Empty Creditors and the Crisis*, *supra* note 2.

/s/ Henry T. C. Hu

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