



April 15, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

VIA ELECTRONIC MAIL
rule-comments@sec.gov

Subject: Modernization of Beneficial Ownership Reporting, File No. S7-06-22

Dear Ms. Countryman:

The National Investor Relations Institute (“NIRI”)¹ appreciates the opportunity to provide comments regarding the rule proposal by the Securities and Exchange Commission (“SEC” or “Commission”) to modernize its rules governing beneficial ownership reporting under Section 13 of the Securities Exchange Act of 1934 (“Exchange Act”).²

NIRI has been an advocate for shortening the reporting deadlines and expanding the definition of beneficial ownership under the SEC’s rules for more than a decade, and was an early supporter of a 2011 Petition for Rulemaking to modernize these reporting rules by the law firm of Wachtell, Lipton, Rosen & Katz.³ NIRI also strongly supported the Brokaw Act, legislation introduced by U.S. Senator Tammy Baldwin (D-WI) to amend the SEC’s beneficial ownership reporting rules for the same purposes.⁴

NIRI strongly supports this Proposed Rule and offers the following comments:

¹ Founded in 1969, the National Investor Relations Institute (“NIRI”) is the professional association of corporate officers and investor relations consultants responsible for communication among corporate management, shareholders, securities analysts, and other financial community constituents. The largest professional investor relations association in the world, NIRI’s more than 2,800 members represent over 1,350 publicly held companies with more than \$7 trillion in stock market capitalization.

² Modernization of Beneficial Ownership Reporting, 87 Fed. Reg. 13,846 (Mar. 10, 2022) (hereinafter “Proposed Rule”).

³ Wachtell, Lipton, Rosen & Katz, Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934 (Mar. 7, 2011), available at <https://www.sec.gov/rules/petitions/2011/petn4-624.pdf>.

⁴ S. 1744, 115th Cong. (1st Sess. 2017) (introduced on Aug. 3, 2017), available at <https://www.congress.gov/115/bills/s1744/BILLS-115s1744is.pdf>; and S. 2720, 114th Cong. (2nd Sess. 2016) (introduced on March 17, 2016), available at <https://www.congress.gov/114/bills/s2720/BILLS-114s2720is.pdf>. The Brokaw Act is named after a village in Wisconsin that was harmed by a group of hedge funds that seized control of the Wausau Paper Company in 2011.

1. **Shortening the Schedule 13D and 13G Reporting Windows.** Under current SEC rules, beneficial owners, *i.e.*, “street name” shareholders, acquiring more than 5% of a registered class of an equity security are required to disclose their ownership interest by filing a beneficial ownership interest report on Schedule 13D.⁵ This report is required to be filed with the SEC within 10 days after a beneficial owner crosses the 5% threshold. This 10-day deadline has been in effect and unchanged since 1968.⁶

As a result of technological advances in the financial markets over the past 50 years, the 10-day window has been the subject of mounting criticism for allowing too much time for activist investors to accumulate large positions in U.S. public companies before being required to disclose anything publicly. Acquiring large blocks of shares secretly for such a long period of time allows these investors to trade on asymmetric price information and continue accumulating shares for almost two weeks after the 5% threshold is reached.

This lengthy reporting window disadvantages selling shareholders after the 5% threshold is reached and permits activist investors to ambush public companies, often by disclosing an ownership interest that far exceeds 5% of shares outstanding. These investors typically pressure executives and directors to agree to their short-term demands, which can include board membership, plant closings, workforce reductions, reduced R&D spending, and other concessions that may or may not be in the long-term interests of shareholders, employees, and other stakeholders.

In an April 2020 survey of NIRI members, more than 82% of investor relations practitioners agreed that modernizing the 13D rules would help public companies be better prepared to respond to an activist taking a significant position.

An excellent example of how this antiquated reporting regime is being used today can be found in the recent acquisition of a large block of Twitter shares (ticker: TWTR) by Tesla CEO Elon Musk. According to his SEC filings, Mr. Musk started acquiring Twitter shares on January 31, 2022.⁷ He reached the 5% threshold on March 14, 2022.⁸ However, he was permitted to continue accumulating Twitter shares and avoid public disclosure for another 21 days, announcing the acquisition of 9.2% of Twitter’s equity shares on April 4, 2022.⁹ Based on the “pop” in the stock price once a 13G report was finally filed with the SEC, a Bloomberg reporter

⁵ 17 C.F.R. § 240.13d-1(a).

⁶ See *Proposed Rule* at 13,849.

⁷ See Elon R. Musk, Schedule 13D (Twitter, Inc.), at Schedule I (Apr. 5, 2022) (hereinafter “Musk 13D Filing”). Mr. Musk first filed a Schedule 13G as a passive investor on April 4, 2022. After being offered a board seat by Twitter, he filed a Schedule 13D the next day, on April 5, 2022.

⁸ See Elon R. Musk, Schedule 13G (Twitter, Inc.) (Apr. 4, 2022).

⁹ *Id.*

has calculated that Mr. Musk was able to save about \$143 million by purchasing shares in secret and delaying his filing from March 24 to April 4.¹⁰

According to his Schedule 13D filing, Mr. Musk acquired 73,115,038 shares at an average price per share of approximately \$36 a share over a 43-day period. After his initial Schedule G filing on April 4, Twitter stock soared to almost \$50 per share and provided this investor with more than \$1 billion in paper profits by being able to acquire 9.2% of Twitter shares without any public disclosure.¹¹

The SEC now proposes to shorten the reporting windows to 5 days for both Schedule 13D and Schedule 13G filings. This change would reduce information asymmetry in the price discovery process and provide companies and the public with more timely notice of the acquisition of a 5% share ownership position. This would also ensure that public companies are not ambushed and are better prepared to respond to an activist investor who has accumulated a significant position over a relatively short period of time.

Although the SEC's proposal to shorten the reporting window is a significant improvement, NIRI encourages the Commission to consider a 2-day reporting deadline. Two days would mirror the SEC's Form 4 disclosure requirements for executive stock transactions. These preplanned sales or purchases by executives under Rule 10b5-1 plans should not be treated as information that is more valuable to the marketplace than an investor who has accumulated a 5% position in a company. Disclosure of such a large stake often moves a company's stock price and is a far more important disclosure to investors than many of the Form 4 disclosures, which are often for small share amounts. From a policy perspective, it makes more sense for the SEC to require that both of these disclosures follow the same 2-day reporting window.

2. **Expanding the Definition of Beneficial Ownership.** Under current SEC rules, investors are considered to be beneficial owners of a security if they have voting and/or investment power over such security.¹² The definition of beneficial ownership does not include anyone with a purely economic interest in a security.

Certain derivative instruments, such as cash-settled equity swaps, provide investors with economic exposure to an equity security, but without any formal voting or investment powers. These instruments are used by certain activist investors to acquire significant equity positions in public companies without any public disclosure requirements.

¹⁰ Matt Levine, "Elon Musk Is Active Now," *Bloomberg Opinion*, April 6, 2022, available at <https://www.bloomberg.com/opinion/articles/2022-04-06/elon-musk-is-active-now>.

¹¹ Based on Mr. Musk's 13D filing, the average price paid for his Twitter shares was approximately \$35.89 per share. The closing price for TWTR on April 4 was \$49.97 a share. The difference is \$14.08 per share. With the acquisition of 73,115,038 shares, this results in an estimated paper profit of approximately \$1,029,459,735. See *Musk 13D Filing* at Schedule I.

¹² 17 C.F.R. § 240.13d-3(a).

Under a typical cash-settled equity swap, two parties enter into an agreement that seeks to replicate the positions of a long equity investor in a particular public company.¹³ A swap investor receives all of the benefits of an increase in the stock price, along with cash flows that replicate any dividends paid by the company. Any differences are settled in cash, and the financial institution that is a counterparty to the swap often holds the underlying securities as a hedge against its position. If the swap is unwound, the swap investor is usually able to immediately purchase the underlying securities, thereby rapidly increasing its ownership position and securing beneficial owner voting rights, without having to accumulate shares directly in the equity markets.

The use of equity swaps to separate or “decouple” stock voting rights from an economic ownership interest in a company was thoroughly described and documented in a series of academic articles as far back as 2006 by Henry Hu and Bernard Black.¹⁴ The SEC noted the issue in its 2010 Concept Release on the U.S. Proxy System,¹⁵ and the Commission staff initiated a review of its disclosure requirements for these types of financial instruments in 2010.¹⁶

A very recent example of the use of derivative instruments to delay public disclosure of the acquisition of an equity security can be found in the accumulation of a large block of GoDaddy shares (ticker: GDDY) last fall by multiple funds controlled by Starboard Value LP. According to an SEC filing, Starboard Value started accumulating GoDaddy stock in October of 2021.¹⁷ At regular intervals, stock purchases were converted into forward purchase contracts, which kept the accumulated shares below the 5% threshold until December 14, 2021.¹⁸ Starboard Value then used the 10-day reporting window to accumulate an additional 1.5% of

¹³ The typical counterparties to an equity swap of this type are: (1) an institutional investor, and (2) a large financial institution.

¹⁴ See, e.g., Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. Cal. L. Rev. 811 (2006), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=904004; Henry T.C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 Bus. Law. 1011 (2006), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=887183; Henry T.C. Hu & Bernard Black, *Hedge Funds, Insiders, and Empty Voting: Decoupling of Economic and Voting Ownership in Public Companies*, 13 J. Corp. Fin. 343 (2007), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=874098; Henry T.C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. Pa. L. Rev. 625 (2008), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030721; and Henry T.C. Hu & Bernard Black, *Debt, Equity and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 Eur. Fin. Mgmt. 4 (2008), available at <https://leeds-faculty.colorado.edu/Bhagat/HybridDecouplings.pdf>.

¹⁵ See Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982, at 43,017-43,020 (July 22, 2010) (hereinafter “2010 Concept Release”).

¹⁶ 2010 Concept Release at footnote 328 (“The staff is also working on the separate but related project of reviewing current disclosure requirements relating to holdings of financial instruments, including short sale positions and derivatives positions.”).

¹⁷ See Starboard Value LP, Schedule 13D (GoDaddy Inc.), at Schedule B (Dec. 27, 2021).

¹⁸ *Id.*

GoDaddy stock, reporting 6.5% of outstanding shares in a Schedule 13D filing on December 27, 2021.¹⁹ On December 27, GoDaddy stock closed up by 8.36%.²⁰

To improve market transparency regarding the use of cash-settled derivative instruments, the SEC proposes to “deem” the holder of the instrument the beneficial owner of the referenced equity security if the instrument is held with the “purpose or effect of changing or influencing the control of the issuer.”²¹ Under the SEC’s proposal, a formula would be used to calculate the number of equity securities that a holder of a cash-settled derivative security would be deemed to beneficially own, for purposes of calculating the 5% ownership threshold.

NIRI strongly supports this proposal. If adopted, it would provide additional transparency in the capital markets for large, concentrated cash-settled derivative instruments and accelerate public disclosure of equity positions that exceed a 5% threshold.

3. **Clarifying the Group Formation Rules.** Current SEC rules state that when two or more persons “agree to act together” for the purpose of acquiring equity shares, the group formed shall be deemed to have acquired beneficial ownership together for the purpose of disclosures under Sections 13(d) and (g) of the Securities Exchange Act.²²

In its Proposed Rule, the SEC notes that a plain reading of these Sections of the Exchange Act does not require an “agreement” among the parties as a necessary element of group formation.²³ The SEC proposes to amend current Rule 13d-5 to track the statutory language and specify that when two or more persons “act as a group,” they would be treated as one beneficial owner for purposes of the Section 13 disclosure requirements.²⁴ Under this clarification, compliance with the group formation rules would not depend on whether there is an express or implied agreement among the parties that are acting together.

NIRI supports this clarification as it ensures that Sections 13(d) and (g) are applied as originally intended in the statute.

* * *

NIRI is very appreciative of the SEC’s efforts to modernize its Section 13 beneficial ownership reporting rules. Thank you for the opportunity to present the Institute’s views on this rulemaking and please feel free to contact us if further discussion would be helpful.

¹⁹ *Id.* at 2.

²⁰ Before the 13D filing, GoDaddy stock closed at \$76.00 a share on December 23, 2021. After the 13D filing, GoDaddy stock closed at \$82.35 a share on December 27, 2021.

²¹ *Proposed Rule* at 13,897.

²² 17 C.F.R. § 240.13d-5(b)(1).

²³ *Proposed Rule* at 13,867. Sections 13(d)(3) and 13(g)(3) of the Exchange Act (15 U.S.C. §§ 78m(d)(3) and (g)(3)), state “[w]hen two or more persons act as a ... group ...”.

²⁴ *Proposed Rule* at 13,868.

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Sincerely,

A handwritten signature in black ink, appearing to read "Matt Brusch". The signature is fluid and cursive, with a long horizontal stroke at the end.

Matthew D. Brusch
Interim President and CEO
National Investor Relations Institute

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Allison Herren Lee
The Honorable Carolyn A. Crenshaw
Renee Jones, Director, Division of Corporation Finance