

March 21, 2022

**Submitted Electronically**

Vanessa A. Countryman, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090

Re: Notice of Proposed Rulemaking on the Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition Against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions  
File Number S7-32-10, 87 Fed. Reg. 6652 (Feb. 4, 2022)

Dear Secretary Countryman:

I am a member of the derivatives team at K&L Gates LLP<sup>1</sup> and welcome the opportunity to provide the Securities and Exchange Commission (the “**Commission**”) with comments on the Commission’s proposal to adopt new Rule 10B-1, which would require the position reporting of large security-based swap positions (the “**Proposal**” or the “**Proposed Rule**”).<sup>2</sup> We support the Commission’s goal of detecting fraud and manipulation and appreciate the Commission’s careful review of comments prior to finalizing any rule, specifically where the rule may have unintended negative consequences to the orderly functioning of the current markets.

**I. Background and Summary**

We represent a broad range of market participants who use security-based swaps to hedge securities positions or to gain exposure to hedging and are thereby affected by the

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<sup>1</sup> My comments reflect the views of a group of attorneys in our global financial services derivatives practice, and only those attorneys. The views expressed in this letter do not necessarily reflect the views of our clients, other members of our global financial services derivatives team, nor our colleagues at K&L Gates, LLP (nor the firm itself).

<sup>2</sup> Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, 87 Fed. Reg. 6652 (Feb. 4, 2022) (“**Proposed Rule**”). We refer to position reporting of large security-based swap positions as “**Position Reporting**” in this letter.

Proposal. Given our role in the representation of these diverse and varied market participants, we have observed the market as a whole and are well-positioned to provide comments.

As discussed in detail below, we urge the Commission to reconsider the Proposal in its entirety. First, existing regulations provide the Commission with the data needed to detect fraud and manipulation related to large or concentrated security-based swap positions. Second, existing regulations also properly protect proprietary trading strategies and hedging activities. In contrast, the Proposal would not protect such proprietary information adequately. Moreover, the Proposal may increase systemic risk. The Proposal's reporting requirements are not needed or, at best, are premature because the Proposal relies on limited and undeveloped data. Finally, the Proposed Rule exceeds the mandate of the Section 10B of the Securities Exchange Act of 1934 (the "**Exchange Act**") and if adopted would ultimately result in an impaired market.

## **II. Regulation SBSDR Already Requires Security-Based Swap Position Reporting, Provides the Information Needed to Detect Fraud and Manipulation and Properly Protects Proprietary Information**

The Commission's press release about the Proposals explains that the Commission's goals are to: (1) provide information about the build-up of large positions that could be indicative of potentially fraudulent or manipulative purposes; (2) flag the existence of concentrated positions, which may not be known to all counterparties; and (3) provide advance notice of a potential manufactured credit event or other opportunistic strategy. However, the Proposal misses the mark on all three objectives. The first two objectives are already met by the requirements of 17 CFR 242.900-242.909 ("**Regulation SBSR**"), rendering the Proposal largely unnecessary. The Proposal itself notes that there is no evidence that the third objective, as identified, will be met by the massive public disclosures, as discussed in Section III of this letter.

First, Regulation SBSR currently requires real-time public transaction data reporting to security-based swap data repositories ("**SBSDRs**"). SBSDRs are required to establish and maintain policies and procedures designed to calculate positions for all persons with open security-based swaps for which the SBSDR maintains records. Further, SBSDRs are required to publicly disseminate these reports, which must include any condition flags that include any characteristics that may cause a person to receive a distorted view of the market.<sup>3</sup> By doing so, the SBSDR is able to identify potentially fraudulent or manipulative positions and report such information to the public. In other words, the Proposal duplicates the SBSDRs reporting and creates an unnecessary burden for market participants without a greater corresponding benefit.

Second, the public dissemination of reports by SBSDRs allows SBSDRs to publicly report the presence of concentrated positions. Further, as noted in Commissioner Peirce's dissenting statement, "the fact that a security-based swap dealer holds large, concentrated security-based swap positions in any particular reference entity is unlikely to be breaking news to us or to market

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<sup>3</sup> See 17 C.F.R. § 242.907(a)(4).

participants.”<sup>4</sup> As such, the utility of the public knowing the exact specifications of concentrated positions is questionable compared to the great cost of such massive public disclosures.<sup>5</sup>

Regulation SBSR became effective in late 2021 and we appreciate that the Commission has not had a meaningful opportunity to consider the voluminous data currently reported for the security-based swaps market. Given that security-based swap trade information is currently subject to mandatory reporting, we would respectfully request that the Commission afford itself some time, as noted below, to review the data that is currently reported to assess whether it is necessary to stand-up an entirely different reporting regime to capture the same information. Having multiple sets of transaction data for the same universe of security-based swap transactions also increases the likelihood of operational error in the reporting, creating challenges for the Commission in reconciling multiple reports for the same underlying security-based swap.

Further, many market participants would be sensitive to the publication of their proprietary trading strategies. Such reporting may ultimately cause market participants to exit the security-based swap market or reduce their activities to avoid the reporting threshold. These events would reduce liquidity. Additionally, for market participants who rely on the security-based swap market to engage in risk management practices such as hedging, such market exits would result in a market wide limitations on participants’ risk management practices and create the potential for greater systemic risk as positions are less-hedged than they otherwise would be.

### **III. There is No Evidence that Position Reporting will Provide Useful Data for Opportunistic Strategies, and Position Reporting would Result in Considerable Compliance Costs**

As noted in Section II, the final goal of the Proposal is to provide advance notice of a potential manufactured credit event or other opportunistic strategy. We share the Commission’s concern that opportunistic trading or use by some market participants of a manufactured credit event is potentially harmful to the markets and security-based swap participants. The Proposal, however, “provides no evidence that security-based swap dealers are more likely than other market participants (or, indeed, likely at all) to engage in opportunistic strategies.”<sup>6</sup> Currently, there is no way to determine which types of entities will meet the threshold for Position Reporting. As a result, there is no support for the premise that security-based swap dealers (“**SBSD**”) are more likely to engage in opportunistic strategies. Therefore, Position Reporting would not provide advance notice of opportunistic strategies. Additionally, there is no evidence that the information required by Position Reporting will actually aid the public in identifying opportunistic strategies.<sup>7</sup>

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<sup>4</sup> See Hester M. Peirce, Comm’r, U.S. Sec. & Exch. Comm’n, Dissenting Statement on Proposed Security-Based Swap Rules, (Dec. 15, 2021), <https://www.sec.gov/news/statement/peirce-statement-proposed-security-based-swap-rules-121521>.

<sup>5</sup> Commissioner Peirce noting, “Other firms that need to monitor their positions pursuant to the complicated calculations required under the rule’s thresholds will face significant compliance costs, and any firm that exceeds the thresholds will be forced to disclose information that these firms may have a legitimate interest in keeping confidential. I cannot support a proposed rule that would produce so little at such great cost.” *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Former Commissioner Roisman agrees: “I question seeking public comment on a proposal that provides for public reporting of a significant amount of information on positions in both swaps and underlying or

While a laudable goal, the possibility of advance notice of a manufactured credit event is too remote and unknown to create a new reporting regime on the entire industry. As Commissioner Peirce stated, “given the information the Commission currently has available to it, it is entirely possible that this new disclosure regime will result primarily in continuously updated reports of positions held by security-based swap dealers.”<sup>8</sup> We agree.

Further, the Position Reporting requirements will result in significant compliance costs both for reporting parties and for other firms that need to monitor their positions. First, market participants would need to perform complex analyses daily to determine whether their positions would exceed the reporting threshold, an already complex requirement. Simultaneously, market participants would need to track underlying and related securities in the context of changing positions and market prices. Such compliance would require significant cost, with no evidence that such reporting would meet the Proposal’s purpose. For market participants that engage outside investment managers, it is the manager that determines whether to affect a security-based swap and as such, the market participant who would be responsible for submitting the reports is dependent on the manager for the information necessary to complete the report. In our experience representing market participants, managers are unlikely to provide the market participant with the required data in a timely manner. Additionally, the Proposal’s one business day timing requirement for Position Reporting will significantly increase compliance costs for market participants.

It is important to note that swap dealers began reporting security-based swaps trades in February 2022 and market participants are not required to report data regarding historical security-based swaps until April 14, 2022. As a result, there no comprehensive or reliable security-based swap market data. In short, the Proposal is based on limited and undeveloped data. As former Commissioner Roisman noted, “the more prudent approach would be to analyze this new data [from SBSDR reporting] in the first instance and use that analysis to inform our proposal. Such an approach would put us in a position to craft a rule that we are confident is calibrated to achieve its stated goals and also enable commenters to respond to the data and help further inform us.” Further, the Commission’s proposed approach to “consider this newly available data in determining thresholds to use in connection with Security-Based Swap Positions based on equity securities when adopting a final rule” without first providing a period for public comment on the threshold seems to suggest that the current thresholds lack sufficient economic justification.<sup>9</sup>

Without knowing which entities will be required to report information as large trader, there is no evidence that SBSDs are more likely to engage in opportunistic strategies and that these significant and burdensome reporting requirements will result in providing the public advance

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related securities, involves complex threshold calculations (particularly for equity security-based swaps), and imposes a one-day reporting timeframe, without having a better sense of whether our proposed approach is fit for this purpose.” See Elad L. Roisman, Comm’r, U.S. Sec. & Exch. Comm’n, Dissenting Statement on Proposed Security-Based Swaps Rules, (Dec. 15, 2021), <https://www.sec.gov/news/statement/roisman-sbs-20211215>.

<sup>8</sup> See Peirce, *supra* note 6.

<sup>9</sup> See Proposed Rule at 6671.

notice of opportunistic strategies. Instead, it is likely that such requirements will chill legitimate market activity, including both dealer and buy-side activity.

#### **IV. The Proposed Reporting Exceeds the Mandate of Section 10B(d) of the Exchange Act and May Damage Market Activity**

The Proposal requires the reporting of other securities, which goes beyond the mandate of Section 10B(d) of the Exchange Act. Specifically, Section 10B(d) permits the Commission to require certain information regarding positions of security-based swaps. The Proposal, however, ultimately would require the reporting of securities other than security-based swaps, thereby exceeding the mandate of Section 10B(d). For instance, the proposed notional-based reporting thresholds will require firms to report large security-based swap positions along with their positions in any underlying or related securities.<sup>10</sup> By doing so, the Proposal exceeds the mandate of the Exchange Act, which only affords the Commission jurisdiction over security-based swaps reporting. We also would note that there are ample existing regulations that make unlawful manipulative or fraudulent security-based swap transactions.

Further, the Proposal would require disclosure regarding “ownership of any other instrument relating to the Security-Based Swap Position.” There is no evidence to suggest that such disclosure on attenuated instruments or securities would further the Proposal’s objectives. Beyond the mandate of Section 10B(d), the required disclosure would compromise the confidentiality of potentially unrelated trading activities, significantly increase the cost of reporting, and reduce the quality of the reported data, in the aggregate, for use by the Commission.

Second, large scale public disclosures of the kind sought by the Proposal could have the unintended consequence of damaging market activity that harms market participants,<sup>11</sup> as noted by the Commission itself in its proposed amendments to Form 13F. Specifically, the Commission found that large scale public reports of similar style and size to the Proposed Rule have resulted “in behavior that is damaging...such as front running or copycatting...”<sup>12</sup> Indeed, after hedge funds began filing Form 13F, there was a drop in fund performance, which could not be explained by alternative explanations like decreased returns to scale or mean reversion.<sup>13</sup> Such damaging activity would be further amplified by the Proposed Rule due to the inclusion of T+1 data. In the Proposed Rule, the Commission itself highlights that Position Reporting would facilitate market participants’ ability to cross-reference data reported on Schedule 10B. Such increased

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<sup>10</sup> Proposed Rule at 6657.

<sup>11</sup> See, e.g., Susan E.K. Christoffersen, Erfan Danesh, & David Musto, *Why Do Institutions Delay Their Shareholdings? Evidence from Form 13F*, (Working Paper, June 11, 2018), [https://www.bwl.uni-mannheim.de/media/Lehrstuehle/bwl/Area\\_Finance/Finance\\_Area\\_Seminar/HWS2018/Christoffersen\\_Paper.pdf](https://www.bwl.uni-mannheim.de/media/Lehrstuehle/bwl/Area_Finance/Finance_Area_Seminar/HWS2018/Christoffersen_Paper.pdf); see also Mary Margaret Frank, et al., *Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry*, 47 J. L. & Econ. 515 (2004).

<sup>12</sup> SEC, Proposed rule, Reporting Threshold for Institutional Investment Managers, [85 Fed. Reg. 46016, 46022](https://www.federalregister.gov/documents/2020/07/31/proposed-rule-reporting-threshold-for-institutional-investment-managers) (July 31, 2020).

<sup>13</sup> Shi, Zhen, *The Impact of Portfolio Disclosure on Hedge Fund Performance*, WFA 2012 Las Vegas Meetings Paper (2012) available at <https://ssrn.com/abstract=1573151>.

capabilities will likely increase market participant's ability to engage in copycatting, front running or other disruptive market activity.<sup>14</sup>

V. **Conclusion**

We support the SEC's ultimate goal of detecting fraud and manipulation to maintain sound markets. We, however, implore the Commission to balance carefully the benefits of the Proposal's reporting requirements against the great costs of such requirements to market participants and to the markets more broadly.

We appreciate the opportunity to comment on the Proposal and would be pleased to meet with the Commission and Staff to discuss our comments. Please do not hesitate to contact me if you have any questions.

Best regards,



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<sup>14</sup> Proposed Rule at 6688.