March 21, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St NE
Washington, DC 20549

Re: Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions (File No. S7-32-10)

Secretary Countryman:

The Americans for Financial Reform Education Fund appreciates this opportunity to provide comment on the Securities and Exchange Commission's (the Commission) proposed rules that would end long running loopholes allowing large derivative positions to go unreported and provide greater transparency in the derivatives market to deter "net-short debt activism" and protect market integrity.

The proposed rule would finally close the long- standing gap between the reporting requirements for large equity holdings and those for derivative holdings by requiring that a gross notional position greater than $300 million or a derivative position representing greater than 5% of the outstanding shares of the underlying stock be reported on a new Schedule 10B over the Commission's EDGAR system.

The Sudden Implosion of Archegos Capital Underlines the Need to Modernize Derivatives Reporting Rules

The sudden implosion of family office Archegos Capital in March 2021 showed how the loopholes in derivatives reporting allowed a family office to build sizeable positions across several stocks without reporting them; those positions ultimately led to billions of dollars in losses for several Globally-Systemically Important Banks (G-SIBs) that lent it money.

Schedule 13D requires that any investor that holds a position greater than 5% of a company's total shares file within 10 days a disclosure to the Commission, but derivatives positions such as total return swaps are not currently subject to this disclosure requirement.[1] Separately,

[1] Zarb, Frank and Rambo, Louis. Proskauer Rose LLP. A Practical Guide to the Regulation of Hedge Fund Trading Activities. Dec 4, 2019. https://bit.ly/344nq24

Schedule 13-F requires investment managers with more than $100 million in exchange traded stocks, options, and warrants to report their long holdings 45 days after every quarter.[2]

Archegos Capital, which was a family office, quietly built-up stakes using Contract-for-Differences (CFDs) and total return swaps rather than the shares of the stocks themselves, amassing stakes representing more than 10% of the outstanding shares of companies such as ViacomCBS, Gaotu Techedu, Discovery, and others.[3] Because they were CFDs and total return swaps, the positions did not need to be reported.

When some of Archegos's positions started losing money, prime brokers such as Goldman Sachs, Morgan Stanley, Credit Suisse, UBS, Nomura, and MUFG were caught off guard by how much Archegos Capital had borrowed from other banks to purchase the same stocks. G-SIBs collectively lost close to $10 billion from their lending to what had until then been a relatively unknown family office. Credit Suisse lost over $5 billion while Nomura took $3 billion in losses, Morgan Stanley $1 billion, UBS $774 million, and MUFG $270 million.[4]

Executives and shareholders at a number of firms were left to wonder if the sharp declines in their own shares were a result of Archegos's positions being unwound by the banks or of other unrelated causes.[5] Some stocks that were well known to be held by Archegos Capital such as ViacomCBS saw shares fall over 50% from $85/share to $48/share in a matter of days once it was revealed that banks that had lent to Archegos Capital were forcibly selling them.[6]

If Schedule 10B had been in place as the Commission is now proposing, company management and other shareholders would have been able to see that Archegos Capital's aggressive derivatives purchases were a major driver of the higher prices of their shares.[7] Schedule 10B would also have shown how exposed other shareholders were to Archegos's forced liquidation.

The proposed new requirement that all investors, including those with security-based swap positions, report their holdings to the Commission will close a loophole, and make sure that

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[2] Securities and Exchange Commission. Frequently Asked Questions about Form 13F. Feb 24, 2020. https://www.sec.gov/divisions/investment/13ffaq.htm

[3] Natarajan, Sridhar and Burton, Katherine. Bloomberg News. Bill Hwang Made a Huge, Secret Bank Bet Before Archegos Collapse. Nov 17, 2021. https://www.bloomberg.com/news/articles/2021-11-17/bill-hwang-made-secret-bank-bet-before-20-billion-loss-archegos-collapse

[4] Patrick, Margot and Webb, Quentin. Wall Street Journal. Archegos Hit Tops $10 Billion After UBS, Nomura Losses. Apr 27, 2021. https://www.wsj.com/articles/ubs-takes-surprise-774-million-archegos-hit-11619501547

[5] Wursthorn, Michael and Rudegair, Peter. Wall Street Journal. Executives Wonder if Their Stock Selloffs Were Linked to Archegos. Apr 21, 2021. https://www.wsj.com/articles/executives-wonder-if-their-stock-selloffs-were-linked-to-archegos-11618997403

[6] Picker, Leslie and Frost, Wilfred. CNBC. Morgan Stanley and Goldman Sachs' roles in volatility of ViacomCBS raise questions. https://www.cnbc.com/2021/04/01/viacomcbs-stock-sales-amid-archegos-debacle-raise-questions-for-banks.html

[7] Chmielewski, Dawn. Forbes. Hedge Fund Stock Dump Crushes The Soaring Fortunes of ViacomCBS' Shari Redstone. Mar 29, 2021. https://www.forbes.com/sites/dawnchmielewski/2021/03/29/hedge-fund-stock-dump-crushes-the-soaring-fortunes-of-viacomcbs-shari-redstone

large positions that are functionally the same as their underlying stock holdings, but structured differently, are properly disclosed to other investors and company management.

Short option positions must also be included in securities-based swap reporting

We also support the Commission's proposal that short notional security-based swap positions greater than $150 million be reported under Proposed Rule 10B-1(b)(1)(iii)(A). All investment managers holding greater than $100 million in 13-F securities (stocks, long options, warrants) must file quarterly reports of those positions, but the same is not true today for those holding options that are functionally equivalent.

Recent hedge fund activist campaigns have been able to completely surprise company management because the funds have intentionally structured their investments via selling options to avoid reporting them in quarterly Schedule 13-F filings. Under current rules, if a large investor seeking aggressive changes to a company wanted to furtively build up a position without alerting company management or other investors, it could sell a put option, giving the buyer of that put the future right to sell a certain number of shares at an agreed price (strike price) to that seller. Since the put seller would not (yet) own those shares, under the current Schedule 13-F, it would not have to report selling those puts.[8]

One prominent example involves $72 billion activist hedge fund Elliott Management, which surprised the management of AT&T and other shareholders on September 9, 2019 by suddenly declaring a $3.2 billion stake made up of "common stock and economic equivalents"[9] and demanding changes including that the company replace its CEO, lay off thousands of workers, and sell several of its key divisions. The declaration came as a surprise; Elliott's 13-F filing (on November 14th) showed only a $118.25 million stake in AT&T held in actual stock. The 13-F filing before that – in June - showed no holdings at all.[10]

By requiring that short notional swap positions greater than $150 million be reported via a new Schedule 10B the Commission can close this other critical loophole and provide better transparency in the public markets to both investors and company management.

Reproposing Rule 9j-1 can end "manufactured credit events" by holders of Credit Default Swaps (CDS)

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[8] FormThirteen. Frequently Asked Questions. 2022. https://formthirteen.com/faq

[9] Businesswire. "Elliott Management Sends Letter to Board of Directors of AT&T". Sep 9, 2019. https://bwnews.pr/36evUmj

[10] Securities and Exchange Commission EDGAR. 13F-HR Filing report. Aug 14, 2019. https://www.sec.gov/Archives/edgar/data/1048445/000156761919016981/xslForm13F_X01/form13fInfoTable.xml

We also support the Commission in reproposing Rule 9j-1 to crack down on fraudulent conduct in the Credit Default Swap (CDS) market that unnecessarily triggers a counterparty to post collateral related to a default for the CDS buyers' benefit.

Recent unconventional credit events related to entertainment company Codere, media company iHeart Communications, and homebuilder K. Hovnanian Enterprises have exposed the perverse incentives stemming from "net-short debt activism". Unlike traditional insurance, where firms can protect themselves from losses on assets they own, net-short debt activism has allowed investors to buy insurance on the property of others, allowing them to profit in the instance of a payout event.

In the case of homebuilder Hovnanian, for example, in February 2018 the company decided to restructure and refinance some of its debt coming due the following year with Blackstone Credit (then known as GSO). As part of the restructuring offer, a new set of notes were issued at a lower interest rate to Blackstone Credit; these notes included language prohibiting Hovnanian from making its upcoming interest payment. This provision effectively led the company to default on its obligations, allowing those who bought protection using Credit Default Swaps to receive a windfall.[11]

Blackstone Credit was also the owner of those Credit Default Swaps - meaning that it benefitted from the homebuilder's inability to pay its debt – while the deal left other hedge funds such as Solus Alternative Asset Management and Goldman Sachs, who were on the other side of those bets with losses from events that were not a result of market or economic forces but rather negotiations riven with conflicts of interest.[12] Further, the transaction put the homebuilder in a worse financial position, as investors demanded higher interest payments on future debt issuance. The increased difficultly of servicing that debt in turn negatively affected the numbers of homes that Hovnanian could build, because the company had to prioritize repaying its debt early.[13]

Transactions like this have led to growing concerns that significant portions of the $11 trillion CDS market will no longer effectively serve as insurance for investors. The Commodity Futures Trading Commission (CFTC) issued a statement saying that "manufactured credit events may constitute market manipulation and may severely damage the integrity of the CDS markets… and the financial industry's use of CDS valuations to assess the health of CDS reference

[11] Kramer Levin. Unconventional CDS Credit Events: Hovnanian Enterprises. Apr 10, 2018. https://www.kramerlevin.com/en/perspectives-search/unconventional-cds-credit-events-hovnanian-enterprises-alert.html

[12] Natarajan, Sridhar. Bloomberg News. GSO Beats Rival Funds to Hovnanian Deal in Credit Swaps Showdown. https://www.bloomberg.com/news/articles/2017-12-28/hovnanian-sides-with-gso-in-hedge-fund-tiff-that-roiled-its-cds

[13] Maidenberg, Micah. Wall Street Journal. Hovnanian's Quarterly Revenue Rises 16%, But Debt Issue Results in Loss. Dec 5, 2019.

entities".[14] The International Swaps and Derivatives Association (ISDA) also issued amendments to deal with this type of manufactured credit event.[15]

The Commission's re-proposal of Rule 9j-1 will better protect the fairness of markets, and better enable appropriate enforcement to police abuses in the swaps market.

Conclusion

We appreciate the Commission's move to propose these important reforms under Title VII of Dodd-Frank, including updating the large position reporting requirements to include security-based swaps and taking steps to combat manipulative and abusive practices in the swaps market.

We appreciate your consideration of these important matters. For further discussion, please contact Andrew Park at.

Sincerely,

Americans for Financial Reform Education Fund

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[14] Commodity Futures Trading Commission. Statement on Manufactured Credit Events by CFTC Divisions of Clearing and Risk, Market Oversight, and Swap Dealer and Intermediary Oversight. Apr 24, 2018. https://www.cftc.gov/PressRoom/SpeechesTestimony/divisionsstatement042418

[15] Quinn Emanuel. ISDA's Proposed Rules Aimed At Manufactured Defaults. Jun 12, 2019. https://www.jdsupra.com/legalnews/may-2019-isda-s-proposed-rules-aimed-at-39033/