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Via Electronic Mail

March 21, 2022

Vanessa A. Countryman
Secretary
U.S. 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 Swap Positions; Release No. 34-93784

Dear Secretary Countryman:

Elliott Investment Management L.P. (“Elliott”) submits this letter in response to proposed Rule 10B-1 (the “Proposed Rule”) relating to position reporting of “large” security-based swap positions, which was published in the Federal Register as part of the Commission’s Release No. 34-93784 on February 4, 2022 (the “Release”).

1. Background and summary.

Elliott is a leading multi-strategy investment advisor and one of the oldest firms of its kind under continuous management. Elliott invests in a wide range of areas in order to protect and grow the assets of our investors, which include 101 educational endowments, more than 180 foundations, and more than 100 private and public pension plans, among others, who are often advised by their own dedicated advisors. Elliott’s activist investments in public equities have become one of our most significant and impactful efforts, resulting over the past decade in more than 140 disclosed engagements with public companies, and more in which our dialogue with the company remained private.

Activism plays a critical role in the health of the U.S. capital markets by helping ensure alignment between shareholders and boards of directors. The role of activists has become more important over time as the rise of passive ownership has diminished the few remaining checks and balances on public companies. As currently framed, the Proposed Rule poses a direct threat to activism and risks undoing the progress activists have made in holding corporations more accountable and catalyzing healthy debate in all sectors of the market. These dynamics lead to changes that improve performance and benefit investors and the U.S. market generally. The Proposed Rule would shortsightedly extinguish one of the last sources of independent criticism

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of public companies and fortify the entrenchment of corporate boards and management, especially of poorly performing companies.

Like many of our peer firms, we use cash-settled security-based swaps (“SBS”) in structuring our positions and executing our trading.¹ These strategies are sophisticated, proprietary, and designed to provide our investors with competitive risk-managed returns earned from opportunities that we identify in the market. By their terms, cash-settled SBS convey no voting power in or beneficial ownership of the underlying securities, but they allow an activist to build a position in a company in an economically efficient manner while it develops and assesses its thesis that a company is not serving its shareholders correctly and has a path to being a stronger company. Purchasing cash-settled SBS permits activists (as well as other investors) to invest in the economic performance of a company without some of the costs and disclosure obligations of investing in stock, but also without any of the powers or legal protections of a shareholder, including most importantly, the power to exercise the voting rights associated with the shares. This is a rational and efficient tradeoff—no voting or ownership rights and accordingly less cost and no disclosure obligation.

Cash-settled SBS—including total return swaps and credit default swaps—are well-established in the market, having existed for decades. Contrary to how they are portrayed in the Release, they have historically been regarded as valid tools that contribute to market efficiency and liquidity, not as “rogue” instruments that inherently pose risks to the markets. Activist investors, such as Elliott, are not required to report publicly their cash-settled SBS position unless and until they are obligated to report a long position in the underlying common stock on Schedule 13D or in a proxy statement. The balanced timing of this disclosure means that activists can build a position without having other investors move into the stock at the outset of a strategy simply based on the expectation that the activist will successfully implement change at the company. If other investors “herd” into a stock on the heels of premature disclosure of an activist’s position, then the price will rise, and the activist will not be able to fully establish its position before it becomes too expensive to pursue. Further, premature disclosure of an activist’s cash-settled SBS position will invite companies to adopt pre-emptive anti-shareholder governance measures before the activist’s strategy and arguments are known to the market, and before the activist has had the opportunity to engage with the company.

The Proposed Rule would thus enable, and provoke, both herding by investors and pre-emptive measures by companies. As a consequence, the Commission would effectively disincentivize and muzzle activists, who remain one of the few independent voices in the marketplace to protect shareholder interests and enhance market efficiency. Based on our more than 40 years of experience as a public-markets investor, we are confident that the Proposed Rule’s new and sweeping regime would undermine the efficient operation of the capital markets, entrench management, and insulate boards from accountability to shareholders. We do not believe that these consequences are intended by the Proposed Rule or are results the Commission, as the protector of all investors, should countenance.

Further, the Proposed Rule’s provisions requiring public disclosure of an activist’s valuable, proprietary cash-settled SBS positions and trading strategies—including disclosure of

¹ References in these comments to “cash-settled SBS” are to products that are defined by the Commission as security-based swaps under Section 3(a)(68)(A) of the Securities Exchange Act of 1934 (the “Exchange Act”) that settle by payment of cash in an amount determined pursuant to the terms of the transaction, and not by delivery of the underlying reference security (which is a type of instrument often called a “physical swap”).

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the subject of its strategy, the core proprietary information at this stage of the process—would conflict with the strong federal and state protection afforded to trade secrets. It would in fact constitute an uncompensated taking under the Fifth Amendment of the U.S. Constitution.

The Commission claims the Proposed Rule will help combat fraud and manipulation or remedy information asymmetry in the markets, but the Commission offers no evidence to support this claim. It also fails to show that the Proposed Rule would address even the limited purported examples it cites. Instead, the Commission cites isolated recent events involving behavior that can be addressed by powerful tools the Commission *already* possesses. In short, the Commission has failed to produce any evidence, or meaningful economic analysis, to support such fundamental changes to the functioning of the capital markets and the relationship between companies and their shareholders.

Rather than serving the Commission's purported objectives of deterring fraud and misrepresentations and enhancing transparency, the Proposed Rule would broadly impinge on legitimate and well-accepted market practices, which have developed in reliance upon longstanding Commission positions. The Proposed Rule also would further tilt the playing field in favor of those in the boardrooms and result in a reduction of efficiency and competition in the capital markets without enhancing investor protection. We therefore respectfully urge the Commission to abandon the Proposed Rule. Alternatively, the Commission should, at a minimum, eliminate the Proposed Rule's public-disclosure provisions and instead rely upon confidential submission of the data regarding cash-settled SBS sought under the Proposed Rule, with safeguards protecting the confidentiality of this proprietary data (to the extent the Commission is not already receiving this data under its recently implemented Regulation SBSR²).

Our analysis following this Section 1 is organized as follows:

2. The Proposed Rule would disincentivize activism, diminish market efficiency, and be anti-competitive.
3. The Proposed Rule would contravene federal and state policy protecting trade secrets and constitute an uncompensated taking under the Fifth Amendment.
4. The Proposed Rule is not a tailored or appropriate means of addressing the Commission's justifications for its intrusive cash-settled SBS disclosure proposal.
5. The Commission lacks statutory authority to compel the disclosure required by the Proposed Rule, and the Commission does not meaningfully consider alternative approaches or provide an adequate cost-benefit analysis as required by law.

² The Commission has not yet had the opportunity to meaningfully evaluate data submitted under Regulation SBSR, which first came into effect on November 8, 2021. *See infra* notes 47–48 and accompanying text (noting that the Commission should evaluate whether the new Regulation SBSR reporting program sufficiently addresses its concerns before proposing and implementing the Proposed Rule).

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6. The Proposed Rule departs from the Commission's longstanding practice of protecting the confidentiality of specific transactions from public disclosure, without acknowledgment of, or reasoned justification for, the change in course.
7. The Proposed Rule's objectives with respect to credit default swaps, as with other cash-settled SBS, are not supported by empirical data demonstrating the need for the public reporting that would be mandated by the Proposed Rule.

We also submit for the Commission's consideration two expert analyses regarding the Proposed Rule's shortcomings:

Exhibit A is a report from NERA Economic Consulting (the "NERA Report"), focusing on the value inherent in proprietary trading strategies such as those used by activist investors. As the NERA Report explains, activists' strategies are of significant value, and the Proposed Rule would destroy that value by making it difficult or impossible to execute such strategies, despite their broad benefits to the market.

Exhibit B is a report from Professor Craig M. Lewis (the "Lewis Report"), the Madison S. Wigginton Professor of Finance at Vanderbilt University's Owen Graduate School of Management and a former SEC Chief Economist and Director of the Division of Economic and Risk Analysis. The Lewis Report focuses on the economic analysis and discussion of efficiency, competition, and capital formation contained in the Release. The Lewis Report identifies fundamental flaws in the Commission's assessment of the Proposed Rule on these topics.

The evidence and analysis contained in these reports strongly counsel against the position the Commission has proposed to adopt. We urge the Commission to consider this evidence—as well as the materials submitted by other commenters—and reconsider the Proposed Rule in light of the costs it will impose on investors and on the markets.

2. The Proposed Rule would disincentivize activism, diminish market efficiency, and be anti-competitive.

A wide body of academic literature supports the view that "activist interventions create long-term shareholder value" and that these benefits accrue to all public-market shareholders.³ Activist investors play an essential role in the public markets by providing a check on underperforming, unresponsive or entrenched corporate management and boards in ways that

³ See, e.g., Edward P. Swanson et al., *Are All Activists Created Equal? The Effect of Interventions by Hedge Funds and Other Private Activists on Long-term Shareholder Value*, J. Corp. Fin. (forthcoming) (manuscript at 4–7), <https://ssrn.com/abstract=3984520> (finding extensive evidence that activist interventions create long-term shareholder value, including that the short- and long-window abnormal returns of hedge fund activist interventions are positive and economically significant and that cumulative abnormal returns are greater than the announcement return); see also Alon Brav et al., *Hedge Fund Activism, Corporate Finance, and Firm Performance*, 63 J. Fin. 1729, 1730–31 (2008) ("[w]e find that the positive returns at the announcement are not reversed over time, as there is no evidence of a negative abnormal drift during the 1-year period subsequent to the announcement"); Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge-Fund Activism*, 115 Colum. L. Rev. 1085, 1100, 1117 (2015) (finding "no evidence supporting concerns that activist interventions are followed by short-term gains that come at the expense of subsequent long-term declines in operating performance," based on data covering five years following the activist intervention); Matthew Denes et al., *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. Corp. Fin. 405, 410 (2017) (summarizing data demonstrating abnormal positive returns from activism, measured across a 36-month period).

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passive investors (such as index funds) cannot.⁴ The U.S. capital markets are more vibrant and dynamic than others because companies in the U.S. can be held to account by activists, who are often the only shareholders who have the resources and incentive to make themselves heard by management and cause positive change.⁵

Like other market participants, shareholder activists have the ability to purchase cash-settled SBS. In our activist investments, as well as our non-activist investments, our firm frequently acquires cash-settled SBS as part of the overall mix of securities in a given position. This approach allows us to buy a portion of our position and gain economic exposure without triggering the kind of “herding” behavior that often accompanies public disclosure, and without notifying the company before our ideas have fully matured. The Proposed Rule will eliminate that approach. Instead, the new disclosure regime contemplated by the Proposed Rule gives activist investors three potential paths: (1) purchasing cash-settled SBS up to the new (and very low) reporting threshold, or triggering a filing that would significantly limit the prospect of a sufficiently profitable investment (with concomitant loss of confidentiality, and thus of intellectual property) far earlier than is currently the case, (2) acquiring common stock and triggering a notification under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 at what, for most public companies, is a *de minimis* level of ownership,⁶ or (3) deciding to stop pursuing activist opportunities entirely.

By forcing investors to choose one of these paths, the new disclosure regime will have a perverse chilling effect on exactly the kind of engagement with companies that is most likely to create value for all shareholders and the U.S. market generally. If an activist with a successful track record of creating sustainable value is forced to make a public disclosure prematurely, then “herding” behavior by new entrants into the stock may make the securities too expensive, preventing an economically worthwhile position from being built and thereby pricing the activist out of the investment.⁷ It is frequently the case that when a well-known activist firm such as

⁴ Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Colum. L. Rev. 2029, 2135 (2019) (“Hedge fund managers closely follow the particular business circumstances of [portfolio] companies and identify ways to remedy underperformance. . . . [I]ndex fund stewardship cannot substitute for hedge fund activism, and especially not with respect to remedying the underperformance of portfolio companies.”).

⁵ See, e.g., Marco Becht et al., *Returns to Hedge Fund Activism: An International Study*, 30 Rev. Fin. Stud. 2933, 2938–40 (2017) (showing high incidence of activism in the U.S. as compared to the rest of the world). As we discuss further below, many individual and small institutional shareholders simply cannot get the attention of company management. Many large institutional shareholders are unwilling to criticize company management because they have intertwined business relationships that they do not want to put at risk. In addition, the rise of index investing has generated a significant increase in the amount of equities held by funds that hold solely to track a specific index, and thus have no authority to engage in efforts to improve the governance or performance of the underlying companies they hold. Other large institutional investors simply remain passive as a matter of policy or preference and hope that improvements will come in the subject company, and often a given company’s non-performance is not as urgent for them because that particular investment is part of a much broader portfolio and is diluted. Activists, then, are among the very few independent voices in the marketplace with the ability to effect meaningful change at underperforming companies.

⁶ The current threshold at which the HSR filing is triggered is \$101 million as of February 2022.

⁷ For discussion of herding and diminished returns in the context of mutual funds disclosing positions, as recently cited by the Commission in its proposed release on beneficial ownership reporting (the 13(d) Proposing Release, 87 Fed. Reg. 13846 (Mar. 10, 2022)), see Mary Margaret Frank et al., *Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry*, 47 J. Law & Econ. 515 (2004) and Vikas Agarwal et al., *Mandatory Portfolio Disclosure, Stock Liquidity, and Mutual Fund Performance*, 70 J. of Fin.

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Elliott is publicly disclosed as having an investment in a company, that company's stock price increases, often rapidly and significantly, on the expectation that the company's performance and shareholder value will improve. Thus, it is not merely a theoretical risk that shareholders may buy stock based on the disclosure that an activist firm is in the stock. In some cases, moreover, under the Proposed Rule, such early disclosure of an activist's cash-settled SBS position may lead to a misunderstanding as to the activist's then-inchoate intentions.⁸ These changes in trading behavior by others in the market would likely result in distorted market prices for the securities. The Proposed Rule would also incent others to enter the stock at an early stage in the investment and impair the ability of the activist to effect its strategy. It would also facilitate a variant of front-running, where the company that is the focus of an activist's campaign learns of the activist's intent prior to disclosure to the company by the activist. The company then preemptively takes limited steps that, while falling far short of the activist's recommendations, cosmetically allow the company to claim it is acting proactively to enhance shareholder value. By thus enabling entrenchment by boards and management, the Commission will actually encourage investor behavior that is based on assumptions and incomplete information and inject confusion into the marketplace.

Further, disclosure of the activist's cash-settled SBS position would give management and boards the ability to utilize entrenchment mechanisms—such as adopting poison pills and other negative anti-shareholder governance steps—that will make it impossible for an activist to push for meaningful change effectively.⁹ By singling out activist strategies for disclosure, the Commission will therefore be inviting a proliferation of defensive governance reactions that are not in the interests of shareholders and the market, but rather will further entrench incumbent management and boards.

In short, we believe the Proposed Rule, if adopted, would severely constrain activism and impair the ability of activist investors to catalyze positive change at companies. Although the management and boards of certain public companies, as well as their advisors, may view this as a welcome development,¹⁰ the impairment of competition in the U.S. will lower the standard of corporate governance and diminish investment returns for U.S. investors, and thus will harm shareholders and the U.S. economy as a whole. This outcome would be contrary to the Commission's obligation not to adopt a rule that would impose a burden on competition that is

2733 (2015). See also John C. Heater et al., *Does Mandatory Short Selling Disclosure Lead to Investor Herding Behavior?* (Dec. 21, 2021) (unpublished manuscript), <https://ssrn.com/abstract=3923046> (describing herding behavior following disclosure of large short positions).

⁸ A different form of herding behavior was recently evidenced in meme stock trading episodes (such as Gamestop, AMC and Hertz). Instead of evidencing a desire to emulate the trading strategy of a known activist based on an expectation of long-term gains that activism historically achieves, these scenarios involve different motivations that we understand the Commission and other observers are still endeavoring to comprehend, but found troubling to the extent they were not based on a fundamental value analysis.

⁹ See Andrew E. Nagel et al., *The Williams Act: A Truly "Modern" Assessment*, Harvard Law School Forum on Corporate Governance at Section II.A (Oct. 22, 2011), <https://corpgov.law.harvard.edu/wp-content/uploads/2011/10/The-Williams-Act-A-Truly-Modern-Assessment.pdf>.

¹⁰ This early alert provision is welcomed by the issuer community because it would provide earlier notification to issuers of entities that hold their stock. See, e.g., Tom Zanki, *3 Issues to Watch as SEC Revisits Activist Disclosures*, Law360 (Feb. 25, 2022, 8:41 PM), <https://www.law360.com/articles/1468292/>.

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not necessary or appropriate in furtherance of the purposes of the Exchange Act.¹¹ The Commission neither acknowledges nor justifies the anti-competitive impact of the Proposed Rule in the Release.

We are surprised and disappointed that the Commission, charged with the protection of investors, is considering a rule that clearly will impair the ability of activists to spark healthy debate and instead will have the effect of further insulating management and boards from criticism.

We are well aware of opinions—often expressed by parties representing the interests of management and boards—claiming that activism does not benefit markets and shareholders.¹² As discussed above, we believe the benefits of activism are well established, but our point in noting this divergence of views is that the Commission should not in effect choose a side in this debate, which we believe the Proposed Rule effectively does. Certain companies, and their management and boards, may in fact support that outcome, but that is not an appropriate justification for the Proposed Rule, nor would such an outcome be consistent with the Commission's obligation to maintain neutrality in exercising its authority under the Exchange Act.¹³ We want to be clear: this proposed rule is in no way neutral and is in fact exactly what certain issuers and their advisors have for some time been advocating to insulate themselves from criticism and change.

Such a change in the Commission's position could not come at a worse time. For structural reasons, activist investors today play an even more important role in providing accountability and creating value than they did in the past. The shareholder base at most S&P 500 public companies has become increasingly concentrated in a small number of index funds, which invest in securities based on their weighting in an index and not based on the analysis of individual companies.¹⁴ As a result, it is increasingly difficult for any individual shareholder—

¹¹ Securities Exchange Act of 1934 § 23(a)(2), 15 U.S.C. § 78w(a)(2).

¹² See, e.g., public client memos from Wachtell, Lipton, Rosen & Katz, dated Mar. 11, 2021 (“The SEC Should Address the Risk of Activist ‘Lightning Strikes’”), <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27398.21.pdf>, Mar. 31, 2020 (“Activists Will Show Their True Colors in COVID-19 Pandemic”), <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.26886.20.pdf>, and Mar. 25, 2020 (“The Crisis and the Activists and the Raiders”), <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.26868.20.pdf>; see also Leo E. Strine Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and our Strange Corporate Governance System*, 126 Yale L.J. 1870 (2017); John C. Coffee & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. Corp. L. 545 (2016); Aspen Inst., *Overcoming Short-Termism: A Call for a More Responsible Approach to Investment and Business Management* (Sept. 9, 2009), https://www.aspeninstitute.org/wp-content/uploads/files/content/docs/pubs/overcome_short_state0909_o.pdf.

¹³ See, e.g., H.R. Rep. No. 1711, at 4 (1968); S. Rep. No 550, at 3 (1968) (noting Congress's intention, in adopting the original Section 13(d) legislation, to avoid “tipping the balance of regulation either in favor of management or in favor of the person [potentially] making the takeover bid,” but instead to “provid[e] the offeror and management equal opportunity to fairly present their case”).

¹⁴ Swanson et al., *supra* note 3 at 2088 (“[T]he Big Three [(State Street, Blackrock and Vanguard)] engage with only a small minority of their portfolio companies, and have multiple engagements in a given year with an even smaller minority of companies in their portfolios.”) and 2095 (“[I]n the vast majority of companies in which a hedge fund activist is not agitating for change, the Big Three pay little attention to whether a company suffers from financial or business underperformance that might call for ‘fixing the management.’”).

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even a relatively large one—to have a meaningful impact on the strategy or direction of any given company.

By contrast, we and other activists have the independence, resources, and incentive to catalyze a discussion that can cause management and boards to take a fresh look at their companies' strategy or governance and set them on a different course.¹⁵ That discussion often includes a company's management and the board, but it also includes the index funds, the analyst community, the views of proxy advisory firms, and the broader shareholder base—because the goal of activists and of each of these cohorts of investors is to achieve long-term gains in the company's performance. The activist point of view may or may not prevail in any given instance, but it prompts substantive debate that is valuable to the market. Activist engagement with companies has resulted in lasting change, creating shareholder value and enhancing governance at the board level by reducing board tenure, increasing diversity, advocating ESG principles, and eliminating outdated devices designed to entrench management. Sometimes our ideas are rejected, and that, as a systemic matter, is fine because it demonstrates that we must have compelling ideas to be heard. Activism has played a key role in increasing the focus and pressure on companies to improve their governance practices, and we believe that activism's role will continue to be critical going forward.¹⁶

Finally, the oft-repeated shibboleth of corporate management, directors and their advisors, who apparently seek immunity from criticism, is that activists gain positions in a company's stock through cash-settled SBS in a secretive and somehow abusive way. This should be put to rest once and for all as self-interested myth. The concern about secrecy seems to underlie the Proposed Rule, which is why we address it. Because an activist entering into cash-settled SBS obtains no voting power and no beneficial ownership of stock in any way, it cannot direct the acquisition or sale of stock at all. There is no secret amassing of a position capable of exerting control over the company and no secret attack in the making.¹⁷ The reason the accumulation of cash-settled SBS is called "secretive" is because that is what certain corporations call it. They do so to conjure stigma because they want to change the rules so they

¹⁵ See, e.g., Nagel et al., *supra* note 9 at 8 ("Engaged investors seek influence, not control, and they add value to companies for the benefit of all shareholders . . .").

¹⁶ See, e.g., Brav et al., *supra* note 3, and Bebchuk et al., *supra* note 3 (both summarizing research demonstrating that hedge fund activists bring about an overall improvement in target firms' performance).

¹⁷ Elliott (and other activists) are well aware of the Commission's long-standing interpretive position that if the long party to a cash-settled SBS, as part of that transaction, obtains the ability to direct the structure and scope of hedging entered into by the short party, and/or the voting of any stock that the short party will hold to hedge its exposure, then the long party may possess beneficial ownership of the short party's hedge position for purposes of Section 13(d) of the Exchange Act. Beneficial Ownership Reporting Requirements and Security-Based Swaps, Release No. 34-64628 (June 8, 2011); Sec. Exch. Comm'n, Commission Guidance on the Application of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rules Thereunder to Trading in Security Futures Products (June 27, 2002). As is standard in the SBS market, Elliott expressly provides in its cash-settled SBS documentation that it has no such rights. See, e.g., International Swaps and Derivatives Association, Inc., 2002 Equity Derivatives Definitions, Section 13.2 "Agreements and Acknowledgements regarding Hedging Activities," which, if incorporated into the confirmation evidencing a SBS transaction, constitutes an acknowledgement by both parties that the long party (in this case, Elliott) has no ability to dictate whether the short party hedges its exposure to the SBS transaction, and if such hedging does occur, the long party has no beneficial or other interest in the stock comprising that hedge, nor any ability to direct the voting of such stock. This provision is included in all cash-settled SBS transactions to which Elliott is a party, along with additional contractual provisions to further support that conclusion. And, of course, it is the short party's decision—not Elliott's—whether it wants to acquire stock to hedge the exposure at all.

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can know the first minute an activist is even interested in their company. Then, they and their advisors can adopt defensive governance measures or adopt other “half-measures” that will insulate their management and board from shareholder-inspired criticism and change in the company. Innumerable types and thresholds of investments are not publicly disclosed—yet they are not called “secretive”—because there is no group with an agenda to call it so, as there is here.

Activists may accumulate cash-settled SBS or not, and they may accumulate stock as and when they see fit to become activist in the stock. Activists, like any other investor, are permitted to acquire public-company stock without immediate public disclosure—unless and until they cross the reporting threshold established by Congress under Section 13(d). This structure reflects a judgment made by Congress in 1968 as to the appropriate balancing of competing interests.¹⁸

Contrary to empty allegations of secrecy, in actuality, once activists become public, they are more transparent than any other shareholders in the market because they put all their ideas forward to be appraised. The market and other shareholders will then render judgment on them. Activists like Elliott analyze a company and come to conclusions about whether the company’s performance, governance and viable future can be improved. If the activist decides that activism is not appropriate (which happens), it goes away and no one ever hears from it. But if it decides that the company can be improved, and engages with management and the board on a path forward, then the company knows exactly what the activist thinks because the activist will have laid out all of its ideas and thoughts for the company. Where an investor is public in its activism, the entire market knows all of its arguments because they are laid out for everyone to approve, reject or compromise on. And even if that debate remains private with the company at first, the company has full transparency on what the activist investor thinks and why. That dialogue can stay private, which companies sometimes prefer, or it can become public at the choice of the activist or the company. But there is nothing secret, and the company can accept or reject our views or attempt to find a middle ground. Ultimately, other shareholders will accept or reject the substance and consequences of these engagements and render judgment on them in a fundamental exercise of shareholder democracy.

In the end, investors, management, and the board can agree with an activist or not but the fact is that activists, and certainly Elliott, are radically transparent about how they view a company, for how else can an activist’s ideas be accepted other than on their merits? By contrast, it is the management and board—not activists—who have the option of relying on limited or opaque communications with a concentrated shareholder base to avail themselves of a protective level of “secrecy.” The language about secretive cash-settled SBS and sneak activist attacks are nice Orwellian turns of phrase by apparently tremulous corporates and their protective advisors, but they are purposeful misrepresentations of reality that should be buried once and for all. *Sit tibi terra levis.*

One way or another, whether our engagements are private or public, other shareholders will render their judgment on our ideas and the results. What is clear is that in either scenario, the fact that the company did not know earlier that the activist was investing in its economic performance through cash-settled SBS is irrelevant and certainly not harmful. The Commission

¹⁸ We are aware of the Commission’s proposal to shorten the 10-day filing period under Section 13(d). We will provide our views on that proposal in a separate comment letter.

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should not want to chill what is an area of already transparent, well-balanced and meritorious debate.

3. The Proposed Rule would contravene federal and state law protecting trade secrets and constitute an unconstitutional taking under the Fifth Amendment.

Contravention of Federal and State Trade Secrets Protection. The Proposed Rule would require market participants to disclose positions in cash-settled SBS in excess of a low threshold. Those positions comprise proprietary trading strategies of investors, and the compelled public disclosure of these strategies will destroy their value. The Commission has acknowledged the proprietary nature of trading strategies and positions in the SBS market, including in its adoption of Regulation SBSR. The Commission has also acknowledged that market participants have legitimate interests in protecting this confidential information.¹⁹ Under the Proposed Rule, however, market participants would be required to disclose this highly sensitive and proprietary information not only to the Commission, but also to the public at large. Such compelled public disclosure would be inconsistent with the Commission's recognition that market participants have a legitimate interest in protecting this proprietary information. The Proposed Rule thus puts the Commission at odds with itself. Forced disclosure would be inappropriate for the additional reason that the information covered by the Proposed Rule includes trade secrets protected by federal and state law.

The cash-settled SBS data subject to the Proposed Rule's disclosure requirements qualify as trade secrets under the federal Defend Trade Secrets Act of 2016 ("DTSA").²⁰ The DTSA reflects Congress's judgment that "[i]n a global economy based on knowledge and innovation, trade secrets constitute some of [a] company's most valuable property,"²¹ and are "an integral part of the operation, competitive advantage, and financial success of many U.S.-based companies."²² To implement Congress's desire to provide robust protections, the statute broadly defines trade secrets as "all forms and types of financial, business, . . . [or] economic . . . information, including patterns, plans, compilations, . . . methods, [or] techniques . . . , whether tangible or intangible" where "the owner thereof has taken reasonable measures to keep such information secret" and "the information derives independent economic value, actual or

¹⁹ See Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. 77337, 77340 (Dec. 10, 2010) ("The Commission anticipates that as a central recordkeeper of SBS transactions, each [SBS data repository, or SDR] will receive proprietary and highly sensitive information, which could disclose, for instance, a market participant's trade information, trading strategy, or nonpublic personal information The Commission agrees with one commenter's view that 'market participants have legitimate interests in the protection of their confidential and identifying financial information,' and Rule 13n-9 sets forth requirements sufficient to protect such information from disclosure, as the commenter suggested."); see also the Commission's discussion of Proposed Rule 13n-6(d) relating to confidential treatment requests in Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 Fed. Reg. 77306, 77337 (Dec. 10, 2010) ("Much of the information that the Commission expects to receive from SDRs is, by its nature, competitively sensitive. If the Commission were unable to afford confidential protection to the information that it expects to receive, then the SDRs may hesitate to submit the required information to the Commission. This result could potentially undermine the Commission's ability effectively to oversee SDRs, which, in turn, could undermine investor confidence in the SBS market.").

²⁰ 18 U.S.C. § 1836; Pub. L. No. 114-153 (May 2016).

²¹ H.R. Rep. 114-529 at 2 (2016).

²² S. Rep. No. 114-220 at 1.

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potential, from not being generally known to, and not being readily ascertainable through proper means by, another person who can obtain economic value from the disclosure or use of the information.”²³

Courts have recognized that the type of information that would be contained in these cash-settled SBS disclosures under the Proposed Rule would expose trade secrets for purposes of the DTSA’s definition of “trade secrets.”²⁴ Data regarding cash-settled SBS positions reflect the patterns, plans, methods, and techniques underlying trading strategies, and the economic value of such data is derived from their confidentiality. The disclosures sought by the Proposed Rule in many instances would allow market participants to glean proprietary strategies by identifying the subject of an activist’s strategy, among other things. Compelled disclosure would also enable market participants to interfere with those strategies by, for example, front-running execution of subsequent trades necessary to establish the position; or benefit from them by, for example, executing trades immediately following disclosure by the activist to seek to benefit from volatility caused thereby.

State law likewise provides substantial protection for trade secrets. Forty-eight states have adopted the Uniform Trade Secrets Act (“UTSA”). Those states include California and Connecticut (two states in which Elliott maintains offices) and Florida (where Elliott maintains its headquarters).²⁵ The UTSA defines trade secrets as “information, including a formula, pattern, compilation, program, device, method, technique, or process that: [d]erives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and [i]s the subject of efforts that are reasonable under the circumstances to maintain its secrecy.”²⁶ New York, where Elliott also maintains an office, has not adopted the UTSA, and instead utilizes the definition of trade secret contained in the Restatement of Torts: “a formula, process, device, or compilation which one uses in his business

²³ 18 U.S.C. § 1839(3). We note that Congress further emphasized its commitment to protecting trade secrets by making it a criminal offense for any officer or employee of the United States, or any of its departments or agencies, to disclose any information acquired in the course of their official duties that concerns or relates to trade secrets in any manner, or to any extent, not authorized by law. 18 U.S.C. § 1905. While of course disclosures pursuant to the Proposed Rule, if implemented, would not violate this statute, we believe that this statute demonstrates the significant importance that Congress has historically accorded the protection of trade secrets.

²⁴ See, e.g., *Trahan v. Lazar*, 457 F. Supp. 3d 323, 343 (S.D.N.Y. 2020) (investment models qualified as a trade secret within the meaning of the DTSA where the models were valuable and developed through great effort and the plaintiff took reasonable measures to keep the models secret); *Tourmaline Partners, LLC v. Monaco*, 2016 WL 614361 (D. Conn. Feb. 16, 2016) (concluding that a reasonable jury could find that certain investment practices and trading information could constitute trade secrets under Connecticut Uniform Trade Secrets Act); *Zabit v. Brandometry, LLC*, 2021 WL 1987007 (S.D.N.Y. May 18, 2021) (an algorithm underlying a stock market index that used brand data and stock prices to pick undervalued stocks was entitled to trade secret protection if the plaintiff took reasonable measures to guard the secrecy of the information); *Wealth Mgmt. Assocs. LLC v. Farrad*, 2019 WL 5725044 at *5 (S.D.N.Y. June 21, 2019) (magistrate judge granted a permanent injunction under the DTSA preventing sales of a book that disclosed financial strategies of the plaintiff, a company that provided financial services to high-income individuals); *Wealth Mgmt. Assocs. LLC v. Farrad*, 2019 WL 6497424, at *1 (S.D.N.Y. Dec. 3, 2019) (the district court adopted the report and recommendation of the magistrate judge as to the status of the plaintiff’s financial strategies as a protected trade secret).

²⁵ The DTSA adds to, and does not preempt, these state laws. See 18 U.S.C. § 1838.

²⁶ UTSA § 1.4. The definition of “trade secret” in the DTSA was designed by Congress to harmonize federal law with the UTSA.

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and which gives him an opportunity to obtain an advantage over competitors who do not know or use it.”²⁷

Under both the UTSA and New York definitions, the data required to be submitted to the Commission and disclosed to the public under the Proposed Rule qualify as trade secrets. Information documenting Elliott’s positions meets the UTSA test because it consists of a “compilation” of proprietary data that, taken together, reveals the formulas, patterns, methods, techniques, and processes used to carry out Elliott’s trading strategies. That information derives independent economic value from its confidentiality, and Elliott engages in reasonable efforts to preserve that confidentiality. The data also satisfy New York’s test, largely for the same reasons: disclosure of Elliott’s positions would reveal proprietary approaches and processes across our firm’s strategies, as well as compilations of market transactions. The confidentiality of these practices gives Elliott an important advantage over its competitors in the market by allowing it to build a cash-settled SBS position without having third parties trade into a position against Elliott’s strategy, and making that strategy economically unviable based on the mere public disclosure of Elliott’s investment in a given company.²⁸ The confidentiality of this information is also an important component of Elliott’s strategy, as it enables Elliott to (1) complete its analysis and determine in a rigorous way whether its thesis is in fact correct before going public with its views and (2) be in a position to execute its strategy before other provisions of federal securities law obligate it to notify the market of its intentions. If that were not possible, then Elliott’s strategy might well be economically unviable, or it could be frustrated by defensive governance steps and other measures that the subject company might take to insulate itself against criticism. Of course, these arguments apply equally to all activists.

Unconstitutional Taking Under the Fifth Amendment. In addition to being inconsistent with Commission policy and contravening federal and state law protecting trade secrets, the Proposed Rule would violate the Fifth Amendment’s Takings Clause.²⁹ The Takings Clause prohibits the Government from taking “private property . . . for public use, without just compensation.”³⁰ The Proposed Rule would violate that Clause by mandating public disclosure of protected trade secrets.

The Supreme Court has long held that trade secrets are property protected by the Takings Clause.³¹ It is likewise well established that public disclosure of a trade secret generally “extinguishe[s] the information’s trade secret status,” resulting in loss of the associated property

²⁷ *Worldwide Sport Nutritional Supplements, Inc. v. Five Star Brands, LLC*, 80 F. Supp. 2d 25, 30 (N.D.N.Y. 1999) (quoting from Restatement of Torts § 757 (1939)).

²⁸ *See, e.g., Trahan*, 457 F. Supp. 3d 323 at 343; *Tourmaline Partners, LLC v. Monaco*, 2016 WL 614361.

²⁹ U.S. Const. amend. V.

³⁰ *Id.*

³¹ *See, e.g., Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001–04 (1984); *see also* Roger M. Milgrim & Eric E. Bensen, 3 *Milgrim on Trade Secrets* § 12.02 (2021) (“The owner of a trade secret has the right to prevent unauthorized use and disclosure by persons owing a contractual, confidential or other duty to the owner,” and “[t]hose rights are his ‘property’ with respect to such secrets.”).

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rights.³² Because statutes and regulations that require public disclosure of trade secrets have the effect of destroying the owner's property, they are subject to scrutiny under the Takings Clause.

Courts evaluating takings claims in this context focus on the nature and character of the trade secret owner's conduct. When the owner is engaged in a "basic and familiar" form of "interstate commerce," the owner's activity is subject to "reasonable government regulation," but "may not be classified as a special governmental benefit that the Government may hold hostage, to be ransomed by the waiver of constitutional protection."³³ While the details of their investment strategies are highly complex, Elliott and other activists are nonetheless engaged in a basic and familiar form of interstate commerce—trading in securities, cash-settled SBS and related products. The Government cannot require a party to give up its trade secrets in order to engage in such basic and familiar business activities.³⁴

The Proposed Rule would violate this bedrock constitutional principle. By forcing disclosure of proprietary cash-settled SBS data to the public, the Proposed Rule would destroy the trade secrets embedded in those data, inflicting serious competitive harm on the owner of those secrets. That competitive harm would constitute a taking because investing in cash-settled SBS tied to securities issued by public companies (including in securities of companies that are the subject of an activist campaign) is a common, lawful form of interstate commerce. While the Commission may subject cash-settled SBS transactions to "reasonable . . . regulation," it has no more authority to require investors to forfeit their trade secrets than the Government has to force a software company to publish its source code for everyone to see and replicate or to force raisin growers to hand over a portion of their crop without compensation.³⁵

The conflict between the Proposed Rule and the Takings Clause arises no matter how the issue is analyzed. The Proposed Rule would inflict a *per se* taking under *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992), by depriving the owner of "all economically beneficial uses [of its proprietary investment strategy] in the name of the common good."³⁶ The Proposed Rule would, in other words, extinguish the trade secrets in their entirety by putting them into the public domain. The Proposed Rule would likewise result in a regulatory taking under the *Penn Central* test because public disclosure of cash-settled SBS data would (1) have a serious adverse economic impact on the investor, (2) interfere with reasonable, investment-backed

³² *Attia v. Google LLC*, 983 F.3d 420, 425 (9th Cir. 2020); see also *Life Spine, Inc. v. Aegis Spine, Inc.*, 8 F.4th 531, 540 (7th Cir. 2021) ("Publication . . . destroys the trade secret").

³³ *Horne v. Dept. of Agriculture*, 576 U.S. 350, 366 (2015) (holding that government program conditioning participation in raisin market on private growers contributing a portion of their annual crops to the government without compensation constituted unconstitutional taking).

³⁴ *Cf. id.*; *Nollan v. Cal. Coastal Commission*, 483 U.S. 825, 834 n.2 (1994); *Lyft, Inc. v. City of Seattle*, 418 P.3d 102, 120 (Wash. 2018) (McCloud, J., concurring) (suggesting that interpretation of statute requiring disclosure of trade secrets for public purposes would raise concerns under Takings Clause).

³⁵ See *Horne*, 576 U.S. at 366–67. Although mandatory disclosure of trade secrets is not necessarily a taking where the owner receives a "valuable Government benefit" (such as "a license to sell dangerous chemicals") in "exchange" for the disclosure, *Horne*, 576 U.S. at 366 (citing *Monsanto*, 467 U.S. at 1007), that rationale does not apply here. The ability to transact in cash-settled SBS is not a special governmental benefit akin to the right to sell hazardous substances. See also *Valancourt Books, LLC v. Perlmutter*, 2021 WL 3129089, at *7 (D.D.C. July 23, 2021) (no taking where owner engages in voluntary exchange in return for federal copyright benefits).

³⁶ *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992) at 1019.

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expectations in confidential cash-settled SBS positions and trading strategies, and (3) have the same character as the compelled disclosures held to constitute a taking in *Monsanto*.³⁷

The Commission finds itself on the wrong side of state and federal law, as well as the Constitution. It should withdraw the Proposed Rule in light of these fundamental defects. Alternatively, the Commission should remove the public-disclosure provisions or replace them with a different framework that provides additional safeguards for proprietary data. (For a discussion of alternative approaches, see Section 5 of this comment letter.)

4. The Proposed Rule is not a tailored or appropriate means of addressing the Commission’s stated concerns with cash-settled SBS disclosure proposal.

Flawed Premises of the Proposed Rule. The federal securities laws are premised in part on the importance of disclosure to accomplish the Commission’s purposes, but they do not mandate disclosure in every circumstance. Here, there is no factual or logical justification to pursue disclosure solely to enhance transparency when that disclosure compromises the valuable voices of activists and their proprietary strategies. The Commission has not established a record of recurring fraud—much less of any fraud causing systemic market disruption—resulting from the non-disclosure of cash-settled SBS to the public. And certainly there is no record that warrants the adverse consequences of the Proposed Rule.

By compelling this level of early disclosure, the Commission has seemingly chosen regulation for regulation’s sake, without any empirical basis. Worse, the Proposed Rule will upset the balance in the marketplace to favor company management over investors. It appears that the Commission is of the view that further regulating private funds, in this instance in connection with the use of cash-settled SBS, is both beneficial and costless, when in fact neither is the case. The Commission fails to consider, much less ascertain, the cost that the Proposed Rule will impose on markets and investors by impairing the power of shareholders to raise important value-enhancing ideas with companies. Diminishing the ability of shareholders to exercise this fundamental right is contrary to the Commission’s mandates to protect investors and enhance market efficiency. Instead, the effect will be to benefit the management and boards of those issuers most in need of the discipline of activism, resulting in continued inefficiency as underperforming companies continue to resist efforts to make improvements. This impairs investors’ returns and market efficiency.

We also note that the Commission’s caption for the Proposed Rule (“Position Reporting of Large Security-Based Swap Positions”) is inaccurate. While we object to the Proposed Rule regardless of the threshold for reporting, the thresholds proposed by the Commission would compel reporting of positions that are far from “large”—in many instances positions that would be completely immaterial to an issuer’s public float.

So what is the purported empirical basis for this Proposed Rule? As its sole example to justify this new regime,³⁸ the Commission refers to the recent Archegos Capital Management

³⁷ See *Monsanto*, 467 U.S. at 1010–14.

³⁸ See Press Release, SEC Proposes Rules to Prevent Fraud in Connection With Security-Based Swaps Transactions, to Prevent Undue Influence over CCOs and to Require Reporting of Large Security-Based Swap Positions (Dec. 15, 2021), <https://www.sec.gov/news/press-release/2021-259>. We discuss in Section 7 the Commission’s references to

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incident. This was a unique and inapposite example. Archegos involved the failure of a single highly leveraged family office, whose checkered history made it a high-risk client from the outset,³⁹ and its conduct was compounded by similarly egregious and serious risk-management failures by certain of the counterparties that Archegos faced.⁴⁰ Archegos ultimately demonstrated a pattern of aberrant and risky behavior: reportedly not being honest with certain of its counterparties about its market exposures, breaching its contractual risk-margin limits as early as 2020, and concentrating its portfolio in a way that created additional risk that was not consistent with the leverage it was being accorded. This behavior was exacerbated by the lack of regulation of family offices. Unlike hedge funds and mutual funds, family offices are not required to disclose portfolio concentration data—because family offices do not have investors and are effectively unregulated in the United States. This lack of oversight facilitated Archegos’s reversion to its prior high-risk behavior.

At the same time, at least some of the sophisticated cash-settled SBS counterparty dealers also reportedly failed to follow their own risk management procedures to control how much leverage they allowed Archegos to enjoy in its swap contracts, even in the face of persistent warning signs for months that Archegos was over-extended. The Archegos failure thus involved contractual breaches and failure to manage the risks presented by an aggressive, and already heavily sanctioned party by reckless counterparties. The Commission does not explain how public disclosure of cash-settled SBS transactions would have prevented these risk management failures, other than to make vague and unsubstantiated assertions that “increased transparency” would better protect against these outcomes. These assertions are not substantiated because they cannot be—the public disclosures that would be mandated by the Proposed Rule, if it is adopted, would not have prevented dealers from disregarding a firm’s internal risk management guidelines as happened here.

One major aspect of risk management that, if properly handled by the counterparties, could have avoided or abated the Archegos fallout would have been for a counterparty to avoid the use of static margining. Static margining was highly attractive to Archegos financially, but left the counterparty exposed. In essence, static margin is set at inception of the trade and does not adjust as the market value of the swap positions changes. Thus, if the margin is set at \$10 million on a notional amount of \$100 million, the counterparty dealer has 10% protection. But with static margin, if the position grew to a \$300 million position, the margin would remain

certain credit default swap strategies as also justifying the Proposed Rule. As noted in that discussion, credit default swaps are a different product from the cash-settled SBS at issue in the Archegos matter, and the Commission also fails to provide any empirical basis to justify the need for public disclosure of cash-settled credit default swap positions under the Proposed Rule. *See also* the Lewis Report at Section III.C. (describing how the Commission mischaracterizes much of the academic literature it cites to support public disclosure of positions).

³⁹ Archegos was formerly known as Tiger Asia. In 2012, Tiger Asia and its principal settled insider trading allegations with the Commission and pled guilty to federal wire fraud charges. Tiger Asia reconstituted itself as a family office that no longer managed client funds, and renamed itself Archegos, but in this reconstituted form was banned from trading securities in Hong Kong in 2014 through 2018, due to the actions underlying Tiger Asia’s settlement with the Commission as well as allegations of subsequent inappropriate actions.

⁴⁰ *See, e.g.*, Credit Suisse Group Special Committee of the Board of Directors Report on Archegos Capital Management (July 29, 2021), <https://www.credit-suisse.com/about-us/en/reports-research/archegos-info-kit.html> (attributing Credit Suisse’s losses from the Archegos matter to “a fundamental failure of management and controls” despite the presence of “numerous warning signals”); *see also* Marion Halftermeyer and Francis Lacqua, Bloomberg, UBS’s Weber Apologizes for Archegos Loss, Urges Transparency (May 5, 2021), <https://www.bloomberg.com/news/articles/2021-05-05/ubs-s-weber-apologizes-for-archegos-loss-urges-transparency> (“blaming a lack of regulation and transparency regarding family offices” for the Archegos situation).

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capped at \$10 million, providing only ~3% protection to the dealer. Under the much more risk-protective and commonly utilized dynamic margin structure, margin is set as a percentage of the mark-to-market value of a client's positions. Thus, if at the inception of the account, the notional amount of a margin account is \$100 million, and the parties agree to a margin of 10%, the client must provide for at least \$10 million of margin. If the value of the position were to increase to \$300 million, then the margin must be increased to at least \$30 million (maintaining protection at 10% of the value of the position).

In addition, the extent to which certain of Archegos's counterparties permitted Archegos to finance mark-to-market gains in its accounts compounded leverage and risk. A client is permitted to borrow against the unmargined position in the account. Several counterparties permitted the amount of available financing available to Archegos to increase as the value of the positions increased, with no increase in the margin required to be maintained against the position. In addition, Archegos was not subject to customary incremental margin add-ons based upon the concentration, liquidity and volatility of the positions within the portfolio. In a dynamic margin structure, the amount of margin required to be maintained against the position increases as the position grows, maintaining the agreed-upon level of margin as noted above. In addition, the margin could be increased by the counterparty to reflect concentration, liquidity and volatility risks posed by the positions within the portfolio.

The inherently risky structure of the static margining relationship certain counterparties afforded to Archegos provided insufficient protection to the counterparty. It could also precipitate margin calls and defaults, creating volatility if the counterparty believed it was excessively exposed in a changing market. Had the counterparties facing Archegos used the now-typical dynamic margining that limits the scope of financing permitted, then the appropriate margin would have been automatically required, adjusting throughout the tenor of the swap, and Archegos would have been extended significantly less leverage.

In our experience, the market has evolved post-Archegos so that most if not all dealers now (i) require dynamic margining with traditional margin add-ons to address particular concentration and other risks in the position, (ii) have strengthened their internal risk management procedures, and (iii) are far more selective as to the extent of financing exposure they allow. This demonstrates that the actions that contributed to the magnitude of the Archegos situation were attributable to fundamental risk-management breakdowns by sophisticated market participants—events that the Proposed Rule would not address.

We cannot predict the nature or extent of future risk-management failures in this or other markets. It is clear, however, that the effects of the Archegos incident did not cause a systemic effect on the markets and did not exemplify a market-wide problem of risk management or information asymmetry. Nor were cash-settled SBS to blame for the failures that occurred, any more than driving drunk is the fault of the car. Accordingly, the Archegos situation does not provide a valid justification for the sweeping new disclosure regime that the Proposed Rule would impose on all market participants. Instead, the Archegos incident arose out of a highly idiosyncratic situation involving risky behavior by both Archegos and certain of its counterparties. It does not suggest, let alone demonstrate, any widespread regulatory gap warranting the imposition of expansive new public disclosures of transactions in cash-settled SBS.

The Commission contemplates adopting the new regime embodied in the Proposed Rule despite the availability of a less restrictive alternative. Rather than adopting the Proposed Rule,

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the more appropriate regulatory response would be for the Commission to utilize the existing regulatory and enforcement authorities to impose on cash-settled SBS dealers the obligation to better evaluate the creditworthiness of their large counterparties. For example, the Commission could recommend or require that SBS dealers obtain from prospective counterparties representations as to the counterparty's aggregate exposures, in a format that is consistent so that an aggressive purchaser such as Archegos cannot play one dealer off against another while withholding material facts that the dealers need to accurately ascertain the risk they are being asked to take on. Indeed, that step could be taken by private parties between each other in their contracts. These alternatives are not considered in the Release.

More fundamentally, the Commission's apparent underlying presumption that *every* concentrated cash-settled SBS position is indicative of potential fraudulent or manipulative intent is inaccurate and overbroad. There are many valid and long-accepted trading strategies that are premised upon holding concentrated positions in cash-settled SBS products. There is also a broad array of products that fall within the Commission's definition of SBS that may settle in cash rather than by physical delivery, but the Commission's sole justification for the Proposed Rule involves narrow situations relating to total return swaps (as discussed above) and credit default swaps (as we will discuss briefly below). These examples fall far short of justifying the broad and intrusive regulation of the entire cash-settled SBS market that the Commission proposes.

In fact, cash-settled SBS trading represents one of the most important and active areas of trading in the SBS markets. Among other things, cash-settled SBS, as compared with other products in the market, are cost-effective tools for trading that greatly enhance market efficiency. These instruments have improved liquidity in the U.S. equities markets generally, and the Commission would cause harm to the markets by inhibiting trading in cash-settled SBS products absent a clear and compelling explanation of how this cost is outweighed by benefits to the markets as a whole.⁴¹ In the Release, the Commission claims that certain strategies involving concentrated positions in cash-settled SBS are neither fraudulent nor manipulative, but are nonetheless unfair and thus warrant the adoption of the Proposed Rule.⁴² We disagree and have seen no evidence to support this vague claim. Tellingly, the Commission provides no empirical justification for these claims, nor does the Commission establish that the public disclosures contemplated by the Proposed Rule are an appropriate response to these cash-settled SBS trading strategies. This is understandable, as the Commission is unable to provide any example of fraudulent, manipulative or otherwise unfair incidents that had a systemic and negative impact on the market that was caused by non-disclosure of cash-settled SBS.

The Commission's lack of evidence cannot be a justification for the Proposed Rule. The Commission is not permitted to adopt the Proposed Rule to collect data primarily to gain an increased understanding of cash-settled SBS positions. The Commission argues that the Proposed Rule's data collection requirement "may" enhance understanding of the impact that a large SBS position can have on the broader securities markets.⁴³ This justification, for which no empirical evidence is provided, is at odds with precedent holding that the Commission may not

⁴¹ We note, as but one example, that SBS dealers regularly locate liquidity without disclosing buy-side information, enhancing liquidity while retaining anonymity.

⁴² See, e.g., the Release, 87 Fed. Reg. 6652, 6657 (Feb. 4, 2022).

⁴³ The Release, 87 Fed. Reg. at 6657 (Feb. 4, 2022).

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justify new reporting mandates by claiming that the information received *might* facilitate future rulemakings.⁴⁴ Also implicit in the Commission's proposal is that public disclosure of cash-settled SBS trading information may enable market participants to identify fraudulent or misleading trading and bring that information to the Commission for enforcement. Not only is this strange deputization theory without any limiting principle, as it is available for any new proposed compelled disclosure rule, it also reflects an abdication of the SEC's enforcement authority. It also improperly leapfrogs consideration of the alternative of requiring confidential disclosure of such information solely to the Commission. This would afford the Commission direct access to the data so as to permit direct monitoring of trading behavior without the adverse effects that public disclosure of that data would cause.

Existing Alternatives Are Available Through Anti-Fraud and Anti-Manipulation Measures. The concerns raised by the Commission would be better addressed through its existing anti-fraud and anti-manipulation authority. As the Proposed Rule observes, existing anti-fraud and anti-manipulation provisions provide the Commission with enforcement authority against cash-settled SBS-based strategies that are manipulative or fraudulent.⁴⁵ Fraudulent or manipulative behavior currently existing elsewhere in the marketplace, such as with respect to direct ownership of equities, certain short-selling practices and high-frequency trading, is dealt with using existing anti-fraud and anti-manipulation tools.⁴⁶ The Commission has failed to provide any explanation, much less justification, for why the cash-settled SBS market is in need of such a new and extraordinary public disclosure requirement.

The Proposed Rule is Premature. The Proposed Rule's restrictive regime is also premature and inappropriate in light of the Commission's recently adopted SBS repository reporting regime, which was implemented to provide less intrusive, *nonpublic* disclosure of swap holdings in a given issuer that would enable the Commission to effectively monitor the SBS market. The Commission began requiring transaction reporting for SBS under Regulation SBSR only recently, on November 8, 2021, and must complete and publish a report using the data collected no later than two years following the initiation of public dissemination of SBS transaction data.⁴⁷ The Commission does not identify information that it needs in order to address its concerns in the cash-settled SBS market that is not available under Regulation SBSR. The Commission should evaluate whether the new Regulation SBSR reporting program sufficiently addresses its concerns, and should complete its statutorily mandated data collection report for consideration by Congress, before proposing, much less seeking to implement, additional, highly burdensome public disclosure requirements on cash-settled SBS market participants.⁴⁸

⁴⁴ See *NYSE v. SEC*, 962 F.3d 541, 555 (D.C. Cir. 2020) ("The Commission has no delegated authority to promulgate a 'one-off' regulation like Rule 610T that imposes significant, costly, and disparate regulatory requirements merely to secure information that *may or may not* indicate to the SEC whether there is a problem worthy of regulation.").

⁴⁵ The Release, 87 Fed. Reg. at 6654 (Feb. 4, 2022).

⁴⁶ We note that the Commission's proposed Rule 9j-1 would further address manipulative or fraudulent behavior without unnecessarily creating a new private right of action.

⁴⁷ Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 80 Fed. Reg. 14563, 14624 (Mar. 19, 2015).

⁴⁸ See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 81 Fed. Reg. 53546, 53640 (Aug. 12, 2016) (stating that the Commission believes that Regulation SBSR will help provide "a means for the

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5. The Commission lacks statutory authority to compel the disclosure required by the Proposed Rule, and the Proposed Rule does not meaningfully consider alternative approaches or provide an adequate cost-benefit analysis as required by law.

Lack of Statutory Authority. The Commission relies upon Section 10B(d) of the Exchange Act for the statutory authority to adopt the Proposed Rule. Section 10B(d) authorizes the Commission by rule or regulation to require any person meeting the description of the statutory provision “to *report* such information as the Commission may prescribe regarding any position or positions in any security-based swap”⁴⁹ There is nothing in this statutory provision (or in the legislative history) suggesting that the Commission should make this information publicly available. In fact, the requirement to “report” such information contrasts with the language of Sections 13(d) and 16(a) of the Exchange Act, both of which authorize the Commission to require the *filing* of information as set forth in those statutory provisions.⁵⁰ It is a basic principle of statutory interpretation that when Congress uses a particular term in one part of a statute and uses a different term in other parts of the statute, it intends the terms to have different meanings.⁵¹ The word “filing” has precise and well-understood meaning in Commission statutes and regulations—it is material that will become publicly available, subject to the limitations of the Freedom of Information Act (“FOIA”). Components of these statutory provisions, as well as of the implementing rules enacted by the Commission, clearly contemplate public availability of such filed information.⁵² By contrast, nothing in the text of Section 10B(d) suggests that “report” should be construed as synonymous with “filing.”⁵³ Instead, the plain meaning of that word in the context of existing Commission statutes and regulations is information provided to the Commission in its regulatory capacity, but *not* made available to the public (subject to compelled disclosure pursuant to FOIA).⁵⁴ In short, Section 10B does not

Commission and other relevant authorities to gain a better understanding of the aggregate risk exposures and trading behaviors”).

⁴⁹ Securities Exchange Act of 1934 § 10B(d), 15 U.S.C. § 78j-2(d) (emphasis added).

⁵⁰ See § 13(d)(1), 15 U.S.C. § 78m(d)(1) (“Any person . . . who . . . is directly or indirectly the beneficial owner of more than 5 per centum of [a class of equity security registered pursuant to Section 12 of the Exchange Act] shall . . . *file* with the Commission [a Schedule 13D]” (emphasis added)); see also § 16(a)(1), 15 U.S.C. § 78p(a)(1) (“Every person who is directly or indirectly the beneficial owner of more than 10 percent of [a class of equity security registered pursuant to Section 12 of the Exchange Act] or who is an officer or director of the issuer of such a security shall *file* the Statements required by this subsection with the Commission”) (emphasis supplied). In both cases, the Commission is explicitly obligated to make such information publicly available. See § 13(d)(4), 15 U.S.C. § 78m(d)(4) (with respect to information required to be filed with the Commission pursuant to Section 13(d)(1)); § 16(a)(4), 15 U.S.C. § 78p(a)(4) (with respect to information required to be filed with the Commission pursuant to Section 16(a)(1)).

⁵¹ See, e.g., *Sosa v. Alvarez-Machain*, 542 U.S. 692, 712, n.9 (2004) (“[W]hen the legislature uses certain language in one part of the statute and different language in another, the court assumes different meanings were intended.”); *Russello v. United States*, 464 U.S. 16, 23 (1983) (“[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.”).

⁵² See, e.g., § 13(d)(1)(B), 15 U.S.C. § 78m(d)(1)(B) (providing that certain information otherwise required to be included in a filing under Section 13(d) relating to financing plans “shall not be made available to the public”).

⁵³ The legislative history of the adoption of Section 10B also does not speak to any public disclosure obligation.

⁵⁴ While the Exchange Act refers, in Section 13(a), to periodic and other reports that registered issuers must provide, that statutory provision also explicitly refers to those reports as being filed with the Commission. These reports are then made public by the Commission pursuant to a long-standing and well-developed process whereby the Commission utilizes an issuer’s Exchange Act reports to supplement its periodic disclosures under the Securities Act

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grant the Commission the authority to compel public disclosure of any information reported to the Commission under that section.

In addition, Section 10B(d) authorizes the Commission to require reporting of information only “regarding any position . . . in any security-based swap . . . as set forth in [Section 10B(a)(1)-(2)].” Subsections (a)(1) and (a)(2) describe security-based swaps (whether or not cash-settled), but solely as a means by which to enforce position limits established by the Commission pursuant to rulemaking authority delegated by Congress in Section 10B(a). The Commission has not proposed to establish any limits on the size of positions in SBS, nor has it demonstrated a need for any such regulation. Thus, the Proposed Rule is simply a reporting obligation. For that reason, Section 10B(d) does not provide the Commission with authority to require the proposed disclosures. Indeed, the Commission’s proposed reliance on Section 10B(d) to obtain this information from market participants (whether or not subsequently publicly disclosed) is beyond the scope of the authority conferred by Congress under Section 10B of the Exchange Act.

We are also concerned by a drafting ambiguity in the Proposed Rule that suggests an impermissible extension of the information sought by the Commission into the beneficial ownership reporting regime of Section 13(d). The Proposed Rule would require reporting by any person (and any entity controlling, controlled by or under common control with such person), or *group of persons*, who is directly or indirectly the owner or seller of a reportable SBS position. That framework improperly utilizes, without definition, a concept (“group”) that is used exclusively in Section 13(d) and regulations thereunder and has a very precise and well-developed meaning. If this term is construed in accordance with its defined use under Section 13(d), the Commission lacks the statutory authority to utilize this term in the context of Rule 10B-1 absent specific analysis and justification for its application, and the Release contains no such justification. If this reference to the term “group” is instead intended to have another meaning (as is implied by the addition of the words “of persons”, a usage found nowhere else in the federal securities laws), then the reference is impermissibly vague.

Relatedly, we believe that the Commission may be seeking to use its statutory authority under Section 10B(d) to achieve the substantive equivalent of beneficial ownership reporting with respect to cash-settled SBS under Section 13(d). This would be impermissible under the Exchange Act. The Commission’s recent proposal titled “Modernization of Beneficial Ownership Reporting” (Release No. 34-94211 (Feb. 10, 2022), 87 Fed. Reg. 13846 (March 10, 2022)) (the “13(d) Proposing Release”) explicitly excludes cash-settled SBS from the scope of the expansion of proposed reporting in the 13(d) Proposing Release.⁵⁵ The Commission correctly notes that, pursuant to Section 13(o) of the Exchange Act, cash-settled SBS may be deemed to confer beneficial ownership of the underlying security *only* if the requirements of Section 13(o) (including consultation with prudential regulators and the Secretary of the Treasury) are met. Later in the 13(d) Proposing Release, the Commission refers to the Proposed Rule, and notes

of 1933 to facilitate capital formation while maintaining investor protection. *See* Disclosure to Investors—A Reappraisal of Federal Administrative Policies under the ’33 and ’34 Acts, Policy Study (the “Wheat Report”), March 1969 at 328–37. The recommendations of the Wheat Report led to the implementation by the Commission of the integrated disclosure system in the early 1980’s. For a discussion of the development of the integrated disclosure system, see Sec. Exch. Comm’n, Report on Review of Disclosure Requirements in Regulation S-K (Dec. 2013) at 8–30, <https://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf>.

⁵⁵ See text accompanying note 110 of the 13(d) Proposing Release.

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that “the position disclosures with respect to cash-settled security-based swaps required under our proposed Rule 10B-1, if adopted, would provide sufficient information regarding holdings of security-based swaps such that additional regulation under Regulation 13D-G at this time would be unnecessarily duplicative.”⁵⁶ By concluding in the 13(d) Proposing Release that proposed Rule 10B-1 will compel public disclosure of substantially the same information as would be required under Section 13(d), the Commission strongly suggests that it is seeking to do indirectly that which, if it sought to do it directly, would require consultation with prudential regulators and the Secretary of the Treasury and compliance with the other requirements of Section 13(o), as well as extensive empirical and other analysis to justify reversing the longstanding and well-established position that cash-settled SBS do not confer beneficial ownership for purposes of Section 13(d). This is a further confirmation that the Commission lacks the statutory authority to adopt the Proposed Rule.

Alternatives to the Proposed Rule. As noted above, the Commission fails to consider reasonable alternatives to the Proposed Rule. For example, the Commission does not meaningfully consider a reporting structure in which SBS data is submitted on a confidential basis solely to the Commission as opposed to being disclosed publicly. Under such a reporting structure, and consistent with prior rulemakings by the Commission,⁵⁷ any submitted information should be exempt from public disclosure under FOIA in the same manner as submissions under these other confidential transaction reporting regimes. In addition, under this alternative structure, participants should have the ability to request confidential treatment electronically, as is the case under Regulation SBSR. As with these other existing reporting requirements, such disclosure also could be provided in a periodic, aggregated manner, rather than on a next-day basis. We further note that the Commission, in its recently proposed short sale reporting rulemaking, expressly includes an alternative that would permit anonymized disclosure, and perhaps reduced disclosure, so as to protect the confidentiality of short sellers and their strategies.⁵⁸

Other alternatives to a broad public-disclosure regime include: (1) the receipt of information by SBS dealers from their counterparties regarding the counterparty’s positions on a confidential, contractual basis, after which the dealers would report information on their

⁵⁶ *Id.* at text accompanying note 114. We also note the submission of a comment letter on the Proposed Rule that advocates for utilizing Section 13(d) rather than Section 10B as the statutory basis for mandating public disclosure of positions in cash-settled SBS. Among many other substantive and analytical deficiencies in that proposal, the commenter fails to note the steps that the Commission would be required to take under Section 13(o) of the Exchange Act to conclude that cash-settled SBS confer beneficial ownership for purposes of Section 13(d). The commenter’s attempt to equate the Proposed Rule with a Section 13(d) mandate is, we believe, nonetheless indicative of the flaws inherent in the Commission’s attempt to rely upon Section 10B(d) of the Exchange Act to mandate broad public disclosure of cash-settled SBS transactions. See Comment Letter of Wm. Robertson Dorsett (Feb. 11, 2022), <https://www.sec.gov/comments/s7-06-22/s70622-20115545-267556.pdf>.

⁵⁷ End-User Exception to Mandatory Clearing of Security-Based Swaps, 75 Fed. Reg. 79992, 80006 (December 21, 2010) (the Commission’s proposal for Rule 3Cg-1 relating to SBS) (“To the extent that the Commission receives confidential information pursuant this collection of information, such information would be kept confidential, subject to the provisions of the Freedom of Information Act (‘FOIA’). Exemption 4 of FOIA provides an exemption for ‘trade secrets and commercial or financial information obtained from a person and privileged or confidential.’ The information required to be submitted to the Commission under proposed Rule 3Cg-1 may contain proprietary financial information regarding SBS transactions and therefore be subject to protection from disclosure under Exemption 4 of the FOIA.”).

⁵⁸ See Short Position and Short Activity Reporting by Institutional Investment Managers; Notice of Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail for Purposes of Short Sale-related Data Collection, 87 Fed. Reg. 14950, at Section IV (Mar. 16, 2022) (the “Short Sale Reporting Proposal”).

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exposures to the Commission on a confidential basis pursuant to the Commission's regulatory authority over SBS dealers, thus providing the Commission with transparency as to concentrated holdings of cash-settled SBS, and (2) the imposition of civil penalties on a market participant that provides false or misleading data to an SBS dealer to incentivize the dealer to enter into a trade with the market participant (or to maintain or adjust a collateral position with respect thereto).

Each of these alternatives would more directly and effectively protect the market from participants assembling overly risky positions and related Archegos-type risk management failures, as well as providing the Commission with the data from which to identify potentially fraudulent or manipulative behavior, in each case with far fewer adverse collateral consequences than the public disclosure under the Proposed Rule.

Inadequate Cost/Benefit Analysis; Imposition of Significant Costs. Along with the other costs described in this comment letter, the Proposed Rule would harm the U.S. markets in a number of ways. As discussed in greater detail above, activist investing strategies would become difficult to execute in the U.S. market, to the detriment of overall market efficiency, including entrenching incumbent management and boards, stifling improved shareholder returns and ESG efforts, as well as making activist-investing returns more difficult to realize. These unambiguous costs are not acknowledged in the Release, much less evaluated against the potential benefits the Commission seeks to achieve by enacting the Proposed Rule.

If the Proposed Rule takes effect, legitimate investing strategies that do not involve activism but nonetheless utilize cash-settled SBS would similarly become difficult or impossible to execute in the U.S. market. The Proposed Rule also would discourage *bona fide* hedging activities (also unrelated to activist campaigns) by market participants that utilize cash-settled SBS as a part of their hedging structures. In either of these situations, entities transacting in cash-settled SBS may be reticent about public disclosure of their investment or hedging transactions and strategies for reasons that have nothing to do with the Commission's professed concerns giving rise to the Proposed Rule. In other words, an ill-conceived rule purportedly designed to reduce risk would actually impede strategies like hedging that help mitigate risk. This has the potential to cause a decline in market efficiency and returns to U.S. investors and increased risk in the U.S. market generally (to the extent that U.S. entities left exposures unhedged). Alternatively, in either scenario, transactions could migrate to offshore markets that do not impose comparable public disclosure obligations, impairing depth and liquidity in the U.S. market, increasing the costs and risks of cross-border transactions, and potentially causing the loss of jobs at U.S. trading operations of SBS dealers. In addition, U.S. market participants utilizing SBS would be placed at an informational disadvantage to non-U.S. market participants, as non-U.S. participants in the affected markets would obtain the benefits of disclosures made by U.S. participants while U.S. participants would not have the benefit of comparable reporting by non-U.S. market participants. We acknowledge that the Commission notes this latter risk in the Release, but it does so without properly quantifying and evaluating the cost of this risk to the U.S. markets.

Despite the significant market harms that may result from the Proposed Rule's disruption of legitimate trading strategies and their collateral benefits, the Commission fails to provide an adequate cost-benefit analysis of the impact of the Proposed Rule on the SBS market as a whole. This violates the Commission's statutory obligations to determine the economic

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implications of the rule.⁵⁹ For example, the Commission states in the Release that “the Commission lacks data that would show the direct link between the current credit default swap market condition (and the degree of adverse selection) and participants’ appetite to trade.”⁶⁰ In a number of instances, the Commission demonstrates its lack of analysis of the costs that the Proposed Rule would impose; in others, it makes assertions as to purported benefits without any empirical data to support such claims.⁶¹ A proper evaluation of the Proposed Rule would lay bare that its costs to the public markets and burden on competition substantially outweigh its purported benefits, which are already hard to discern (as implicitly acknowledged by the Commission in its cost-benefit analysis in the Release) and likely to prove ephemeral at best.

6. The Proposed Rule departs from the Commission’s longstanding practice of protecting the confidentiality of specific transactions from public disclosure, without acknowledgment of, or reasoned justification for, the change in course.

Failure to Recognize Confidentiality Concerns. The Proposed Rule addresses confidentiality concerns arising from its public-disclosure provisions in only a single, narrow context: it protects the identities of a trader’s counterparties. That is a strangely gerrymandered and insufficient focus. The Commission ignores that disclosure of detailed information regarding significant trades in the securities of a particular issuer signals to the market, and the potential focus of an activist’s campaign, the position holder’s intent with far greater precision than would disclosing the identity of a given counterparty. It readily permits others to trade or act against the position holder. The Commission also seems to disregard the fact that both a trader and a counterparty have the same disclosure obligation on the same time frame, making it easy for the public to figure out both sides of the trade, greatly diluting the sole concession to confidentiality the Commission makes in the Proposed Rule.

Disclosure of trading strategies and positions as proposed would not only be disadvantageous to the disclosing party, but may also result in speculative transactions that could be detrimental to investors.⁶² In addition, it may incentivize market participants to

⁵⁹ See, e.g., *Business Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (holding that “the Commission acted arbitrarily and capriciously for having failed once . . . adequately to assess the economic effects of a new rule”); *Chamber of Commerce v. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005) (recognizing that the Commission has a “statutory obligation to determine as best it can the economic implications of the rule”).

⁶⁰ The Release, 87 Fed. Reg. at 6680 (February 4, 2022).

⁶¹ See, e.g., conclusory (and, in some instances, qualified) statements in the Proposed Rule noting without any corresponding data that “liquidity for the overall market *would* improve as a result,” that by making the information public, the reporting “*could*” alleviate the negative externality that the party attaining the large position “*may*” create, that it “*could* lead to increased supply and demand for SBS,” that the Proposed Rule “*could* have positive spillover benefits in markets of the specific underlying entity” or that the Commission and relevant market participants “*could*” benefit from having access to information that “*may* indicate that one or more market participants has a financial incentive to take an action that would be harmful to the issuer.” The Release, 87 Fed. Reg. at 6656, 6681, 6687–89 (Feb. 4, 2022) (emphases added).

⁶² See, e.g., Markus K. Brunnermeier & Lasse Heje Pedersen, *Predatory Trading*, 60 J. Fin. 1825 (2005).

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opportunistically enter into cash-settled SBS and disclose information under the Proposed Rule with the intent to influence market traders.⁶³

The Commission's example of its restraint in not compromising a party's confidential information and strategies, after admitting the very concerns we cite above, is to offer the following comfort: "However, the information provided would be limited to only security-based swaps and related securities, and would not include information about the reporting parties' entire portfolios."⁶⁴ This is quite cold comfort that parties should be relieved that the Commission is not making them disclose their entire portfolios to the public—which it is doubtful the Commission would have the power to do.

We point this out because it underlines how unaware the Commission seems to be with respect to how it is compromising parties' legitimate confidential information. Why the Commission valued the confidentiality of cash-settled SBS counterparties' identities (usually large financial institutions with no discernible strategy at stake) over the confidentiality of investors and their strategies is a mystery at best. In instances where market participants misconstrue the strategy reflected in such disclosures and act on it or lead others to act on it, the Commission will have caused the injection of mistaken information into the market. Investors may be harmed by such mistaken information by acting on a perception of what an activist thinks or is going to do at a time when the activist may not have concluded its analysis or determined to take steps to influence management or the board. In effect, this compelled disclosure is the worst of both worlds in that it compromises the activists' proprietary information but does not even deliver the virtue of accurate information to the market since it is more likely to mislead than illuminate.

Historical Protection and Reliance. The Proposed Rule would depart from current, longstanding Commission policy to not require public disclosure of specific transactions in most instances. For example, Regulation SBSR provides for reporting of SBS transaction information to the Commission on a confidential basis, rather than to the public.⁶⁵ Any disclosures to the

⁶³ In the Short Sale Reporting Proposal, the Commission is far more cognizant of both the potential detrimental impacts that the proposed short sale disclosure requirements would have on the incentives of short sellers and also on the markets generally if short selling were to be disincentivized as a result of the new disclosure requirement. Short Sale Reporting Proposal at text accompanying note 269 ("Publicly releasing the aggregated Proposed Form SHO data has the potential to reveal some of the information that short sellers may have acquired through fundamental research. Revealing this information to the market may cause prices to adjust to the information that the short seller uncovered before the short seller is able to acquire their full desired position – decreasing the profits to acquiring the information and providing less incentive to produce fundamental research. Thus, the publication of Proposed Form SHO data represents an additional cost to short selling in the form of potentially lower profitability for trading on negative information."). The Commission also acknowledged the risk of retaliation against the short seller by the issuer and by other market participants as a result of the proposed enhanced disclosure, including the risk that the market could reverse engineer the identity of a given trader if trade information was made public on an anonymized basis. *Id.* at Section IV. Similarly, the Commission acknowledged these concerns in adopting Regulation SBSR. See *supra* note 19.

⁶⁴ The Release, 87 Fed. Reg. at 6689.

⁶⁵ 17 C.F.R. § 242; *see also* Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information, 81 Fed. Reg. 53545, 53629 (Aug. 12, 2016) ("For all security-based swaps, the information collected pursuant to Rule 901(d) is for regulatory purposes and will not generally be available to the public . . . To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential, subject to the provisions of applicable law."); Security-Based Swap Data Repository Registration, Duties, and Core Principles, 80 Fed. Reg. 14438, 14514 (March 19, 2015) ("[A]n SDR may seek confidential treatment

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public under Regulation SBSR must be aggregated and anonymized. Other existing reporting requirements, including in connection with Form 13F and Form 13H, also require periodic and (in the case of Form 13H) anonymized position reporting on a confidential basis rather than the detailed next-day *public* transaction reporting called for by the Proposed Rule. In addition, all disclosures to the Commission under any of the foregoing provisions are entitled to protection under FOIA.

Market participants have long relied upon the existing scope of public-disclosure requirements relating to securities positions in developing their models for executing proprietary trading strategies, which are the product of painstaking and expensive research, and the Commission has not provided any basis to justify disrupting this reasonable reliance.⁶⁶ The Commission has made narrow exceptions where disclosure requirements are clearly justified by well-recognized policy goals, such as protecting against creeping tender offers or protecting against trading on material non-public information.⁶⁷ These issues have no relationship with the concerns set forth by the Commission to justify the Proposed Rule. In addition, authority from the Commission and the courts supports the conclusion that cash-settled SBS do not confer beneficial ownership of underlying shares, as holders do not possess the power to vote or dispose of underlying equity securities to the holders, and therefore no public disclosure should be required.⁶⁸

of certain information pursuant to Exchange Act Rule 24b-2. . . . [T]his approach is consistent with how the Commission generally treats the filings that it receives from its regulated entities, including exchanges.”).

⁶⁶ In the context of an adjacent area of disclosures under the Exchange Act, *see* Beneficial Ownership Reporting Requirements and Security-Based Swaps, Release No. 34-64628 at 25–26 (June 8, 2011) (“The purpose of this rulemaking [confirming prior interpretations of the Commission regarding the applicability of disclosure obligations to security-based swaps] is solely to preserve the regulatory *status quo* and provide the certainty and protection that market participants have come to expect with the existing disclosures required by the rules promulgated under Sections 13(d), 13(g) and 16(a) [of the Exchange Act].”). In addition, in response to a judge’s request for the Commission’s views on two questions regarding whether cash-settled SBS should be viewed as subject to Section 13(d) of the Exchange Act, a senior member of the Commission staff stated: “The Division believes that interpreting an investor’s beneficial ownership under Rule 13d-3 to include shares used in a counter-party’s hedge, absent unusual circumstances, would be novel and would create significant uncertainties for investors who have used equity swaps in accordance with accepted market practices understood to be based on reasonably well-settled law.” (emphasis added). Letter, dated June 4, 2008, of Brian V. Breheny, Deputy Director, Division of Corporation Finance of the Commission to the Hon. Lewis A. Kaplan, United States District Judge, Southern District of New York, re: *CSX Corp. v. The Children’s Inv. Fund Mgmt, L.L.P., et al.*

⁶⁷ *See* Securities Exchange Act of 1934 § 13(d)(1), 15 U.S.C. § 78m(d)(1) and Regulation 13D thereunder (17 C.F.R. § 240.13d-1 et seq.) and § 16, 15 U.S.C. § 78p.

⁶⁸ *See CSX Corp. v. Children’s Inv. Fund Management (UK) LLP*, 654 F.3d 276 (2d Cir. 2011) (after district court had ruled that defendants’ total return swaps were a scheme to evade Section 13(d) reporting, circuit court vacated an injunction that district court had issued against further violations of Section 13(d) by defendants and limited the scope of a remand to issues concerning an alleged “group” violation of Section 13(d) in respect of shares owned outright by defendants rather than whether such swaps conferred beneficial ownership of the shares); *id.* at 288–310 (2d Cir. 2011) (Winter, J., concurring) (finding that “cash-settled total-return equity swaps do not, without more, render the long party a ‘beneficial owner’ of . . . shares [held by the short party as a hedge] with a potential disclosure obligation under Section 13(d)”); *In re Bear Stearns Cos., Secs., Derivative, & ERISA Litig.*, 995 F. Supp. 2d 291 (S.D.N.Y. 2014) (citing Judge Winter’s concurrence in *CSX*); *Galopy Corp. Intl. N.V. v Deutsche Bank, AG*, 2016 N.Y. Misc. LEXIS 3062 (N.Y. Sup. Ct. 2016) (same); Beneficial Ownership Reporting Requirements and Security-Based Swaps, Release No. 34-64628 at 25–26 (June 8, 2011), 76 Fed. Reg. 34579 (June 14, 2011) (confirming, in conjunction with the enactment of Section 13(o) of the Exchange Act, the Commission’s prior interpretation that security-based swaps are subject to Section 13(d) and Rule 13d-3(d)(1) if the SBS confers a right to acquire the underlying equity security); *see also* Commission Guidance on the Application of Certain Provisions of the Securities

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7. The Proposed Rule’s objectives with respect to credit default swaps, as with other cash-settled SBS, are not supported by empirical data demonstrating the need for the public reporting that would be mandated by the Proposed Rule.

In addition to the Proposed Rule’s misguided focus on fraud and manipulation in the cash-settled total return swap market as discussed above, the Commission erroneously points to what it characterizes as opportunistic strategies in the credit default swap market to justify the Proposed Rule. Credit default swaps that constitute SBS and thus are subject to the Commission’s jurisdiction make up a small component of the overall SBS market. As for credit-default-swap strategies cited in the Release, the Commission concludes, without analysis or apparent evidentiary support, that these strategies are either fraudulent or otherwise warrant regulatory intervention.⁶⁹ But many of the credit default swap strategies criticized by the Commission in the Release constitute the valid exercise by an investor of its contractually provided rights (*e.g.*, the right to accelerate upon an event of default if holding in excess of 25% of the CUSIP); concurrently holding credit default swaps does not render exercising contractual remedies any less valid. Other credit default swap strategies identified by the Commission (including the Hovnanian situation) would appear to constitute, at a minimum, manipulative behavior; with respect to those strategies, the Commission’s existing anti-fraud and anti-manipulation authorities afford the Commission ample tools to combat such schemes.⁷⁰

* * *

By proposing far-reaching public disclosure for cash-settled SBS, the Commission has signaled that it intends to pursue a form of radical, compelled transparency without precedent in any area of the federal securities laws. As described above, these laws require the Commission to strike the appropriate, nuanced balance between too much disclosure and not enough. This principle explains why, for example, the Commission has never mandated real-time public disclosure of day-by-day trading activity identifying the buyers and sellers in public company trades. On a fundamental level, the regime contemplated by the Proposed Rule would alter the relationship between shareholders and companies to the detriment of markets and investors in the United States. In effect, the Commission has proposed to implement changes that would reinforce the interests of management and boards at the expense of public shareholders—results surely not desired by the Commission and not consistent with its obligation to promote efficiency, competition and capital formation while protecting investors. These changes would

Act of 1933, the Exchange Act, and Rules thereunder to Trading in Security Futures Products, Release No. 34-46101 (June 21, 2002), 67 Fed. Reg. 43234 (June 27, 2002) (stating that mere economic exposure through cash-settled securities futures does not confer beneficial ownership of the underlying equity security for purposes of Section 13(d)).

⁶⁹ The Release, 87 Fed. Reg. at 6656–57 (Feb. 4, 2022).

⁷⁰ The Commission acknowledges the existence of existing anti-fraud and anti-manipulation tools in its discussion of these credit default swap strategies. The Release, 87 Fed. Reg. at 6654 (Feb. 4, 2022). As noted in note 38 above, the Commission also mischaracterizes academic literature it cites in the Release to support its flawed proposition that activities in the credit default swap market warrant the adoption of the Proposed Rule. *See* the Lewis Report at Section III.C.

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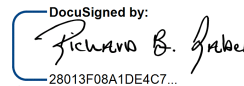
also be confusing and damaging to the market, distort the prices of securities, and result in a level of volatility that would be harmful to market participants.

The Commission has failed to establish the need for the intrusive public disclosure that the Proposed Rule would require, and it has failed to consider more tailored approaches that could achieve its stated goals. Even apart from the constitutional and statutory barriers to implementation of the Proposed Rule, such an extreme rewriting of the market rules should not be undertaken without a clear-cut empirical basis for doing so. The Commission offers none.

We respectfully urge the Commission to abandon the Proposed Rule. Alternatively, the Commission should, at a minimum, eliminate the Proposed Rule's public-disclosure provisions and instead rely upon a regime based on confidential disclosure.

We would welcome the opportunity to discuss our comments with the Commission. Thank you for your consideration.

Sincerely,

DocuSigned by:

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cc: The Hon. Gary Gensler, SEC Chair
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Allison Herren Lee, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner

Exhibit A
NERA Report

Dr. Sharon Brown-Hruska, Ph.D.,¹ Dr. Patrick Conroy, Ph.D.,² and Nadim Siddique, MBA³

March 21, 2022

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I. INTRODUCTION AND SUMMARY OF OPINIONS

1. This report has been prepared in response to the Securities and Exchange Commission's ("SEC") proposed Exchange Act Rule 10B-1 on "Position Reporting of Large Security-Based Swap Positions" (the "Proposed Rule").⁴ Based on our assessment of the Proposed Rule, our review of academic literature, and the analysis that we have conducted of recent activist campaigns, we have reached the following opinions:

2. The Proposed Rule, if enacted, will significantly and adversely affect activist investment strategies and will decrease or eliminate the positive impact provided by activism to market participants and the U.S. economy.

- a. Activist investors benefit other shareholders and the market in significant ways that are well-documented by academic literature and supported by our analysis of recent activist campaigns. The benefits of activism, such as those listed here, would be largely lost as a result of the Proposed Rule; all shareholders would participate in less efficient markets and public companies would become less accountable to shareholders.
- i. Activist investors are uniquely situated to effect long-term and beneficial change in public companies. The importance of activism is especially relevant given the substantial proportion of shares at U.S. public companies that are now held by passive investors. These investors (equally with all other shareholders) benefit from activism without taking on monitoring costs themselves. Activists build positions, influence management, and increase firm efficiency even in companies in which passive fund managers constitute a significant portion of the ownership of the stock.

⁴ U.S. Securities and Exchange Commission, "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," *Federal Register* 87, no. 24 (February 4, 2022): 6652. <https://www.federalregister.gov/d/2021-27531>.

- ii. Activists improve corporate governance and operational efficiency by working with management and boards to effect change that is in the best interest of all shareholders. The gains from this enhanced efficiency flow to all shareholders (in the form of increased value of the company) and also to all market participants (in the form of enhanced efficiency in the markets generally).
 - iii. When activists increase shareholder value, that increase is realized by all shareholders – whether retail, institutional, pension fund or other investors. NERA analysis shows that between 2017 and 2021, a group of activists characterized by Bloomberg as “core activists” generated \$90 billion of value for all shareholders the day after public announcement of the activists’ strategies. These gains were generated as a result of the implementation by the activist of a carefully structured, highly confidential campaign, financed by their own capital and the capital of investors in the activist fund. These campaigns are designed to effect change and enhance efficiency at these companies.
- b. Activists deploy valuable and proprietary strategies in their campaigns and in making their investments, frequently use of cash-settled security-based swaps (“SBS”). The Proposed Rule would require activists to disclose their positions in SBS prematurely, in contrast to longstanding regulatory precedent and market practice.⁵ As a result, the Proposed Rule would eliminate the necessary confidentiality of activists’ holdings and prematurely reveal activists’ valuable and proprietary investment strategies to the markets, to the companies they intend to interact with, and to their competitors. Activists’ business would be harmed, and the Proposed Rule would cause the reduction or elimination of activist participation in the U.S. markets:

⁵ See Appendix A (The Concept of Proprietary Information in Securities Markets in Law and Rule).

- i. Premature disclosure of activists' positions will lead to front-running and free-riding, raising the cost of activism and decreasing its efficacy.
- ii. The higher execution costs that activists would face as a result of free-riding and front-running could eliminate their ability to pursue an activist campaign.
- iii. Premature disclosure of activist positions will facilitate management entrenchment tactics such as the adoption of poison pills and the implementation of unilateral "half measures" to entrench boards and management, all of which reduce shareholder value and can thwart an otherwise well-designed activist campaign.
- iv. A reduction in activist activity resulting from the Proposed Rule would have negative consequences for market efficiency, liquidity, and price discovery.

II. BACKGROUND ON ACTIVIST INVESTORS

3. Activist investors take a stake in a public company and seek to persuade the company to make strategic, operational and/or governance changes to increase the company's value. Activists start campaigns by identifying public companies that are underperforming, doing extensive research on a particular company to establish a specific thesis that will improve the long-term value of the company, establishing a stake in the company, and then, assuming they want to move forward with a campaign, reaching out to the company privately, or publicly announcing their position, with a goal of implementing the thesis to improve the value of the company for the benefit of all of its shareholders.

4. One of the most valuable skills of an activist investor is the ability to identify underperforming companies. Activists seek out publicly traded companies that they believe are undervalued and could be improved through better governance, reallocation of assets, a change in capital structure, or by entry into mergers and acquisitions or other transactions.⁶ Identifying such a company requires sophisticated analysis, and in many instances results in a determination that a prospective company is not suitable for an activist campaign.

5. Activists can acquire a stake in a public company in a variety of ways, including open-market purchases of the common stock and the purchase of physically-settled or cash-settled derivatives. Many factors influence the structure and size of the stake, as well as the manner in which it is established, including the size of the company and the liquidity and volatility of its publicly traded stock. In addition to long positions in the company's common stock, activists may use a variety of instruments as part of their trading strategy, including cash-settled options and total return swaps ("TRS"). TRS can provide economic exposure to a company's common stock at low financing and transaction costs and without triggering public disclosure requirements, but also with certain tradeoffs, such as the fact that the TRS holder does not obtain the right to vote the underlying shares.

⁶ Alon Brav, Wei Jiang, Frank Partnoy, and Randall Thomas, "Hedge Fund Activism, Corporate Governance, and Firm Performance," *The Journal of Finance* 63, no. 4 (August 2008): 1729-1775, <https://doi.org/10.1111/j.1540-6261.2008.01373.x>.

6. After they establish a desired stake, the activist may make a position public either in a public announcement or, if required by federal securities law, by filing a Schedule 13D. When the activist files a Schedule 13D, it reports holdings in the common stock of the company, as well as any positions in cash-settled security-based swaps or other derivatives. The activist can also elect to disclose its objectives and intentions (and must do so if it is filing a Schedule 13D). Recent examples of campaigns that initiated by a public announcement by an activist include JANA Partners LLC's ("JANA") campaign in **Zendesk Inc.** in November 2021 and Icahn Enterprises' campaign in **Southwest Gas Holdings Inc.** in October 2021.⁷ Recent examples of activist campaigns that were announced through the filing of a Schedule 13D include Mantle Ridge LP's campaign in **Dollar Tree, Inc.** in November 2021 and Starboard Value LP's campaign in **GoDaddy, Inc.** in December 2021.⁸

7. Active investing uses complex and costly strategies that require a unique set of skills. There are significant costs involved in identifying an undervalued company that the activist believes it can improve, performing the detailed quantitative and qualitative analysis to fully develop the thesis of its investment strategy, structuring, acquiring, and maintaining positions in and related to the company's stock and negotiating with the company and its advisors. Those costs can include hiring legal counsel, proxy advisors, industry experts, investment banks, and public relations firms. Estimates suggest that these third-party advisor costs can be upwards of \$10 million for a single campaign;⁹ the capital required to develop the investment thesis, establish and maintain the necessary positions, and engage with the company and its advisors will be many multiples of that amount. Accordingly, activists need adequate returns to activism to offset their costs and provide a return to their investors. The top activists

⁷ See JANA Partners LLC, "JANA Partners Demands Zendesk Board Immediately Terminated Proposed Acquisition of Momentive," Press release, November 30, 2021, <https://www.prnewswire.com/news-releases/jana-partners-demands-zendesk-board-immediately-terminate-proposed-acquisition-of-momentive-301434335.html>; See Yun Li, "Carl Icahn reveals stake in Southwest Gas, urging company to drop acquisition," *CNBC*, October 5, 2021, <https://www.cnbc.com/2021/10/05/carl-icahn-reveals-stake-in-southwest-gas-urges-company-to-drop-acquisition.html>.

⁸ See Form 13D filed by Mantle Ridge LP on November 30, 2021; See Form 13D filed by Starboard Value LP on December 27, 2021.

⁹ Nikolay Gantchev, "The Costs of Shareholder Activism: Evidence from a Sequential Decision Model," *The Journal of Financial Economics* 107, no. 3 (March 2013): 610-631, <https://doi.org/10.1016/j.jfineco.2012.09.007>. (Using a sequential decision model to find that the average cost of an activist campaign that ends in a proxy fight is \$10.71 million).

have earned significant credibility in the market over the course of many engagements with public companies by establishing a track record of creating value at the companies where they have been investors.¹⁰

8. Between 2017 and 2021, 43 activists labeled by Bloomberg as “core activists” (the “Bloomberg Core Activists”) pursued campaigns in U.S. exchange-traded companies.¹¹ **Exhibit 1** provides summary data for these 43 activists during this period. Bloomberg Core Activists pursued 419 campaigns in U.S. companies during this period. Some of these activists pursued only one campaign in that time, while others pursued more than 40. The U.S. companies average market capitalization of approximately \$19 billion at the time that the campaign was announced, although only 13 of the Core Activists engaged with companies with an average market capitalization of \$10 billion or higher. Bloomberg Core Activists are generally minority stakeholders when they announce a campaign; Bloomberg reports that these activists take an average stake of 5.7% in their companies.¹²

¹⁰ C.N.V. Krishnan, Frank Partnoy, and Randall S. Thomas, “The second wave of hedge fund activism: The importance of reputation, clout, and expertise,” *The Journal of Corporate Finance* 40 (October 2016): 296-314. <https://doi.org/10.1016/j.jcorpfin.2016.08.009>.

¹¹ Data are from Bloomberg L.P. Accessible using the “BI ACT” function.

¹² The “Stake” reported by Bloomberg is based on publicly available information, and thus does not reflect non-public positions that an activist takes as part of its campaign, such as cash-settled TRS that are not otherwise reported publicly by the activist.

III. THE BENEFITS OF ACTIVIST INVESTING

9. There is a large and well-established body of academic literature demonstrating that activists improve the underperforming companies that are the focus of their campaigns and create long-term value, benefiting all shareholders in a variety of ways. We summarize this literature, and also describe findings from our independent research, in this Section.

10. In particular, activists create operational efficiencies and therefore a higher shareholder value in the long run at the companies that they engage with. Activist firms have a proven history of making changes to management, making changes to the composition of the board of directors, influencing operational changes, improving the deployment of assets, and increasing the efficiency of the firm's capital allocation.¹³ Activists have the resources and incentives to build concentrated positions in public companies so that they can meaningfully engage with firm management and boards to seek to effect beneficial change at the company. If the activist succeeds, it is then able to recoup the costs of its activism campaign by virtue of the gains it realizes on its investments in the company.¹⁴ Without these expected gains, activists would not invest in costly research and monitoring to identify and engage the underperforming companies.

A. Activist Investors are Uniquely Situated to Influence Change

11. Activists are critical to promoting efficiency in the market because they have the ability to identify underperforming companies for a potential activist campaign, have the financial wherewithal to establish and maintain concentrated positions to support a campaign, and are uniquely situated to influence management changes, especially as more shares of public companies are held passively. Brav et al. (2008) describe their critical role:

¹³ Alon Brav, Wei Jiang, Frank Partnoy, and Randall Thomas, "Hedge Fund Activism, Corporate Governance, and Firm Performance," *The Journal of Finance* 63, no. 4 (August 2008): 1729-1775, <https://doi.org/10.1111/j.1540-6261.2008.01373.x>; C.N.V. Krishnan, Frank Partnoy, and Randall S. Thomas, "The second wave of hedge fund activism: The importance of reputation, clout, and expertise," *The Journal of Corporate Finance* 40 (October 2016): 296-314. <https://doi.org/10.1016/j.jcorpfin.2016.08.009>.

¹⁴ Andrei Shleifer and Robert W. Vishny, "A Survey of Corporate Governance," *The Journal of Finance* 52, no. 2 (June 1997): 737-783. <https://www.jstor.org/stable/2329497>; Nickolay Gantchev, "The Costs of Shareholder Activism: Evidence from a Sequential Decision Model," *The Journal of Financial Economics* 107, no. 3 (March 2013): 610-631, <https://doi.org/10.1016/j.jfineco.2012.09.007>.

Unlike mutual funds and pension funds, [activists] are able to influence corporate boards and managements due to key differences arising from their different organizational form and the incentives that they face. [Activists] employ highly incentivized managers who manage large unregulated pools of capital. Because they are not subject to regulation that governs mutual funds and pension funds, they can hold highly concentrated positions in small numbers of companies, and use leverage and derivatives to extend their reach. [Activist] managers also suffer few conflicts of interest because they are not beholden to the management of the firms whose shares they hold. In sum, [activists] are better positioned to act as informed monitors than other institutional investors.¹⁵

12. The role of activism is even more important given the increasing proportion of public companies now held by passive shareholders. Passive shareholding and attendant shareholder indifference increase the potential for management decisions to deviate substantially from the interests of shareholders. Fichtner et al. (2017) label BlackRock, Vanguard, and State Street the “Big Three,” and describe them as the dominant forces in the passive index fund industry. They find that, if their holdings were to be aggregated, the Big Three would be the largest shareholder in 88% of S&P 500 firms in the United States. Importantly, the authors note that “the incentive structure of passive index fund managers is such that they are rewarded more for keeping the costs low than for improving firm governance.”¹⁶ As passive shareholders become increasingly dominant in the market, activists are all the more essential to ensuring that companies remain accountable to shareholders and maximize shareholder value.

B. Activist Investors Achieve Various Positive Operational and Corporate Governance Changes in Public Companies

13. Numerous empirical studies show that companies that are the focus of activist campaigns achieve improvements in corporate governance and long-run operational performance. Academics consistently have concluded that activist participation improves long-term firm performance using a variety of different measures.¹⁷ Additionally, in our research we

¹⁵ Alon Brav, Wei Jiang, Frank Partnoy, and Randall Thomas, “Hedge Fund Activism, Corporate Governance, and Firm Performance,” *The Journal of Finance* 63, no. 4 (August 2008): 1729-1775, <https://doi.org/10.1111/j.1540-6261.2008.01373.x>.

¹⁶ Jan Fichtner, Eelke M. Heemskerk, and Javier Garcia-Bernardo, “Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk,” *Business and Politics* 19, no. 2 (2017): 298-326. <https://doi.org/10.1017/bap.2017.6>.

¹⁷ For a broad discussion, see Alon Brav, Wei Jiang, and Hyunseob Kim, “Hedge Fund Activism: A Review,” *Foundations and Trends in Finance* 4, no. 3 (2009), <https://ssrn.com/abstract=1551953>; see also Matthew R. Denes, Jonathan M. Karpoff, and Victoria B. McWilliams, “Thirty years of shareholder activism: A survey of

have found that activists achieve a high degree of success in convincing shareholders to elect nominees put forward by the activists to seats on boards of public companies. These findings are discussed in this section.

1. Improved Production Efficiency and Productivity

14. Academic research demonstrates that public companies exhibit improved production efficiency in the years following an activist intervention. The impact that activism has on production efficiency and productivity is demonstrated in a Brav et al. (2015) study, “The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes.” The authors analyzed the impact on production efficiency using a sample of approximately 2,000 activism events from 1994 to 2007. For these activism events, the authors studied the return on assets (“ROA”)¹⁸ for the public companies for six years: three years before the announcement of the activism campaign starts and three years after. The results show that, on average, activists intervene when firm performance production efficiency is declining, and that the level of ROA three years after the intervention is three percentage points higher than the year of the intervention.¹⁹ These results show that activist interventions result in public companies making needed changes that improve their utilization of assets to generate enhanced ROA for years after the initial intervention. In addition to improving use of assets, activist interventions also improve productivity over a three-year time horizon. In the same study by Brav et al. (2015), they used the sample of 2,000 activism events between 1994 and 2007 to explore how activism impacts productivity.²⁰ They measured productivity as output generated per worker per hour worked (“output per labor hour”) and how much value added per worker per hour worked (“value per labor hour”), where value is defined as sales minus the cost of materials. They find that, as a result of activism, the companies’ output per labor hour improves by 8.4% and their value per

empirical research,” *Journal of Corporate Finance* 44, (2017): 405-424, <https://doi.org/10.1016/j.jcorpfin.2016.03.005>.

¹⁸ ROA is a measure of a company’s profitability relative to the value of their assets. A relatively high ROA suggests that a firm is using their assets efficiently to generate a profit.

¹⁹ Alon Brav, Wei Jiang, and Hyunseob Kim, “The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes,” *The Review of Financial Studies* 28, no. 10 (October 2015): 2723-2769, <https://doi.org/10.1093/rfs/hhv037>.

²⁰ Alon Brav, Wei Jiang, and Hyunseob Kim, “The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes,” *The Review of Financial Studies* 28, no. 10 (October 2015): 2723-2769, <https://doi.org/10.1093/rfs/hhv037>.

labor hour improves by 9.2% by the third year after the campaign announcement. Again, activism campaigns have positive impacts on productivity for years after the intervention.

2. Improved Innovation Output and Efficiency

15. Multiple studies have shown that activists increase the level of innovation at the companies they engage with without an increase in their research and development (“R&D”) expenses, thus increasing the efficiency of their R&D resources. Brav et al. (2018) studied the innovation output and efficiency of companies that are the focus of activist investors.²¹ They conducted this study in response to a claim that activists are focused on short-term gains that sometimes come at the expense of long-term gains. The researchers studied innovation because it is “arguably the most important long-term investment that firms make.” They conducted their study on a sample of 1,770 activist events in companies with market capitalization above \$1 billion between 1994 and 2007. They measured the costs of innovation using annual research and development expenditures. To measure innovation output, the researchers relied on firms’ patenting activity, which they note is “standard practice in the literature.” They reduced their sample of activist events to only include “innovative companies,” defined as those that had at least one recent patent filing.

16. Brav et al. found that, controlling for firm and fixed effects, firms file for 15.1% more patent applications following the commencement of an activist campaign as compared to matched firms that were not the subject of activist campaigns. They also found that patents filed by these firms collect 15.5% more citations than matched firms. These improvements come despite the finding that these firms do not increase their R&D expenditure relative to matched firms following the commencement of the activist campaign, indicating that they improved the efficiency of their innovative functions.

17. A study by Tang (2020) also found that activist interventions improve innovation without having to increase inputs to innovation. The researcher used a sample of 1,169 activist

²¹ Alon Brav, Wei Jiang, Song Ma, and Xuan Tian, “How does hedge fund activism reshape corporate innovation?” *Journal of Financial Economics* 130, no. 2 (November 2018): 237-264, <https://doi.org/10.1016/j.jfineco.2018.06.012>.

interventions between 2001 and 2007 and measured innovation inputs and outputs similarly to Brav et al. (2018). Input was measured as R&D expenses per year and output was measured as the number of patents filed in a year, where both were relative to sales in that year. Consistent with the findings of Brav et al. (2018), Tang (2020) found that innovation output increased by 16.8% after an activist intervention, despite finding that there was no statistically significant increase in innovation input. Importantly, the author also found that these results persisted two years after the activist intervention.²²

3. Improved Operating Performance

18. Activists improve public companies' allocation of resources to generate shareholder value, or a firm's operating performance. Bebchuk et al. (2015) examined the operating performance of public companies in the five years after an activist intervention.²³ The sample included more than 2,000 activist campaigns that occurred between 1994 and 2007. As a measure of operating performance, this study used Tobin's Q, which "is the metric most commonly used by financial economists for studying the effectiveness with which firms operate and serve their shareholders." In short, Tobin's Q measures the ability to turn book value of equity and debt into value for investors.²⁴ The sample also used ROA as a proxy for operating performance. The researchers found that by both these measures, at the time of the activist intervention, the public companies that are the focus of an activist intervention were on average performing worse than their industry. In the subsequent five years, these firms showed operating performance improvement, adjusted for industry average. For example, the researchers found that public companies that were the focus of an activist intervention increased their ROA by 1.9

²² Tingfeng Tang, "Hedge fund activism and corporate innovation," *Economic Modelling* 85 (February 2020): 335-348, <https://doi.org/10.1016/j.econmod.2019.11.004>.

²³ Lucian A. Bebchuk, Alon Brav, and Wei Jang, "The Long-Term Effect of Hedge Fund Activism," *Columbia Law Review* 115 (June 2015): 1085-1156, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577.

²⁴ Lucian A. Bebchuk, Alon Brav, and Wei Jang, "The Long-Term Effect of Hedge Fund Activism," *Columbia Law Review* 115 (June 2015): 1085-1156, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577. As described by the authors, "Tobin's Q is measured as the ratio of market value of equity and book value of debt to the book value of equity and book value of debt."

percentage points and their Tobin's Q by 0.42, adjusted for industry effects, and that those changes were statistically significant.²⁵

4. Reduced Costs and Increased Efficiency in Supplier Agreements

19. Cost management is a basic tenet of running a company.²⁶ When management becomes negligent with respect to costs, activists intervene and guide management and boards to reduce costs. Aslan (2020) tested the hypothesis that activist campaigns reduce costs for public companies by observing the profitability of the company's suppliers. If activism results in lower costs, then the profits to the public company's suppliers should decrease. The author examined campaigns from 1994 to 2015, consisting of 674 activists and 3,668 engaged companies. They utilized statistical analysis to estimate the reduction in profitability of suppliers that was due to activism. They compared the company's suppliers to similar suppliers of same-industry firms that were not engaged by activists. They found that on average suppliers of companies that had engaged with activists had 0.8% lower return on assets, 1.4% lower profit-cost margin, and 0.9% lower capital expenditures and research and development after the activist intervention.²⁷ If activism decreases, management will have less incentive to control costs, which will translate into deflated productivity and shareholder value.

5. Replacement of Complacent Boards

20. In public companies, the board of directors oversees management and is responsible for ensuring that the choices they and management make for the firm are in the best interest of their shareholders. A board member that is not fulfilling this duty should be replaced, not only for the sake of the company's performance, but also to increase shareholder value. Activist campaigns routinely identify boards or board members that are underperforming, which could be the root cause for some of the weaknesses in company performance that an activist

²⁵ Lucian A. Bebchuk, Alon Brav, and Wei Jang, "The Long-Term Effect of Hedge Fund Activism," *Columbia Law Review* 115 (June 2015): 1085-1156, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577.

²⁶ Dan L. Heitger, Maryanne M. Mowen, and Don R. Hansen, *Cost Management* (United States: Cengage Learning, 2021), 3-4.

²⁷ Hadiye Aslan, "Shareholders versus stakeholders in investor activism: Value for whom?" *Journal of Corporate Finance* 60 (February 2020), <https://doi.org/10.1016/j.jcorpfin.2019.101548>.

intends to improve. The evidence that activists' expenditure and subsequent campaigns result in board turnover that benefits all shareholders in the company is strong.²⁸

21. We analyze the extent to which activism leads to changes in board composition, and find that over the past five years, more than 350 board seats have been won by Bloomberg Core Activists at U.S. public companies as part of activism campaigns.²⁹ In campaigns where the activist sought board seats, activists won an average of 1.4 board seats per campaign.³⁰ In 59% of such campaigns, activists won at least one board seat, and 40% of the time activists won two or more. Winning board seats, which requires the concurrence of a significant number of shareholders in addition to the activist, helps the activist achieve objectives that will improve company performance.

22. The importance of board turnover for maximizing shareholder value is illustrated in the literature. Bebchuk et al. (2009) constructed an "entrenchment index" based on six provisions: staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments.³¹ The researchers found that this entrenchment index was negatively associated with firm value, and that the relationship was statistically significant. This indicates that the changes in board composition driven by activism have positive effects on firm value. This also demonstrates the importance of the ability of the activist to develop its investment thesis and build its position in the company confidentially, so that the company cannot preemptively engage in other actions captured by the entrenchment index to thwart the activist's approach.

²⁸ Lucian Bebchuk, Alma Cohen, and Allen Ferrell, "What Matters in Corporate Governance," *Review of Financial Studies* 22 (2009): 783-828. (The researchers found that the level of management entrenchment is negatively associated with firm value, and that the relationship was statistically significant. This indicates that activists' promotion of board turnover has positive effects on firm value.)

²⁹ Data are from Bloomberg, L.P. Includes deals in U.S. exchange-traded companies by Bloomberg Core Activists from 2017 to 2021.

³⁰ We define activists who sought board seats as campaigns where the "Objectives" include "Board Control" and/or "Board Representation," or "Board_Seats_Sought" is greater than 0. There were 157 such campaigns among Bloomberg Core Activists between 2017 and 2021.

³¹ Lucian Bebchuk, Alma Cohen, and Allen Ferrell, "What Matters in Corporate Governance," *Review of Financial Studies* 22 (2009): 783-828.

C. Activist Investor Campaigns Generate Increases in Value

23. Consistent with the operational improvements that activists bring, empirical studies have documented a significant positive price reaction at the time of an activist announcement. When information about a public company is announced, the market attempts to efficiently incorporate that news into the company's stock price. This represents the market's assessment of the quality of the activist's thesis and also of the activist's effectiveness at implementing initiatives that will result in value creation at the company. The change in stock price in response to the announcement can be viewed as the market's best estimate of the impact the activist will have on the company's long-term value. Brav et al. (2008) found an average abnormal return in the 40-day window around the announcement of an activist campaign of approximately 7%.³² A later study, Bebchuk et. al (2015), found an average abnormal return of approximately 6% in the same 40-day window using a sample of about 2,000 activist events spanning 1994 and 2007.³³ These data illustrate that the market expects activist involvement to increase the future value of the public companies with which the activist engages.

24. In addition to these immediate gains, Bebchuk et. al (2015) found no evidence of price reversal or stock-return underperformance for these activist events in the long term. In the 36 months after the activist intervention, they estimated that companies outperform the market by an average of 0.52% per month.³⁴ Swanson, Young, and Yust (2021) also found that activists benefit the long-term value of the companies they engage. Using a sample of over 4,000 activist campaigns between 1994 and 2014, the authors found that 24 months and 36 months after intervention, these companies experienced cumulative abnormal returns, or returns that exceed

³² Alon Brav et al., Wei Jiang, Frank Partnoy, and Randall Thomas, "Hedge Fund Activism, Corporate Governance, and Firm Performance," *The Journal of Finance* 63, no. 4 (August 2008): 1729-1775, <https://doi.org/10.1111/j.1540-6261.2008.01373.x>.

³³ Lucian A. Bebchuk, Alon Brav, and Wei Jang, "The Long-Term Effect of Hedge Fund Activism," *Columbia Law Review* 115, (June 2015): 1085-1156. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577.

³⁴ An alternative approach to estimating returns results in an average monthly market-adjusted return of 0.33%. Lucian A. Bebchuk, Alon Brav, and Wei Jang, "The Long-Term Effect of Hedge Fund Activism," *Columbia Law Review* 115, (June 2015): 1085-1156. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2291577.

market returns, of 12.8% and 14.6%, respectively.³⁵ These market-adjusted returns indicate that the short-term gains generated by activist engagement are sustained.

25. While these price improvements – and the longer-term performance that follows – contribute to returns for activists and their investors, all shareholders of the company reap these gains. We used an event study analysis to uncover the value that Bloomberg Core Activists add for shareholders in the first day following the announcement of a campaign. Financial economists frequently use the event study methodology to isolate the degree to which stock price movements are related to a specific news item. For each campaign, we constructed a market model using the S&P 500 Total Return Index (“S&P Total Return”). A market model allows us to analyze how the stock return of the company was correlated with the S&P 500 Total Return *prior* to the activist intervention. The historical period used for the market model is the year prior to the first day after the announcement of the campaign. Once we established how much of a company’s return is due to the market, we adjusted the return following the activist announcement to isolate the effect of the activist. Since 2017, the announcement of campaigns by Bloomberg Core Activists in U.S. public companies has resulted in an average market-adjusted stock price reaction of approximately 4% on the first day after the announcement of the campaign. This represents more than \$90 billion in shareholder value generated by the announcement of the activist’s involvement. **Exhibit 2** shows the results of this event study analysis, and the value created by the Bloomberg Core Activists in announcement-day returns alone. Because these gains accrue to all shareholders, a very significant majority of this value is realized by shareholders other than the activists themselves.³⁶

³⁵ Edward P. Swanson, Glen Young, and Christopher G. Yust, “Are All Activists Created Equal? The Effect of Interventions by Hedge Funds and Other Private Activists on Long-Term Shareholder Value,” December 16, 2021, *Journal of Corporate Finance* (Forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3984520#.

³⁶ Includes deals in U.S. public companies by Bloomberg Core Activists from 2017 to 2021. Data are from Bloomberg, L.P. Accessible using the “BI ACT” function.

IV. ACTIVIST INVESTORS DEPLOY VALUABLE PROPRIETARY STRATEGIES, AND THE PROPOSED RULE WOULD NEGATIVELY IMPACT THAT VALUE

26. The data and strategies of activists are extremely valuable. These strategies maintain their value because current law protects their confidentiality, and activists retain a level of control over when their proprietary strategies are disclosed to the market. See **Appendix A** for a discussion of the framework that is currently in place to protect the confidentiality of information in securities markets. This background illustrates how critical it is for activists to keep their data confidential.

27. In this section, we consider academic literature evaluating the adverse effects that disclosure of confidential proprietary trading strategies has on the value created by the traders that developed those strategies. The findings in this literature apply to the confidential proprietary trading strategies of activist investors.

A. Trading Strategies are Valuable Proprietary Information for Which Confidentiality is Critical, Particularly for Activists

28. Researchers have studied the value inherent in confidentially held positions and proprietary trading strategies. One well-documented area of research explores the value of positions that are reportable to the SEC on Form 13-F but receive temporary confidential treatment. Investors who file Form 13-F can request confidential treatment of their position data, and have public disclosure delayed up to one year (which can be extended further). The literature evaluates this delayed public disclosure to determine the importance of confidentiality for these trading positions. Agarwal et al. (2013) studied Form 13-F filings that received confidential treatment to assess whether confidentially held positions indicated that managers had proprietary, private information.³⁷ Their findings demonstrated the value created by maintaining the confidentiality of trading information. The researchers reviewed 52,272 original Form 13-F filings by 3,134 institutions, and 1,554 confidential Form 13-F filings by 232 institutions between March 1999 and June 2007. The researchers found that confidential holdings exhibited significantly higher abnormal performance than those that did not receive confidential treatment;

³⁷ Vikas Agarwal, Wei Jiang, Yuegua Tang, and Baozhong Yang, "Uncovering Hedge Fund Skill from the Portfolio Holdings They Hide," *The Journal of Finance* 68, no. 2 (April 2013): 739-783, <https://doi.org/10.1111/jofi.12012>.

they reported a difference for a 12-month horizon of 5.2% to 7.5% on an annualized basis.³⁸ Furthermore, they found that “confidential treatment provides institutions tangible relief from revealing their private information about the issuers before reaping the full benefits, and from incurring additional trading costs due to leakage of information regarding their own ongoing trading plans.”³⁹ Their findings support the view that proprietary trading strategies are valuable and that value is enhanced by the protection of the confidentiality of that research.

29. Aragon et al. (2013) made similar findings. The researchers tested and confirmed the hypothesis that managers request confidential treatment to protect valuable trading strategies. Specifically, they found that in the period between filing and public disclosure, confidential holdings “earn significantly positive abnormal returns,”⁴⁰ illustrating the value of the underlying proprietary research.

30. These principles apply to activist investors and their proprietary trading strategies. Overall, the literature clearly suggests that activists’ confidentially held positions have value that is derived from private information and proprietary research. The value of trading strategies for activists is illustrated by the initial stock price reactions to campaign announcements by Bloomberg Core Activists. Specifically, as a direct result and product of activists’ proprietary and confidential strategies, Bloomberg Core Activists generated more than \$90 billion in total shareholder value in U.S. public companies between 2017 and 2021 based on announcement-day returns alone.⁴¹ Next-day disclosure of cash-settled SBS positions that are integral to these strategies, as would be mandated by the Proposed Rule, will destroy that value.

³⁸ Vikas Agarwal, Wei Jiang, Yuegua Tang, and Baozhong Yang, “Uncovering Hedge Fund Skill from the Portfolio Holdings They Hide,” *The Journal of Finance* 68, no. 2 (April 2013): 739-783, <https://doi.org/10.1111/jofi.12012>.

³⁹ Vikas Agarwal, Wei Jiang, Yuegua Tang, and Baozhong Yang, “Uncovering Hedge Fund Skill from the Portfolio Holdings They Hide,” *The Journal of Finance* 68, no. 2 (April 2013): 739-783, <https://doi.org/10.1111/jofi.12012>.

⁴⁰ George O. Aragon, Michael Hertzel, and Zhen Shi, “Why Do Hedge Funds Avoid Disclosure? Evidence from Confidential 13F Filings,” *The Journal of Financial and Quantitative Analysis* 48, no. 5 (October 2013): 1499–1518. <http://www.jstor.org/stable/43303849>.

⁴¹ See section III.C above.

B. Publicly Disclosing an Activist's Positions Would Reveal Legitimate, Proprietary Investment and Market Strategies and Would Reduce the Value of Those Strategies

31. If activists' trading strategies become public prematurely, opportunities emerge for other investors to take gains that would otherwise be earned by the activists, and ultimately reduce the gains derived from activism for all investors if the strategies are disincentivized from being carried out fully. Specifically, activists would be exposed to front-running and free-riding by other market participants. Those third-party activities would substantially reduce the value of the activists' investments in their proprietary trading strategies.

1. "Free-Riding" Occurs When Investors Gain Knowledge of Sophisticated Investors' Strategies

32. Frequently, knowledge of the placement of "smart money," or the assets of reputable and experienced investors, leads other investors, both retail and institutional, to attempt to mimic the strategy. This mimicry is often referred to as "free-riding," where investors attempt to profit off the research and investment of a sophisticated investor without doing research of their own or developing their own strategy.

33. Frank et al. (2004) explained why free-riding can be problematic in the investment context:

If disclosure permits a fund manager who does not pay for research to replicate the portfolio of a manager who does, investors may be able to earn higher returns net of expenses by investing with the 'copycat' manager than with the manager who does research. This could reduce the demand for shares in actively managed funds.⁴²

34. To test the efficacy of a free-riding strategy, the authors constructed a model in which a hypothetical "copycat fund" replicated the holdings publicly reported by an actively managed fund beginning on the date of disclosure of the actively managed fund's holdings. They found that the copycat funds earned a return net-of-expenses greater than the actively managed fund portfolios. In a hypothetical case like this, the copycat fund had to invest fewer resources to

⁴² Mary Margaret Frank, James Poterba, Douglas A. Shackelford, and John B. Shoven, "Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry," *Journal of Law and Economics* 47, no. 2 (October 2004): 515–541.
<https://search.ebscohost.com/login.aspx?direct=true&db=eoh&AN=0762042&site=ehost-live>.

identify a favorable investment and was able to free-ride off the research likely performed by the actively managed fund portfolio. While activists are not the same as active fund managers, we believe that this finding is applicable to the intellectual property embodied in the positions of an activist investor.

35. Verbeek and Wang (2013) performed a similar analysis and found that the copycats “on average can generate returns that are close to their actively managed counterparts.” Furthermore, the performance of the copycat funds improved after the SEC implemented increased portfolio disclosures in 2004.⁴³ These results indicate that, if active managers are required to disclose more frequently, they may be susceptible to free-riding. This outcome will disincentivize activists to spend capital on research and price discovery that is necessary to effect their strategies, strategies that benefit the market overall.

2. “Front-Running” Occurs When Investors Are Able to Anticipate Other Investors’ Trades

36. Similar to free-riding, “front-running” refers to a scenario where traders buy (or sell) securities in anticipation of trades to be made by another market participant. That participant may therefore be forced to trade at unfavorable prices.⁴⁴

37. Academic literature in the context of mutual funds shows evidence that front-running can be effective when funds are required to disclose their strategies. Parida and Teo (2018) analyzed the performance of mutual funds before and after they were required by the SEC to report their portfolio holdings more frequently beginning in 2004 with the hypothesis that more frequent disclosure invites front-running.⁴⁵ They used a sample of domestic equity funds where 777 made quarterly disclosures voluntarily prior to 2004 and 392 made semi-annual disclosures before 2004 and then were required to make quarterly disclosures thereafter. Their

⁴³ Marno Verbeek and Yu Wang, “Better than the original? The relative success of copycat funds,” *Journal of Banking and Finance* 37, no. 9 (September 2013): 3454-3471. <https://doi.org/10.1016/j.jbankfin.2013.04.024>.

⁴⁴ For a discussion of this phenomenon in the context of mutual fund trading, see Sitikantha Parida and Terence Teo, “The impact of more frequent portfolio disclosure on mutual fund performance,” *Journal of Banking and Finance* 87, (February 2018): 427-445. <https://doi.org/10.1016/j.jbankfin.2015.01.018>.

⁴⁵ Sitikantha Parida and Terence Teo, “The impact of more frequent portfolio disclosure on mutual fund performance,” *Journal of Banking and Finance* 87, (February 2018): 427-445. <https://doi.org/10.1016/j.jbankfin.2015.01.018>.

results confirmed the hypothesis and found that after 2004, the mutual funds that were forced by regulation to disclose quarterly performed 22 basis points worse, on average. The researchers also found that a hypothetical front-running strategy was more profitable in periods where portfolio disclosures occurred more frequently. While these findings show that front-running based on position disclosure can be costly for mutual fund traders, we believe the analysis is applicable to an activist, which faces high costs for each campaign. If traders learn of an activist's strategy at an early stage, they can effect trades designed to make it more costly for the activist to continue to implement its strategy.

3. Costs of Free-Riding and Front-Running Would Be Borne by Activists and Benefits Would be Taken by Sophisticated Investors

38. As discussed above, disclosure of an activist's TRS position may prematurely reveal the activist's strategy and objectives. The disclosure of an activist campaign is frequently accompanied by a large stock price reaction as discussed above in section III.C. Among Bloomberg Core Activists, the average disclosure results in a 4% market-adjusted increase in the stock price of the public company that is the focus of an activism campaign. Given this historical pattern, investors are likely to anticipate similar price responses to future activist announcements.⁴⁶ If an activist was required to disclose its position prematurely, it is likely that the market would attempt to predict the activist's intentions and future contributions to the public company and the price would rise, reflecting those predictions.

39. Bebchuk and Jackson (2012) explain that activist investors are incentivized by acquiring shares at prices "that do not yet fully reflect the expected value of the [activist's] future

⁴⁶ In fact, there are already analysts that attempt to anticipate the identities of companies that may become the focus of activist investors. *See, e.g.,* Don Bilson, "Event-Driven Research: Splunk finds its own steal, Anaplan leaves the hiccups behind, Elliott is 'Activist X' at Mercury, Pentair loads up on ice (SPLK, PLAN, ZUO, MRCY, PNR, SWX, Foley, DOMO)," Gordon Haskett Research Advisors, March 3, 2022. (In reference to Mercury Systems, "...a 13-G filed by Bank of America on 1/31 MIGHT be traceable to 'Activist X.' Other prime brokers also bought stock during Q4."). Don Bilson, "Event-Driven Research: Macy's isn't headed for Splittsville, Cummins scores points for meritorious deal, Verisk can't stop making news, Tegna says 'yes' (M, CMI, VRSK, TGNA, HTA, VOYA, RSG)," Gordon Haskett Research Advisors, February 22, 2022. (In response to governance and compensation changes by Verisk Analytics, "TBD is whether an activist now jumps out of the woodwork today and tries to take some credit for all this activity. We mentioned on Friday that the aforementioned changes smelled funny and because they were announced just as the nomination window was opening, we reasoned that VRSK might have someone pushing it in this direction.").

monitoring and engagement activities.”⁴⁷ The rise in price following the premature disclosure of an activist position may make the activist’s strategy uneconomical to pursue further. If, as would almost certainly be the case under the Proposed Rule, the activist had not yet fully built its position, any further increase in its position would come at a greater cost and may be less likely to be profitable if the value of the activist’s contributions is already incorporated. This reduces the incentives for investors to pursue activist strategies, and in some cases may make activist strategies entirely unviable.

40. Aragon et al. (2013) further described the type of costs that activists would face in the context of confidentially treated Form 13-F filings:

Increased transparency... comes at a cost if it reveals proprietary information that allows competitors to free-ride on a fund manager’s efforts to identify profitable investments and trading strategies. Increased transparency is also costly when it allows front-runners to trade against a fund that is in the process of accumulating or disposing of a position.⁴⁸

41. Premature disclosure of activist positions creates more opportunities for the rewards of activists’ research and monitoring to be taken by other sophisticated investors. This would serve to disincentivize activist strategies, and the market would lose the many benefits that activist investors bring.

C. Additional Considerations

42. In addition to the consequences related to the price increase that commonly accompanies an activist announcement, the Proposed Rule would also lead to increased opportunities for the companies in question to adopt well-known shareholder defense mechanisms that could further reduce market efficiency.

⁴⁷ Lucian A. Bebchuk and Robert J. Jackson Jr., “The Law and Economics of Blockholder Disclosure,” *Harvard Business Law Review* 2, no. 1 (Spring 2012): 39-60.
<https://heinonline.org/HOL/P?h=hein.journals/hbusrew2&i=49>.

⁴⁸ George O. Aragon, Michael Hertzel, and Zhen Shi, “Why Do Hedge Funds Avoid Disclosure? Evidence from Confidential 13F Filings,” *The Journal of Financial and Quantitative Analysis* 48, no. 5 (October 2013): 1499–1518. <http://www.jstor.org/stable/43303849>.

1. Companies Would Have Increased Opportunities to Adopt Management Entrenchment Mechanisms

43. The Proposed Rule would alert management and the board to the activist’s plans far earlier than would otherwise be the case. This early alert may give the company the opportunity to react by adopting defense mechanisms before the activist has a chance to develop its strategy. For example, companies may have additional opportunities to adopt so-called “poison pills” and other defensive measures that entrench management. Poison pills are a tactic used by public companies to prevent hostile takeovers and can also be used to prevent activist investors from acquiring large stakes.⁴⁹

44. In a recent example, JANA disclosed their 6.6% stake in **Mercury Systems, Inc. (“Mercury”)** on December 23, 2021. In response to the threat of activism, Mercury put a poison pill in place with a 7.5% threshold, deterring JANA from increasing its stake.⁵⁰ Such mechanisms not only deter the activist from acquiring a larger stake in the company, but also entrench management and insulate them from outside engagement, which can impose costs on all shareholders of the company.⁵¹

⁴⁹ Marcel Kahan and Edward Rock, “Anti-Activist Poison Pills,” *Boston University Law Review* 99, no. 3 (May 2019): 915-970. See also Lucian Bebchuk, Alma Cohen and Allen Ferrell, “What Matters in Corporate Governance,” *Review of Financial Studies* 22 (2009): 783-828 (discussion of the negative impact on firm value of the adoption of poison pills and other entrenchment actions taken by companies in response to activism, as discussed in Section III.B.5 above).

⁵⁰ Tomi Kilgore, “Mercury Systems adopts 1-year ‘poison pill,’ following disclosure of Jana Partners acquiring a 6.6% stake,” *Dow Jones MarketWatch*, December 28, 2021. <https://www.morningstar.com/news/marketwatch/20211228123/mercury-systems-adopts-1-year-poison-pill-following-disclosure-of-jana-partners-acquiring-a-66-stake>.

⁵¹ Lucian A. Bebchuk, Robert J. Jackson Jr., and Wei Jiang, “Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy,” *Journal of Corporation Law* 39, no. 1 (Fall 2013): 1-34. <https://heinonline.org/HOL/P?h=hein.journals/jcor139&i=11>. (“Consider, for example, a situation in which an outside investor opposed by management makes a public announcement immediately upon accumulating a five percent stake in the company. Then suppose that the company quickly adopts a poison pill with a low threshold that prevents, or significantly limits, further accumulation of stock by the buyer. In this case, the company’s response to the immediate disclosure would not enable public investors to capture higher prices for shares they sell to the large shareholder; to the contrary, it would prevent these investors from selling shares to the outside shareholder at mutually beneficial prices. Furthermore, by entrenching insiders and insulating them from engagement by large outside shareholders, low-threshold poison pills could well impose costs on even those public shareholders who do not wish to sell their shares.”)

2. Reduction of Activist Activity in the Market Would Reduce Market Liquidity and Price Discovery

45. A reduction in activist activity would impair price discovery.⁵² Sophisticated investors such as activists contribute critical research to the market that promotes price discovery. If activists are disincentivized from conducting price-discovering research, stocks will trade at inefficient prices and bid-ask spreads will widen, which creates more opportunities for price manipulation, leading to further inefficiencies.

46. A reduction in activist activity in the TRS market will also likely impair liquidity and price discovery in TRS and other security-based swaps.⁵³ Investors trade significantly more volume in stocks if their position is confidential.⁵⁴ When activists build their positions, their trading adds to the market liquidity in the underlying stocks. Liquidity also increases due to increased activity as the stock comes on the radar of other types of investors, including people who believe in strategies of the activist fund. A reduction in activist and other TRS investor activity will reduce overall TRS trading, likely by a material amount. This reduction in TRS activity will result in a reduction in liquidity of the underlying stock, reducing price discovery and widening bid-ask spreads, making markets less efficient.

47. Liquidity is critical as it provides an opportunity for investors who are disposing their positions to do so without causing price volatility. Furthermore, liquidity in the stock leads to better liquidity in derivative products, as investors looking to hedge their positions are able to

⁵² Vikas Agarwal et al., Vikas Agarwal, Wei Jiang, Yuegua Tang, and Baozhong Yang, “Uncovering Hedge Fund Skill from the Portfolio Holdings They Hide,” *The Journal of Finance* 68, no. 2 (April 2013): 739-783, <https://doi.org/10.1111/jofi.12012>. (“Timely disclosure of portfolio holdings may reveal information about proprietary investment strategies that outside investors can free-ride on without incurring the costs of research themselves. Hence, some delay in disclosure is desirable for the preservation of incentives to collect and process information, which contributes to the informational efficiency of financial markets.”)

⁵³ Grossman, S. J., & Stiglitz, J. E. (1980). On the Impossibility of Informationally Efficient Markets. *The American Economic Review*, 70(3), 393–408. <http://www.jstor.org/stable/1805228>.

⁵⁴ Vikas Agarwal, Wei Jiang, Yuegua Tang, and Baozhong Yang, “Uncovering Hedge Fund Skill from the Portfolio Holdings They Hide,” *The Journal of Finance* 68, no. 2 (April 2013): 739-783, <https://doi.org/10.1111/jofi.12012>. (“Confidential treatment allows hedge funds to accumulate larger positions in stocks, and to spread the trades over a longer period of time. Such relief benefits both informed and liquidity-motivated trading. Hedge funds trade approximately three times more in their confidential stocks compared to the stocks included in their original holdings; they also take almost three times as long to accumulate their confidential stakes. Such trades may well be motivated by information, as indicated by the superior performance of confidential holdings as a whole. Nevertheless, price impact is also an important factor motivating confidentiality seeking.”)

more effectively and efficiently execute trades. Reduced liquidity in the market for a stock can be very costly for investors as well as the company's management. Lower liquidity prevents many institutional investors (such as pension and mutual funds) from investing in such companies as it increases the cost of accumulation and disposal of positions. Additionally, the company suffers as it is not able to efficiently raise capital for its operations.

V. APPENDIX A: THE CONCEPT OF PROPRIETARY INFORMATION IN SECURITIES MARKETS IN LAW AND RULE

48. The present rulemaking for 10B-1 departs from longstanding regulatory precedent by proposing that information that has historically been considered proprietary and subject to protection in statute and regulatory rules be publicly disclosed.

49. The proposal abandons well-developed regulatory protections for proprietary information that have existed in commercial agreements and financial markets going back over a century. Congress, in adopting the Securities Exchange Act of 1934 and the Commodity Exchange Act of 1936, granted the agencies the ability to regulate organized exchanges where price discovery was centralized and governed by exchange rules. At the same time, the exchanges, self-regulatory organizations, securities information providers, and others who processed data rigorously limited public disclosure of trader identities or individual positions.

50. The SEC and the CFTC are also limited by separate statutory provisions from disclosing names of customers associated with specific positions and trading strategies inherent in commercial contracts and derivatives. Thus, the sweeping application envisioned under the Proposed Rule conflicts with the protections imposed on exchanges, market participants, and swap data repositories who are disseminating securities-based swaps data in furtherance of the Dodd Frank Act.

51. Based on longstanding precedent both in law and rule, the information that is reported publicly is generally presented in aggregate to protect commercially sensitive information of market participants (e.g., their trading strategies). For example, publicly reported data generally do not reveal specific names of entities or individuals entering the transactions, their associated positions in these or other related assets, or the evolution of their positions in derivatives. While the SEC requires Schedule 13-D and 13-F filings that ultimately reveal some market participants' positions, these filings are well established and serve specific purposes.

52. Most public reports maintain the confidentiality of specific trade information, and to the extent those reports include such information, they are anonymized and aggregated.⁵⁵ Swap data repositories produce reports containing aggregated data, including notional amounts, price, and other specific contract fields, but they do not reveal individual counterparties' identity or names to the public.⁵⁶

53. While the SEC refers to the OTC derivatives market and SBS as “opaque”⁵⁷, the market has already attained substantial transparency thanks to the efforts of the SEC and many in the industry. Entities such as the BIS, the International Swaps and Derivatives Association, prudential regulatory authorities including the Office of the Comptroller of the Currency, and the CFTC have access to and produce useful analyses and reports made available to and used by the public.

54. Additionally, the Dodd Frank Act requires the CFTC to produce a report on volumes, notional outstanding, clearing, and participation type for the swaps traded within their jurisdiction on a semiannual and annual basis. Although the CFTC elected to produce the report on a more frequent basis, the CFTC's Weekly Swaps Report (the “CFTC Swaps Report”) does not provide information on the identities or specific positions that it has available to it through the SDR data. As the CFTC explains, the CFTC Swaps Report “aggregates a comprehensive body of swap market data that was not previously reported to regulators or regulated entities” and “complements the data made available to the public pursuant to the requirements of the SEC's regulations governing Real-Time Public Reporting of Swap Transaction Data.”⁵⁸ Even though the SEC receives a significant amount of additional information in furtherance of the

⁵⁵ This includes reports generated by entities such as regulators, self-regulatory authorities, swap data repositories, and securities information providers.

⁵⁶ See ICE Trade Vault, “Public Dissemination Guide,” January 2021, <https://www.sec.gov/rules/other/2021/ice-trade-vault/exhibit-n.4-ice-trade-vault-public-dissemination-guide-final-february-2021.pdf>; See ICE Trade Vault SEC Real-time ticker, <https://icetradevault.com/tvsec/ticker/>.

⁵⁷ U.S. Securities and Exchange Commission, “Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information,” *Federal Register* 80, no. 53 (March 19, 2015): 14564, <https://www.govinfo.gov/content/pkg/FR-2015-03-19/pdf/2015-03124.pdf>.

⁵⁸ “Weekly Swaps Report.” CFTC, <https://www.cftc.gov/MarketReports/SwapsReports/index.htm>.

Large Trader Reporting requirements for physically settled commodity swaps, these aggregated data are the only data or schedule of information made available by the CFTC to the public.

55. Academic literature also strongly supports the importance of confidentiality of proprietary trading information. (See section IV.A).

Exhibit 1
Campaign Summary Statistics for Bloomberg Core Activists Engaging with U.S. Companies¹
2017 - 2021

Activist (1)	Number of Campaigns (2)	Average Market Value of Company at Start of Campaign (\$M) ² (3)	Average Stake at Start of Campaign ² (4)
Ancora Advisors LLC	18	1,519	5.6%
Barrington Capital Group LP	7	2,012	2.1%
Cannell Capital LLC	14	201	6.9%
Cevian Capital AB	1	12,481	6.9%
Corvex Management LP	7	13,816	6.3%
Elliott Investment Management LP	47	20,040	6.8%
Engaged Capital LLC	10	1,323	7.9%
Engine Capital Management LLC	16	1,094	3.6%
FrontFour Capital Group LLC	4	1,077	4.1%
Gatmore Capital Management LLC	1	32	6.5%
Heng Ren Investments LP	4	408	5.3%
Hudson Executive Capital LP	10	711	7.4%
Icahn Enterprises LP	16	17,538	8.4%
JANA Partners LLC	21	53,459	4.9%
JCP Investment Management LLC	8	803	4.8%
KGI - Global Investments AS	6	19,171	0.7%
Land & Buildings Investment Management LLC	16	9,799	1.0%
Legion Partners Asset Management LLC	19	1,456	4.8%
Lion Point Capital LP	8	2,400	8.3%
Macellum Capital Management LLC	5	3,646	6.9%
Mangrove Partners	3	551	7.6%
Mantle Ridge LP	3	23,060	10.0%
Northern Right Capital Management LP	1	77	9.5%
Pershing Square Capital Management LP	5	64,461	2.4%
Praesidium Investment Management Co LLC	4	1,426	6.0%
Privet Fund Management LLC	4	133	5.9%
Quarz Capital Management Ltd	1	1,183	N/A
Raging Capital Management LLC	7	1,019	11.7%
Red Mountain Capital Partners LLC	1	1,805	3.3%
Roumell Asset Management LLC	8	118	4.6%
Sachem Head Capital Management LP	10	7,721	5.4%
Sarissa Capital Management LP	5	1,344	12.1%
Seidman & Associates LLC	7	69	5.5%
Sherborne Investors Management LP	1	3,433	16.0%
Starboard Value LP	41	11,563	5.5%
Stilwell Value LLC	11	64	7.5%
TCI Fund Management Ltd	11	239,965	3.5%
Third Point LLC	9	74,435	1.8%
Trian Fund Management LP	7	67,836	5.4%

Exhibit 1
Campaign Summary Statistics for Bloomberg Core Activists Engaging with U.S. Companies¹
2017 - 2021

Activist	Number of Campaigns	Average Market Value of Company at Start of Campaign (\$M)²	Average Stake at Start of Campaign²
(1)	(2)	(3)	(4)
ValueAct Capital Partners LP	16	21,551	5.1%
Viex Capital Advisors LLC	12	261	7.7%
Voce Capital Management LLC	8	850	2.4%
Wynnefield Capital Inc	6	151	10.8%
Total	419	19,181	5.7%

Notes and Sources:

Data are from Bloomberg, L.P.

¹ Campaigns in U.S. exchange-traded companies by activists that Bloomberg defines as "Core Activists" between 2017 and 2021.

² Bloomberg does not report stake and market value for every campaign. Averages are only taken across campaigns with available data. The "Stake" reported by Bloomberg is based on publicly available information, and thus does not reflect non-public positions that an activist takes as part of its campaign.

Exhibit 2
One-Day Returns to Campaign Announcements and Aggregate Market
Impact by Bloomberg Core Activists Engaging with U.S. Companies¹
2017 - 2021

Activist	Number of Campaigns	Average Market-Adjusted Return to Campaign Announcements ²	Aggregate Market Impact to Campaign Announcements (\$M) ³
(1)	(2)	(3)	(4)
Ancora Advisors LLC	18	4.0%	1,073
Barington Capital Group LP	7	2.6%	264
Cannell Capital LLC	14	2.7%	100
Cevian Capital AB	1	1.2%	151
Corvex Management LP	7	3.1%	428
Elliott Investment Management LP	47	8.0%	29,892
Engaged Capital LLC	10	4.2%	407
Engine Capital Management LLC	16	2.9%	423
FrontFour Capital Group LLC	4	3.1%	57
Gatemoore Capital Management LLC	1	6.0%	2
Heng Ren Investments LP	4	0.5%	(12)
Hudson Executive Capital LP	10	4.7%	240
Icahn Enterprises LP	16	4.4%	3,367
JANA Partners LLC	21	6.6%	824
JCP Investment Management LLC	8	1.3%	226
KGI - Global Investments AS	6	2.6%	(1,110)
Land & Buildings Investment Management LLC	16	1.6%	2,001
Legion Partners Asset Management LLC	19	4.3%	761
Lion Point Capital LP	8	0.3%	126
Macellum Capital Management LLC	5	7.2%	379
Mangrove Partners	3	1.5%	26
Mantle Ridge LP	3	5.7%	2,906
Northern Right Capital Management LP	1	3.6%	3
Pershing Square Capital Management LP	5	2.8%	9,289
Praesidium Investment Management Co LLC	4	3.7%	210
Privet Fund Management LLC	4	5.6%	7
Quarz Capital Management Ltd	1	20.1%	238
Raging Capital Management LLC	7	4.5%	141
Red Mountain Capital Partners LLC	1	2.9%	52
Roumell Asset Management LLC	8	4.3%	39
Sachem Head Capital Management LP	10	6.7%	4,620
Sarissa Capital Management LP	5	0.7%	309
Seidman & Associates LLC	7	2.7%	9
Sherborne Investors Management LP	1	-5.2%	(178)
Starboard Value LP	41	4.5%	11,648
Stilwell Value LLC	11	2.7%	19

Exhibit 2
One-Day Returns to Campaign Announcements and Aggregate Market
Impact by Bloomberg Core Activists Engaging with U.S. Companies¹
2017 - 2021

Activist	Number of Campaigns	Average Market- Adjusted Return to Campaign Announcements ²	Aggregate Market Impact to Campaign Announcements (\$M) ³
(1)	(2)	(3)	(4)
TCI Fund Management Ltd	11	-0.2%	(3,522)
Third Point LLC	9	2.4%	13,710
Triam Fund Management LP	7	5.3%	2,633
ValueAct Capital Partners LP	16	2.4%	8,657
Viex Capital Advisors LLC	12	2.2%	65
Voce Capital Management LLC	8	1.0%	54
Wynnefield Capital Inc	6	-0.7%	(8)
Overall	419	3.9%	90,523

Notes and Sources:

Data are from Bloomberg, L.P. and FactSet Research Systems.

¹ Campaigns in U.S. exchange-traded companies by activists that Bloomberg defines as "Core Activists" between 2017 and 2021.

² Market-adjusted returns are calculated using an event study methodology that controls for the returns of the market on the event date. The event date is the first trading day impacted by the announcement. Raw returns are adjusted by removing market effects, which are estimated using a linear market model that regresses log returns of the target company on the log returns of the S&P 500 Total Return index for the calendar year prior to the announcement. In cases where less than one calendar year of data is available, the regression includes all available data prior to the announcement. Market-adjusted log returns are converted to percent returns. Four campaigns with missing data are excluded.

³ In instances where multiple Core Activists announce campaigns in the same company on the same date, net market impact is split equally among the activists. Seven campaigns with missing data are excluded.

Exhibit B
Lewis Report

Review of the Economic Analysis for Proposed Rule 10B-1 on the “Position Reporting of Large Security-Based Swap Positions”

Craig Lewis¹

March 21, 2022

¹ I am the Madison S. Wigginton Professor of Finance at Vanderbilt University’s Owen Graduate School of Management and a Professor of Law at Vanderbilt Law School. From 2011 to 2014, I was the chief economist of the Securities and Exchange Commission (the “Commission”), where I also served as director of the Division of Economic and Risk Analysis. At the Commission, I focused on economic analysis in the financial regulatory process, and oversaw activities related to agency policy, rulemaking, and risk analysis. This comment letter was commissioned by Elliott Investment Management L.P. I was supported by staff of Global Economics Group, who worked under my direction.

Overarching Comments:

- The Commission fails to identify a market failure that would necessitate the unprecedented public position reporting of cash-settled security-based swap (“SBS”) positions prescribed by proposed Rule 10B-1 (the “Proposed Rule”).² Rather than articulating a demonstrated need for regulation of cash-settled SBS, the Proposed Rule alludes to two potential concerns based on anecdotal discussions of correlated counterparty risk and opportunistic credit default swap (“CDS”) strategies.³
 - The Commission’s concern about correlated counterparty risk is motivated by the collapse of Archegos Capital Management (“Archegos”), an episode that resulted in losses at a number of large banks. Although Archegos revealed flaws in bank risk management systems that require remediation, the current market system was resilient in the sense that there were no significant disruptions to the SBS or underlying markets, or to the banking system. Market discipline was exacted through those losses, and responsible executives appropriately lost their jobs due to their poor judgment. An independent review of the bank that suffered the most significant loss associated with the event pointed the finger directly at the failures of the risk management function and decisions at the bank itself.⁴
 - Separately, the Commission’s concern of providing more transparency to “net-short debt activism” activities, as well as the other opportunistic strategies in the CDS market, is supported by anecdote rather than a systematic analysis of the frequency and scale of such issues.⁵
- The Commission overstates the deleterious role of asymmetric information and adverse selection. All markets are characterized by asymmetric information. Trading on information obtained through proprietary research leads to price discovery—an essential feature of an efficient market.
- Moreover, the Commission’s cost-benefit analysis is incomplete, and as a result, the Commission cannot reliably reach a conclusion of a net improvement to liquidity in the SBS market from the Proposed Rule. Similarly, the Commission’s discussion does not consider

² 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 Swap Positions, Release No. 34-93784 (December 15, 2021); 87 FR 6652 (February 4, 2022).

³ Proposed Rule at pp. 6655-6656.

⁴ Credit Suisse Group Special Committee of The Board of Directors Report on Archegos Capital Management (July 29, 2021), available at <https://www.credit-suisse.com/about-us/en/reports-research/archegos-info-kit.html>; SEC Proposes Rules to Prevent Fraud in Connection With Security-Based Swap Transactions, to Prevent Undue Influence over CCOs and to Require Reporting of Large Security-Based Swap Positions, Release No. 2021-259 (December 15, 2021).

⁵ Proposed Rule at pp. 6654-6656.

many of the economic consequences the Proposed Rule will have on efficiency, competition, and capital formation (“ECCF”).

- The Commission’s conjecture that position reporting will enhance liquidity is premised on the assumption that the Proposed Rule will not materially change the level of market participation, which is unlikely given reduced participation incentives. The more likely outcome is that the unintended consequence of public position reporting will be to reduce incentives to collect information resulting in a corresponding reduction in liquidity. See Grossman and Stiglitz (1980).⁶
- Mandatory public disclosure of positions will discourage investors from making an effort to collect marketplace information because others will be able to free ride on their labor by employing “copycat” strategies.⁷ If, as expected, the reporting of large positions reduces incentives to participate in the market, markets will become less liquid, and it will become costlier to trade.
- The Commission has failed to recognize that the proposed measures could have the effect of reducing the positive governance and economic effects of investor activism. The singular focus on preventing future events based on isolated and anecdotal evidence ignores the broader societal benefits of allowing market participants to take large positions to affect changes at public companies. An unintended consequence of the Proposed Rule is weaker market discipline and governance, which in turn has ECCF consequences that are not discussed in the Commission’s analysis.
- The Proposed Rule is premature considering public reporting of SBS transaction quantities and prices only became effective under Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information (“Regulation SBSR”) in February 2022.⁸ The Commission understood when enacting Regulation SBSR that it would need to better understand the impact post-trade transparency has on price efficiency—that is why the Commission promised to perform an economic analysis of the impacts of Regulation SBSR and make those findings available to the public.⁹ The Commission has not completed its retrospective

⁶ Grossman, Sanford J., and Joseph E. Stiglitz. “On the impossibility of informationally efficient markets.” *The American economic review* 70.3 (1980): 393-408, available at <http://www.jstor.org/stable/1805228>.

⁷ Copycat strategies can be employed where disclosure allows other investors to copy an actively managed fund’s investments. See Frank, Mary Margaret, et al. “Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry.” *The Journal of Law and Economics* 47.2 (2004): 515-541.

⁸ Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 34-74244 (Feb. 11, 2015), 80 FR 14564 (Mar. 19, 2015); SEC Approves Registration of First Security Based Swap Data Repository; Sets the First Compliance Date for Regulation SBSR, Release No. 2021-80 (May 7, 2021).

⁹ Regulation SBSR at pp. 14708-14709.

reviews, which should be a prerequisite to the consideration of imposing additional reporting obligations on the SBS market.

- The Commission repeatedly mischaracterizes the academic research it relies upon to support the benefits of transparency. The opportunistic framing of the academic literature was one of the concerns that caused the U.S. Court of Appeals for the District of Columbia Circuit to vacate the Commission’s rule on “proxy access” in 2011, in which the court determined that the Commission failed to adequately address the rule’s economic effects.¹⁰
- There are striking differences in the Proposed Rule’s economic analysis and those presented in the Commission’s recent rule proposals regarding position reporting for short sales and beneficial ownership. The Commission’s decision to apprise the public about the negative economic consequences regarding corporate governance, predatory trading, and investors’ incentives to trade in contemporaneous rules but not in the Proposed Rule (despite direct overlap in economic issues) is arbitrary and capricious.¹¹
- The Commission has not considered a number of reasonable alternatives to the Proposed Rule, including an alternative in which SBS data is provided on a confidential basis to the Commission as opposed to being disclosed publicly and an alternative that establishes good faith obligations on CDS counterparties to disclose material incentives or conflicts in respect to their CDS positions.

¹⁰ *Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission* (D.C. Cir. July 22, 2011), [https://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/\\$file/10-1305-1320103.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf).

¹¹ Modernization of Beneficial Ownership Reporting, Release No. 34-94211 (Feb. 10, 2022), 87 FR 13846, (Mar. 10, 2022); Short Position and Short Activity Reporting by Institutional Investment Managers, Release No. 34-94313 (Feb. 25, 2022).

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I. Overview of Analysis

I was commissioned by Elliott Investment Management L.P. (“Elliott”) to assess the soundness of the economic analysis included in the Commission’s proposed Rule 10B-1 requiring public position reporting of large SBS positions, which was published in the Federal Register as part of the Commission’s Release No. 34-93784 on February 4, 2022 (the “Release”).¹² In this report, I compare the Commission’s analysis to what is required by statute or otherwise acknowledged by the Commission as a practice it follows to maintain consistency with Executive Orders on regulatory economic analysis.

The statutory requirements and practices are provided in the Commission’s March 2012 memorandum covering economic analysis in Commission rulemakings (the “Guidance”). Under the direction of former Commission Chairman Schapiro, the Guidance was developed by the Division of Risk, Strategy, and Financial Innovation (now the Division of Economic and Risk Analysis) and the Office of the General Counsel. The Guidance was the Commission’s response to court decisions, reports by the U.S. Government Accountability Office and the Commission’s Office of Inspector General, and inquiries from Congress that raised questions about the efficacy of the Commission’s economic analysis in rulemaking.¹³

The Guidance draws on the principles set forth in the Office of Management and Budget (OMB) Circular A-4, which provides guidance for implementing Executive Order 12866. The Guidance states:

*It is widely recognized that the basic elements of a good regulatory economic analysis are: (1) a statement of the need for the proposed action; (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation; (3) the identification of alternative regulatory approaches; and (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.*¹⁴

In addition to following these principles, the Commission has a statutory obligation to:

*consider efficiency, competition, and capital formation whenever it is “engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest”.*¹⁵

¹² This report is provided to the Commission as an exhibit to Elliott’s March 21, 2022 comment letter on the Proposed Rule. I was supported in this effort by the staff of Global Economics Group, who worked under my direction.

¹³ “Current Guidance on Economic Analysis in SEC Rulemakings,” March 16, 2012, available at: https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

¹⁴ Guidance at p. 4.

¹⁵ Guidance at p. 3.

Based on my review, the Proposed Rule's economic analysis does not comply with the Commission's internally established standards on economic analyses. The Commission does not consider many important market effects from the Proposed Rule, and in consequence, the Commission does not provide a reliable analysis of the impact of the Proposed Rule on ECCF. The economic analysis narrowly focuses on the compliance costs of filing the proposed reports, which are inferior to the effects the Proposed Rule will have through the release of the proprietary trading strategies and intellectual property belonging to some of the largest participants in the SBS market.

The stated purpose of the Guidance was to ensure, "that decisions to propose and adopt rules are informed by the best available information about a rule's likely economic consequences, and allows the Commission to meaningfully compare the proposed action with reasonable alternatives, including the alternative of not adopting a rule."¹⁶ The Commission has not met this standard. As a result, the Commission has presented the public with an unsupported and speculative conclusion that the Proposed Rule will create net benefits for liquidity in the SBS market.¹⁷

II. The Commission Has Not Identified a Market Failure

The Release justifies the Proposed Rule: by claiming that additional transparency of large SBS positions will mitigate against the effects of (1) net-short debt activism and other CDS opportunistic strategies and (2) risk posed by the concentrated exposure of a counterparty.¹⁸ Neither of these events provide the basis for a market failure requiring regulatory intervention. Moreover, the intervention proposed is not proportional to the harm purported. The Proposed Rule would:

- Require any person, or group of persons, with a security-based swap position that exceeds a specified reporting threshold to promptly file a Schedule 10B disclosing certain information related to its position.
- Provide that any Schedule 10B be filed promptly but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the security-based swap position exceeding a reporting threshold.
- Require reporting persons to file amendments promptly in the event of any material change to a previously filed Schedule 10B.
- Require persons to disclose certain information including: the identity of the reporting person and the security-based swap position, as well as the underlying loans or securities and any related loans and securities.¹⁹

Requiring reporting for all positions of a certain size goes well beyond the limited instances of CDS net-short debt activism and opportunistic strategies. The Commission has not shown these

¹⁶ Guidance at p. 1.

¹⁷ Proposed Rule at p. 6689.

¹⁸ Proposed Rule at p. 6656.

¹⁹ Proposed Rule at pp. 6668 - 6673.

practices to be anything but anecdotal.²⁰ And the Commission has failed to document any episode let alone systemic evidence of counterparty risk exposure of concentrated positions causing harm to markets. This would be a necessary first step to establish a market failure where disclosure of position data is warranted.

A. Opportunistic CDS Strategies and Net-Short Debt Activism

The Release and the related academic literature - Hu (2018), Fletcher (2019), and Danis and Gamba (2019) - describe opportunistic behavior by CDS counterparties.²¹ These strategies often include: (1) attempts to either accelerate or delay technical default, and (2) situations where there is an “empty creditor” problem, in which the bondholder owns the bond but is not exposed to price risk due to an offsetting position in a CDS.²² One form of the empty creditor problem is called “net-short debt activism.” In this scenario, the bondholder creates net-short exposure by buying CDS with a notional amount that exceeds its investment in the underlying bonds. The empty creditor’s incentives deviate from those of other creditors because the empty creditor has incentives to trigger payment mechanisms—an outcome other creditors and CDS sellers would prefer to avoid. This is a moral hazard cost that results from the possibility that protection buyers behave opportunistically. While the Proposed Rule points to a relatively small number of anecdotal examples of this behavior, there can be legitimate business reasons for a bond investor to be simultaneously long bonds and CDS that range from hedging to speculation about underperformance. Since there is no “smoking gun,” public disclosure can only alert investors to potential empty creditor concerns; it does not prevent them from occurring.

²⁰ The Release cites three academic studies that address opportunistic strategies. Danis and Gamba (2019) report that over the 2013-2019 period, 12 of the 13 events in their Table 1 summarizing recent cases involve situations where protection buyers and/or sellers have taken actions designed to influence the determination of a credit event. Hu (2018) and Fletcher (2019) respectively describe four and three events, all of which are included in the Danis and Gamba sample. Danis, Andras, and Andrea Gamba. “Dark knights: the rise in firm intervention by CDS investors.” WBS Finance Group Research Paper 265 (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479635; Fletcher, Gina-Gail S. “Engineered Credit Default Swaps: Innovative Or Manipulative.” NYUL Rev. 94 (2019): 1073, available at <https://www.nyulawreview.org/wp-content/uploads/2019/11/Gina-Gail-S.-Fletcher.pdf>; Hu, Henry TC. “Corporate distress, credit default swaps, and defaults: Information and traditional, contingent, and empty creditors.” Brook. J. Corp. Fin. & Com. L. 13 (2018): 5, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3302816). By contrast, concerns about correlated counterparty exposure are limited to a reference to Archegos Capital Management in the press release introducing the Proposed Rule. See SEC Proposes Rules to Prevent Fraud in Connection With Security-Based Swap Transactions, to Prevent Undue Influence over CCOs and to Require Reporting of Large Security-Based Swap Positions, Release No. 2021-259 (December 15, 2021).

²¹ See *supra* note 20.

²² See the discussion in Hu, Henry TC. “Corporate distress, credit default swaps, and defaults: Information and traditional, contingent, and empty creditors.” Brook. J. Corp. Fin. & Com. L. 13 (2018): 5, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3302816) at pp. 18-20.

The Commission fails to assess the significance of the problem it is proposing to address.²³ The public needs to understand the frequency of events the Commission is trying to address relative to the overall size of the market and the frequency of CDS events in order to understand the baseline against which the Proposed Rule's likely economic impact can be measured.

In addition to the Proposed Rule, the Commission is simultaneously proposing Rule 9j-1 to address manipulative or fraudulent behavior in the CDS market. Rule 9j-1 states that it would be unlawful for:

*any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange, to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security-based swap, in connection with which such person engages in any fraudulent, deceptive, or manipulative act or practice, makes any fictitious quotation, or engages in any transaction, practice, or course of business which operates as a fraud or deceit upon any person.*²⁴

This is problematic because the economic analysis conflates the intended benefits and costs without considering whether both rule elements (10B-1 and 9j-1) are strictly necessary. I argue below that the deterrence benefits of Rule 9j-1 would effectively address many of the manufactured and other opportunistic CDS strategies the Commission is concerned about and render the public reporting of positions unnecessary. Even though Rule 9j-1 is yet to be adopted, the Commission needs to address the redundancy between the two proposals so the benefits of an adoption of the Proposed Rule and/or proposed Rule 9j-1 can be properly understood. It would be necessary for the Commission to establish that a market failure exists that would require public position reporting were proposed Rule 9j-1 to be finalized.

A.1 Private action solutions to the empty creditor problem

The SBS market is not a retail market; eligible contract participants who, when individuals, have \$10 million invested on a discretionary basis (or \$5 million if hedging), can participate.²⁵ The Commission's own analysis acknowledges that:

*Active participants in the CDS market tend to be (a) highly-informed investors, such as hedge funds, pension funds, endowments, etc., that have a directional view on the economic prospects of an issuer; and (b) participants who have some natural exposure to the credit risk they want to hedge, such as ownership of the issuer's bonds or counterparty exposure to the issuer. The latter category tends to include, for example, insurance companies, fixed-income investment funds, and broker-dealers.*²⁶

²³ The Guidance addresses the need for the Commission to assess the significance of the problem addressed by a rule. See the Guidance at p. 5.

²⁴ Proposed Rule at p. 6653.

²⁵ Section 1a(18) of the Commodity Exchange Act 7 U.S.C.

²⁶ Proposed Rule at p. 6680.

Despite the sophistication of market participants in the SBS and fixed income markets, the Commission speculates in the Proposed Rule that a lack of transparency prevents market participants from acting in an informed manner. Before concluding that a small number of examples constitute a market failure, the Commission should consider whether market-based solutions can solve these problems. One recent example is the ISDA 2019 Narrowly Tailored Credit Event Supplement to the 2014 Credit Derivatives Definitions.²⁷ In this amendment, ISDA amended the definition of “Failure to Pay” to provide that the relevant payment failure must result from the deterioration in creditworthiness of the underlying corporate entity. While this change is narrow in scope, it demonstrates how targeted contracting by private actors can be an effective substitute for regulation.

Additionally, the attachment of legal liability is expected to deter opportunistic trading practices. To the extent that proposed Rule 9j-1 is not fully effective, one might expect sophisticated bond investors to demand covenants that directly address the empty creditor problem. One possibility is the inclusion of a covenant that would vacate the opportunity for individual bondholders to participate in bankruptcy proceedings if they have conflicting economic incentives relative to other bondholders.

A shortcoming of the Commission’s characterization of a market failure is the failure to address why private action by sophisticated market participants cannot address the concerns noted in the Release.

A.2 Monitoring opportunistic behavior and the benefit of public position reporting

The Commission could have demonstrated the potential for a market failure by developing a rigorous baseline using data to which it already has access. The Proposed Rule claims that data gaps exist that make it difficult to match long bond positions contained in Forms N-PORT, 13-F, and to a lesser extent Form PF with CDS position data derived from the Depository Trust & Clearing Corporation Trade Information Warehouse (“DTCC-TIW”).²⁸ While such an exercise poses challenges, it is feasible. Had the Commission tried to link these databases, it could have provided summary data that characterized the extent of the empty creditor problem, which would then support a proper economic analysis of this aspect of the Proposed Rule.

When Commission rules are intended to deter bad actors, the Commission still needs to monitor compliance. Position reporting could be helpful in this regard because it would place all of the data the Commission requires to identify potential violations in a convenient location. There are a

²⁷ 2019 Narrowly Tailored Credit Event Supplement to the 2014 ISDA Credit Derivatives Definitions, International Swaps and Derivatives Association, Inc. (July 15, 2019) at p. 3, <https://www.isda.org/a/KDqME/Final-NTCE-Supplement.pdf>.

²⁸ Proposed Rule at p. 6683-6685. It is possible to use the existing DTCC transaction data to compile daily gross and net CDS positions. Given a long enough time series, the Commission can build positions from transaction data. Historically, it also has had access to DTCC position files, which could serve as an unambiguous starting point.

number of reasons, however, that the Commission has failed to identify the necessity of *public* position reporting:

- The Commission may already have access to much of the required information in Form N-PORT, Form 13-F, Form PF, and Regulation SBSR and its access to swap data through the DTCC-TIW.
- Given the infrequency of insolvency events that trigger technical defaults, the Commission’s monitoring of potential empty creditor problems resolves itself over relatively long periods of time. Effective monitoring would not require next day position reporting because the Commission already has access to this information.
- Public position reporting accommodates copycat trading strategies and position front running. This reduces liquidity and results in less efficient markets. It may alert issuers to potential problems, but the Commission’s existing anti-fraud and anti-manipulation authorities should mitigate these concerns (and, if adopted, expanded proposed Rule 9j-1 should further mitigate these concerns).
- Convenience is not a justification for rulemaking.

Even if the Commission decides that it needs to close existing reporting gaps by requiring the submission of a newly designed form, it is unclear why the disclosure needs to be public.²⁹ In a notably ironic set of policy choices, the Commission’s recently proposed rule on Short Position and Short Activity Reporting by Institutional Money Managers (the “Proposed Short Sale Rule”) reaches the opposite conclusion regarding public disclosure.³⁰ It opts instead for aggregated data and monthly disclosure. It concludes:

The Commission believes that publicly disclosing the identity of individual reporting Managers may not currently be necessary to advance the policy goal of increasing public transparency into short selling activity, and that aggregating across reporting Managers would help safeguard against the concerns noted above related to retaliation against short sellers, including short squeezes, and the potential chilling effect that such public disclosure may have on short selling.³¹

This conclusion was reached in an environment in which retail investor protection concerns are of first-order importance. This contrasts with the decidedly institutional environment for fixed

²⁹ The Release notes that the Commission did not have access to total return swap data at the time of the release. Since reporting under Regulation SBSR has become effective, the Commission could gain access to this data.

³⁰ Short Position and Short Activity Reporting by Institutional Investment Managers; Notice of Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail for Purposes of Short Sale-related Data Collection, Release No. 34-94313 (Feb. 25, 2022), at p. 16.

³¹ Proposed Short Sale Rule at p. 18.

income and security-based swap trading and the sophistication of those that participate in these markets.

B. Counterparty Risk (Archegos)

According to Commission Chair Gary Gensler,

*In March, when Archegos Capital Management collapsed, we saw once again the risks that might arise from the use of another security-based swap — total return swaps. As part of the Dodd-Frank Act of 2010, Congress granted this agency broad authority with regard to security-based swaps, including three important authorities we’re acting upon here today.*³²

The Release highlights that “...a market participant who decides to take on a large leveraged position in the underlying entity through a TRS will not internalize the total societal cost of a negative outcome where it declares” and states: “[r]eporting could alleviate the externality by making information public that could be incorporated into TRS prices, thus requiring the party with the equity exposure to fully pay for the additional risks that it is incurring.”³³

If the Commission believes that there are negative externalities from large positions, it should present evidence to support this claim. As previously stated, the Archegos episode demonstrated well-functioning markets that included appropriate disciplining mechanisms for the market participants that exhibited poor judgment. Importantly, market participants had the ability and recourse to collect the necessary information before enacting positions, and the participants that did so prudently, avoided the losses. There were no externalities from this episode that engendered systemic or other risk concerns.

With Regulation SBSR in place, the Commission and other regulatory authorities can now access detailed information for SBS transactions. The Commission now knows the counterparties involved in SBS market transactions and has an understanding of how concentrated the risks are in the SBS market. The Commission explicitly stated its view that the data available under Regulation SBSR, “will enable the Commission and other relevant authorities to conduct robust monitoring of the security-based swap market for potential risks to financial markets and financial market participants.”³⁴ In presenting the need for the Proposed Rule and its benefits, the Commission should put the public on notice that the baseline regulatory structure already includes robust monitoring; or the Commission should inform the public as to what has changed since the passing of Regulation SBSR and why the Commission can no longer achieve the robust monitoring that it promised the public.

³² SEC Proposes Rules to Prevent Fraud in Connection With Security-Based Swap Transactions, to Prevent Undue Influence over CCOs and to Require Reporting of Large Security-Based Swap Positions, Release No. 2021-259 (December 15, 2021).

³³ Proposed Rule at p. 6681.

³⁴ Regulation SBSR at p. 14700 (emphasis added).

The Commission argues that current SBS reporting data is incomplete because market participants only report transactions and not position data.³⁵ This is a disingenuous claim given that position data is directly derived and can be readily calculated from transaction data, particularly over the timeframes covered in the Regulation SBSR release.³⁶ Similarly, the Commission mentions that Regulation SBSR does not provide positions in related securities, so the Proposed Rule can further help understand systemic risks.³⁷ This was true at the time Regulation SBSR was adopted and this fact did not stop the Commission from saying robust monitoring would be achieved under Regulation SBSR.

Finally, as with opportunistic CDS strategies, the Proposed Rule fails to explain why private solutions are not sufficient to address concerns about correlated counterparty risk. If SBS dealers are concerned about such risks, they can require information about outstanding positions before transacting. This information can be used to adjust margin requirements and evaluate capital reserves. They can also use the information to decide whether to transact. If a counterparty declines to provide the requested information, a security-based swap dealer can adjust margin or decide not to transact. Consistent with these conjectures, market participants indicated that following the Archegos episode, swap dealers have cut the number of clients, the costs of trading have increased, and swap dealers have shifted to dynamic margining.

III. Incomplete and Mischaracterized Analysis of Costs and Benefits

A central conclusion of the Commission's cost-benefit analysis is that "liquidity for the overall market would improve as a result of the Proposed Rule."³⁸ However, it does not fully analyze the likely impact on market participation. Most notably, the Commission has not adequately addressed the indirect costs from the reduction of incentives to trade and the loss in incentives to engage in corporate governance and operational improvement initiatives.

Additionally, to support the benefits of broad public disclosure of CDS and related positions under the Proposed Rule, the Commission repeatedly mischaracterizes the legal and academic research on manufactured or other opportunistic CDS strategies. This type of opportunistic framing of the academic literature risks confusing the public and was one of the concerns that caused the proxy access rule to be vacated by the D.C. Circuit Court, which determined that the Commission's cost-benefit analysis was arbitrary and capricious.³⁹

³⁵ Proposed Rule at p. 6657.

³⁶ The Commission obtained position data when it studied the economic effects of Regulation SBSR. Since it already has position data at a specific point in time, it should be able to create a time series of positions using transaction data.

³⁷ Proposed Rule at p. 6688.

³⁸ Proposed Rule at p. 6689.

³⁹ *Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission* (D.C. Cir. July 22, 2011), at pp. 11-12, [https://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/\\$file/10-1305-1320103.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4D084BA5EBDA852578D5004FBBBE/$file/10-1305-1320103.pdf).

A. The Commission Fails to Recognize the Loss in the Corporate Governance Function of the Market

The public release of SBS position data will prematurely reveal information about the value of a security that activist investors have developed through their own fundamental research. SBS allow activist investors to take an economic stake in a company without some of the costs and disclosure obligations of investing in other securities. It has been well recognized that the ability to acquire large economic stakes at prices that do not fully reflect the expected value of the activist's future engagement with a corporate entity is an important source of incentives to engage in such activities.⁴⁰

There is considerable economic value shared amongst activist investors and shareholders from corporate governance and operational improvement initiatives.⁴¹ Preemptively revealing this information to the market will cause prices to adjust to the information of the activist investor's involvement before the investor is able to acquire its full desired position. The result is a decrease in the profits from employing an activist campaign and reduces incentives for investors to engage in such activities or makes them impractical. Furthermore, public disclosure would allow corporate actors to preemptively engage in actions that could hinder an activist's campaign (such as the adoption of poison pills).

The mandatory disclosure of large positions within one day of crossing the reporting threshold will materially reduce the incentives and ability for market participants to take on these positions. The Commission clearly understands this consequence. As the Commission has stated in a contemporary proposal on modernizing the reporting period of large beneficial ownership positions ("13(d) Proposing Release"):

*We also recognize that the proposed amendments could impose costs on the affected parties. For instance, the proposed amendments could increase the costs for blockholders to influence or control an issuer and potentially inhibit shareholder activism and its goal of improving corporate efficiency.*⁴²

And as the Commission has acknowledged in detail in its 13(d) Proposing Release, there is widely documented and well-established academic research supporting the positive relation between investor activism and target firm outcomes.⁴³ See for example, Brav, Jiang, Partnoy, and Thomas (2008), Clifford (2008), Becht, Franks, Mayer, and Rossi (2008), Klein and Zur (2009), Greenwood

⁴⁰ Grossman, Sanford J., and Oliver D. Hart. "Takeover Bids, the Free-rider Problem, and the Theory of the Corporation." *The Bell Journal of Economics* (1980): 42-64.; and Bebchuk, Lucian A., and Robert J. Jackson Jr. "The Law and Economics of Blockholder Disclosure." *Harv. Bus. L. Rev.* 2 (2012): 39.

⁴¹ See the report from NERA Economic Consulting attached as an exhibit to Elliott's March 21, 2022 comment letter on the Proposed Rule.

⁴² Modernization of Beneficial Ownership Reporting, Release No. 34-94211 (Feb. 10, 2022), 87 FR 13846 (Mar. 10, 2022), at p. 13880.

⁴³ 13(d) Proposing Release at pp. 13883 - 13885.

and Schor (2009), Boyson and Mooradian (2011), Gantchev (2013), Boyson, Gantchev, and Shivdasani (2017), and Fos (2017).⁴⁴

The unintended consequences of the Proposed Rule that result in weaker market discipline and lost governance are not developed by the Commission but need to be addressed. Additionally, activists may choose to execute transactions at a faster pace than they would otherwise find optimal once they approach a reporting threshold. As the Commission noted in the Proposed Short Sale Rule, faster trading “imposes increased transaction costs on [investors]” and “trading faster than is optimal may harm price efficiency by leading prices to over-react to the aggressive trading.”⁴⁵ The Commission’s failure to develop these costs is striking given that the Proposed Short Sale Rule and the 13(d) Proposing Release were released less than three months after the Proposed Rule.

B. The Proposed Rule Will Result in Front Running and Market Fragility

If the Commission’s intent is to eliminate manufactured credit events, it should recognize the potential for market participants to put trading pressure on large, *known* positions to manufacture book losses with an aim of forcing holders to liquidate their positions to avoid future losses. Front-running in this way is not only predatory, but can also lead to additional, procyclical price pressures that are dangerous to the broader market.⁴⁶

Brunnermeier and Pedersen (2005) analyze predatory trading in the context of disclosure policies, financial contagion and systemic risk. Their work highlights that, “generally, the possibility of predatory trading is an argument against very strict disclosure policy.”⁴⁷ Even under conditions, in which there are multiple predators and the disclosures are broad, predatory trading will exist. Importantly, the effects of predatory trading are not isolated to individual investors. The authors find that there are spillover effects from the financial shock to individual entities that can trigger a systemic crisis that impacts the entire financial sector. With the Proposed Rule, the Commission is introducing *potential* systemic risk for a previously existing set of risks where they have already stated they have a robust ability to monitor. Furthermore, an increase in the risk of predatory activity

⁴⁴ Brav, A., W. Jiang, F. Partnoy, and R. Thomas. “Hedge Fund Activism, Corporate Governance, and Firm Performance.” *Journal of Finance*, 63.4 (2008), 1729–1775; Clifford, C. “Value Creation or Destruction? Hedge Funds as Shareholder Activists.” *Journal of Corporate Finance*, 14 (2008), 323–336; Becht, M., J. Franks, C. Mayer, and S. Rossi. “Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes UK focus fund.” *Review of Financial Studies*, 22 (2009), 3093–3129; Klein, A. and E. Zur. “Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors.” *Journal of Finance*, 64 (2009), 187–229; Fos, V. “The Disciplinary Effects of Proxy Contests.” *Management Science*, 63(3) 2017, 655-671; Boyson N. M., N. Gantchev, and A. Shivdasani. “Activism mergers.” *Journal of Financial Economics*, 126 (2017), 54–73; Boyson, N. M. and P. Pichler. “Hostile Resistance to Hedge Fund Activism.” *Review of Financial Studies*, 32 (2019), 771–817; and Gantchev, N., M. Sevilir, and A. Shivdasani. “Activism and Empire Building.” (2020) *Journal of Financial Economics*.

⁴⁵ Proposed Short Sale Rule at p. 139.

⁴⁶ Brunnermeier, Markus K., and Lasse Heje Pedersen. “Predatory trading.” *The Journal of Finance* 60.4 (2005): 1825-1863.

⁴⁷ Brunnermeier, Markus K., and Lasse Heje Pedersen. “Predatory trading.” *The Journal of Finance* 60.4 (2005): 1825-1863, at p. 1827.

would come with corresponding reduction of position size and remove investor activity from the market.

The authors state that a reduction in predatory trading risk comes from disclosure regimes limiting information to only portfolio characteristics (as opposed to specific positions) and delaying the time of the disclosure —measures the Commission has taken in the past and actively recommended in other areas but are not part of the Proposed Rule. The Commission addressed the concerns in the Proposed Short Sale Rule, specifically noting the ill effects of knowing specific investor positions and how a reduction in liquidity could come as a result.

*The Commission believes that publicly disclosing the identity of individual reporting Managers may not currently be necessary to advance the policy goal of increasing public transparency into short selling activity, and that aggregating across reporting Managers would help safeguard against the concerns noted above related to retaliation against short sellers, including short squeezes, and the potential chilling effect that such public disclosure may have on short selling.*⁴⁸

Notably the Commission cites this concern in the Proposed Short Sale Rule under which the Commission does *not* expect to release data publicly until weeks after the end of the reporting period.⁴⁹ The disparate treatment of costs between these rules highlights one of the many infirmities of the Proposed Rule’s economic analysis.

The Commission further notes concern of releasing the data any earlier due to the increased “likelihood of copycat behavior which decreases the incentive that short sellers have to gather information potentially leading to lower price efficiency and greater volatility.”⁵⁰ Unlike the Proposed Short Sale Rule, the Proposed Rule does not address the possibility that public disclosure could “reduce certain industry participants’ incentives to gather information about the marketplace and specific securities.”⁵¹ An unintended consequence is that these circumstances could reduce the value of marketplace information gathered to develop legal trading strategies. The Proposed Short Sale Rule notes that more rapid disclosure “could discourage investors from making an effort to gather marketplace information. A reduction in information collection could harm price efficiency,

⁴⁸ Proposed Short Sale Rule at p. 18.

⁴⁹ Proposed Short Sale Rule at p. 18.

⁵⁰ Proposed Short Sale Rule at p. 187. The Commission cites Mary Margaret Frank et al., “Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry,” *Journal of Law and Economics* 47, no. 2 (October 2004): 515–541; and Agarwal, Vikas, et al. “Mandatory portfolio disclosure, stock liquidity, and mutual fund performance.” *The Journal of Finance* 70.6 (2015): 2733-2776. Agarwal et. al. find a decline in mutual fund performance following an increase in the frequency of periodic portfolio holdings disclosures from semi-annually to quarterly; notably, the decline comes despite a delay in reporting of up to 60 days.

⁵¹ Proposed Short Sale Rule at p. 10.

which could, in turn, affect capital allocations and managerial decisions.”⁵² This contrasts with the absence of a similar discussion in the Proposed Rule.

Concerns about investor anonymity have been addressed in prior rulemakings related to the consolidated audit trail and Form N-PORT.⁵³ In these prior rulemakings, the Commission has taken measures to protect the anonymity of traders and their proprietary trading strategies, yet the Commission fails to develop these costs in the current Proposed Rule.

C. The Commission Mischaracterizes Much of the Academic Literature it Relies on to Support Public Disclosure of CDS Positions

In its support of the benefits of public disclosure the Commission states, “[s]everal academics discuss disclosure as a potential solution to some of the manufactured or other opportunistic CDS strategies...”⁵⁴ The Commission then proceeds to excerpt quotes from several papers in footnote 111 of the Proposed Rule. The Commission first leans on the following quote from Fletcher (2019):

*By requiring disclosure of plans to engage in an engineered CDS transaction, traders are able to reject counterparties that have indicated their intentions to intervene in the market. Alternatively, it allows CDS traders to decide if they want to charge or demand a higher price from the counterparty to offset the risk of loss. Disclosure, therefore, minimizes informational asymmetry between the counterparties, which would increase the cost of engineered transactions and in turn lower their profitability and their occurrence. Additionally, this disclosure requirement may also enhance market discipline, enabling CDS traders to avoid counterparties that might engage in engineered transactions or have done so in the past.*⁵⁵

Setting aside the obvious disconnection here that the Commission’s proposal requiring public reporting for all positions over a certain size goes far beyond what the paper discusses about investor intent, the paper does not discuss the idea of *public* disclosure. The article advocates for the Commission to regulate contractual disclosures between counterparties engaging in CDS transactions. The full quote provides the context that the Commission removed from its analysis.

[U]nder the [SEC and the CFTC’s] business conduct rules, swap dealers are required to disclose any “material incentives or conflicts of interest” that they have with respect to the transaction to their nonswap dealer counterparties. Further, they are required to communicate with counterparties fairly and in keeping with the principles of fair dealing and good faith. These provisions are intended to protect swap dealers’ counterparties particularly non-dealers such as pension funds or municipalities, but could be expanded to reach the conduct of all CDS

⁵² Proposed Short Sale Rule at p. 10.

⁵³ Investment Company Reporting Modernization, Release No. 33-10231 (Oct. 13, 2016), 81 FR 81870 (Nov. 18, 2016); and Amendments to the National Market System Plan Governing the Consolidated Audit Trail to Enhance Data Security, Release No. 89632 (August 21, 2020), 85 FR 65990 (October 16, 2020).

⁵⁴ Proposed Rule at p. 6667.

⁵⁵ Fletcher, Gina-Gail S. “Engineered Credit Default Swaps: Innovative Or Manipulative.” NYUL Rev. 94 (2019): 1073, at p. 1139 (emphasis added).

counterparties that transact with swap dealers. In order to accomplish this, the requirement to disclose material incentives and conflicts of interest should flow equally between both parties and not merely from swap dealers to non-dealer counterparties. To prevent the disclosure obligation from being too onerous, it would be limited to material incentives or conflicts that may affect or trigger the CDS payout. The disclosure obligation would also accompany future trades of the CDS such that the information is available to later counterparties. By requiring disclosure of plans to engage in an engineered CDS transaction, traders are able to reject counterparties that have indicated their intentions to intervene in the market.⁵⁶

In the same footnote, the very next quote supplied by the Commission in support of public disclosure uses ellipses in a way that obscures the authors' very limited call for the disclosure of decoupled investment positions in bankruptcy proceedings rather than broad public disclosure of positions. Here is the quote the Commission provided:

...to address debt ... decoupling, we propose ... disclosure of their aggregate holdings of debt and debt derivatives.⁵⁷

And here is the full quote from Hu and Black (2008) with the key portion of the text excluded using ellipses underlined:

Here, to address debt and hybrid decoupling we propose disclosure of coupled assets within bankruptcy, expansion of equity disclosure to include related debt instruments, and vice versa. For financial institutions, hedge funds, and other major investors, we propose disclosure of their aggregate holdings of debt and debt derivatives.⁵⁸

Hu and Black (2008) later make it clear that they do not recommend real-time position specific disclosures, the very thing the Commission is recommending in the Proposed Rule.

We expect that real time disclosure of specific positions will not be needed. But delayed disclosure of specific positions might be appropriate, partly as a check on the accuracy of aggregate disclosure. Delayed position-specific disclosure would be analogous to current US equity-side disclosure by major institutions.⁵⁹

The Commission then relies on the following quote from Bolton and Oehmke (2011):

⁵⁶ Fletcher, Gina-Gail S. "Engineered Credit Default Swaps: Innovative Or Manipulative." NYUL Rev. 94 (2019): 1073, at p. 1139.

⁵⁷ Hu, Henry TC, and Bernard Black. "Debt, equity and hybrid decoupling: Governance and systemic risk implications." European Financial Management 14.4 (2008): 663-709, at p. 694.

⁵⁸ Hu, Henry TC, and Bernard Black. "Debt, equity and hybrid decoupling: Governance and systemic risk implications." European Financial Management 14.4 (2008): 663-709, at p. 694.

⁵⁹ Hu, Henry TC, and Bernard Black. "Debt, equity and hybrid decoupling: Governance and systemic risk implications." European Financial Management 14.4 (2008): 663-709, at p. 693.

...disclosure of CDS positions may mitigate the inefficiencies resulting from the empty creditor problem, without undermining the ex-ante commitment effect of CDS. In particular, if public disclosure allows borrowers and lenders to contract on CDS positions, they may allow the lender to commit not to over-insure once he has acquired the bond. More generally, public disclosure of positions may also be beneficial by giving investors a more complete picture of creditors' incentives in restructuring.⁶⁰

The Commission failed to make clear that Bolton and Oehmke (2011) were only advocating for public disclosure for investors with CDS positions who also hold the underlying bond or loan; not every large position in the entire CDS market.

Note that in our analysis this type of disaggregated disclosure to facilitate contracting or gauge renegotiation incentives would only need to apply to investors who simultaneously hold the underlying bond or loan.⁶¹

The Commission finally points to Danis and Gamba (2019), but the authors only address CDS position disclosure by large protection sellers, not all CDS market participants; and the authors recommend that additional research is needed to determine what might constitute a large position (with the suggestion of 5% of the face value of the debt or the top five protection sellers in each reference entity).⁶² This is something the Commission could have analyzed but chose not to do so.

The Commission has taken very narrow and specific requests in academic literature for CDS disclosure (sometimes even in the form of non-public disclosures) and presented them as support for public reporting for all large CDS positions. These papers were never designed to support the broad recommendations in the Proposed Rule; and in fact, Hu and Black (2008) recommend against the very proposal the Commission is offering.

IV. Economic Considerations of Efficiency, Competition, and Capital Formation

Securities Exchange Act of 1934 (“Exchange Act”) Section 3(f) requires the Commission, when it is engaged in rulemaking pursuant to the Exchange Act, such as the Proposed Rule, to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. The discussion of ECCF effects in the Proposed Rule is unbalanced and is designed to support the Proposed Rule rather than to objectively analyze its likely economic effects.

⁶⁰ Bolton, Patrick, and Martin Oehmke. “Credit default swaps and the empty creditor problem.” *The Review of Financial Studies* 24.8 (2011): 2617-2655, at p. 6.

⁶¹ Bolton, Patrick, and Martin Oehmke. “Credit default swaps and the empty creditor problem.” *The Review of Financial Studies* 24.8 (2011): 2617-2655, at p. 34.

⁶² Danis, Andras, and Andrea Gamba. “Dark knights: the rise in firm intervention by CDS investors.” WBS Finance Group Research Paper 265 (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479635).

The Proposed Rule conflates the overall economic effects by simultaneously evaluating deterrence benefits (Rule 9j-1) and public position reporting (the Proposed Rule). A robust economic analysis would need to separately consider the economic effects of Rules 9j-1 and 10B-1. Such an analysis would have allowed the Commission to assess whether both elements were needed for the Proposed Rule to be effective. Unfortunately, the Commission has not demonstrated the existence of a systematic market failure that would require regulatory intervention with respect to either proposed Rule 9j-1 or 10B-1.

Since my comment letter focuses on the public position reporting aspects of the Proposed Rule, I describe aspects of the ECCF analysis that should have been considered but were ignored. In that sense, the ECCF analysis is infirm.

A. Impact of the Proposed Amendments on Efficiency

The discussion of the Proposed Rule's effect on efficiency is based on the underlying premise that increased transparency results in more efficient capital markets. While this reasoning holds for a given information set, it ignores the disincentives that public position reporting would have on investing in information gathering. Disclosure of positions would reveal the names of the firms that take large positions and the public companies in which they take such positions. Firms with strong reputations will become less profitable as other investors "front-run" the proprietary trading strategies by employing "copycat" strategies. This would reduce investment in marketplace information collection, which would have a deleterious effect on price discovery. In effect, markets would be more efficient in the sense that information about who is trading is reflected in stock prices faster. The "who" would be the only incremental information revealed by public position reporting because real-time reporting of security-based swap transaction price and quantity data already accommodates price discovery. Unfortunately, the reduced incentives to perform fundamental research would result in less aggregate efficiency because there will be less price discovery. If, as expected, the reporting of large positions reduces incentives to participate in the SBS and underlying cash markets, one would expect markets to become less liquid, which would make it costlier to trade. Reduced incentives have two complementary effects: (1) individual traders will trade less and (2) some traders may choose to exit the market entirely. Unfortunately, a discussion of this possibility is absent in the Proposed Rule.

In fact, the Proposed Rule reaches the opposite conclusion. It argues that increased transparency may enhance liquidity in the underlying market and related swap indices, and in general, lower debt and equity capital costs for security-based swaps referenced entities.⁶³ As discussed above, this interpretation of the ECCF seems unrealistic and unsupported.

B. Impact of the Proposed Amendments on Competition

As noted throughout this report, the Commission largely overlooks or is dismissive of all costs associated with public position reporting of positions outside of the narrow direct compliance

⁶³ Proposed Rule at pp. 6687-6689.

cost of filing the reports. The result is a short-sighted claim that the Proposed Rule may increase investor confidence and as a result, “Proposed Rule 10B-1 could lead to increased supply and demand for security-based swaps, leading to greater competition as more security-based swap market participants enter the market.”⁶⁴

A complete evaluation of how public position reporting costs would affect competition would lead to the opposite conclusion. The Proposed Rule reveals the proprietary business strategies of large traders to the market and to competitors (and in the case of activist investors, to the companies that are the focus of their interest at a far earlier time than would otherwise be the case). Copycat trading would reduce profitability and the incentives to take on such activities. This not only harms efficiency but also would be expected to reduce competition as some market participants decide to exit.

The competition impacts extend beyond just the SBS market. Take for example the role activist investors play in improving corporate governance and operational performance. If activism declines due to reduced investment incentives, weaker corporate governance would negatively impact competition within individual industries as companies become less accountable to shareholders, as well as the returns that investors would have received if the company had in fact improved its governance and performance. This could ultimately lead to less job creation, higher prices and lower quality of goods and services.

C. Impact of the Proposed Amendments on Capital Formation

The ECCF discussion of capital formation hinges on the idea that position holder transparency is expected to increase the price efficiency in the underlying securities markets which then would have “a positive impact on capital formation and the cost of capital for the underlying entities.”⁶⁵ As discussed above, it is likely that the Proposed Rule would reduce price efficiency and therefore have exactly the opposite implications—less capital formation and higher costs of capital. If as we expect, there will be less price discovery, asymmetric information between management and investors may increase resulting in greater adverse selection costs. Less price discovery may increase cost of capital for underlying entities.

The Commission argues that:

*Proposed Rule 10B-1 could increase market integrity, increase liquidity, decrease counterparty risk, lower litigation costs, decrease cost of capital for underlying entities, decrease contagion risk in the market, and assist the Commission in identifying concentrated position and holdings in related securities.*⁶⁶

It is helpful to unpack these assertions:

⁶⁴ Proposed Rule at p. 6687.

⁶⁵ Proposed Rule at p. 6686.

⁶⁶ Proposed Rule at p. 6687.

- *Increase market integrity.* It is unclear what incremental impact the Proposed Rule would have on market integrity. Proposed Rule 9j-1 is designed to deter opportunistic behavior by making it illegal. This, along with the Commission's existing anti-fraud and anti-manipulation authorities, should be sufficient to ameliorate concerns about market integrity.
- *Decrease cost of capital for underlying entities.* The Proposed Rule fails to consider the above discussion. If, for example, incentives to engage in activist strategies are reduced, weaker corporate governance and impaired operational efficiency would be expected to increase the cost of capital.
- *Decrease contagion risk in the market.* Outside of the Archegos episode, there is no systemic evidence of correlated counterparty risk that could lead to contagion in financial markets. In fact, the evidence suggests exactly the opposite. The existing capital and margin regimes at large banks worked as intended.
- *Assist the Commission in identifying concentrated position and holdings in related securities.* While this is a factual statement, the Commission already has access to data that would allow it to identify concentrated positions in swaps and the underlying securities. This is largely a matter of convenience rather than need. Assuming the Commission is unable to link the various data sources at its disposal, there is no compelling reason to make these disclosures *public*. Confidential reporting is a possibility that is not considered in the Proposed Rule. This is surprising given that the Commission reached the opposite conclusion in the recently Proposed Short Sale Rule.⁶⁷

V. Failure to Properly Consider Alternatives

Identifying and evaluating reasonable alternatives to a proposed rule is one of the central components of the Commission's economic analysis in rulemaking.⁶⁸ This process helps the public understand the economics behind the trade-offs the Commission must consider when deciding certain aspects of the rule, such as which firms must comply and what time periods compliance would cover. The Guidance provides that for each alternative the Commission should consider the best available quantitative and qualitative costs and benefits and compare those to the proposed rule.⁶⁹

The Commission's economic analysis for the Proposed Rule does not meaningfully consider reasonable alternatives. With respect to counterparty risk, the Commission has options that would not require costly public position reporting.

⁶⁷ Proposed Short Sale Rule at p. 18.

⁶⁸ Guidance at p. 1.

⁶⁹ Guidance at pp. 1-2.

- The Commission could require SBS dealers to obtain and maintain aggregate exposure levels of the large counterparties.
- The Commission could alternatively collect the information it hopes to collect under the Proposed Rule and provide that information to SBS dealers on a confidential basis under strict guidelines that the information cannot be used for any purpose other than to price and maintain SBS positions.

For either of these alternatives, the Commission would be able to simultaneously achieve its goal of informing SBS dealers of counterparty risk and eliminate the costs associated with front-running and the potential detrimental effects of predatory trading. In maintaining fair and orderly markets, the Commission's starting point in rulemaking should be to protect the proprietary data of market participants unless absolutely necessary to serve a market function, something the Commission fails to do here.

Regarding Commission concerns about CDS manufactured strategies and opportunistic trading problems, any new regulatory regime should target specific situations where such manufacturing exists. Fletcher (2019) contemplated this type of tailored alternative in the same quote the Commission opportunistically framed as support for public disclosure; in reality the proposal was for the Commission to reevaluate its business conduct standards (Rule 15Fh-3) and establish good faith obligations for SBS dealers and their counterparties.

*[U]nder the [SEC and the CFTC's] business conduct rules, swap dealers are required to disclose any "material incentives or conflicts of interest" that they have with respect to the transaction to their nonswap dealer counterparties. Further, they are required to communicate with counterparties fairly and in keeping with the principles of fair dealing and good faith. These provisions are intended to protect swap dealers' counterparties particularly non-dealers such as pension funds or municipalities, but could be expanded to reach the conduct of all CDS counterparties that transact with swap dealers. In order to accomplish this, the requirement to disclose material incentives and conflicts of interest should flow equally between both parties and not merely from swap dealers to non-dealer counterparties. To prevent the disclosure obligation from being too onerous, it would be limited to material incentives or conflicts that may affect or trigger the CDS payout. The disclosure obligation would also accompany future trades of the CDS such that the information is available to later counterparties. By requiring disclosure of plans to engage in an engineered CDS transaction, traders are able to reject counterparties that have indicated their intentions to intervene in the market.*⁷⁰

⁷⁰ Fletcher, Gina-Gail S. "Engineered Credit Default Swaps: Innovative Or Manipulative." NYUL Rev. 94 (2019): 1073, at pg. 1139 (emphasis added).

VI. Conclusion

The Proposed Rule would introduce an unprecedented level of public disclosure of disaggregated position information. Access to large SBS investor identities and their positions in near real-time would impose a number of large and disruptive costs on the market. Large reporting SBS participants will experience reduced profits as investors front-run disclosed positions and the SBS market will experience a corresponding reduction in incentives to build SBS positions. The mandatory disclosure would materially reduce the incentives and the ability of market participants to take on activist positions, which could decrease positive governance and economic effects of investor activism. The Commission's economic analysis spends considerable time focused on the narrow direct compliance costs of filing the proposed reports while failing to address the broader economic consequences of position disclosure. As a result, the Commission has not met its statutory requirement to provide an analysis of the Proposed Rule's likely effects on efficiency, competition, and capital formation; and the Commission's position that under Rule 10B-1 the SBS market will experience enhanced liquidity is left incomplete and unsupported.