ISDA Safe, Efficient Markets

March 21, 2022

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

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

Dear Ms. Countryman:

The Institute of International Bankers ("IIB"), the International Swaps and Derivatives Association ("ISDA"), and the Securities Industry and Financial Markets Association ("SIFMA") (together, the "Associations")[1] appreciate the opportunity to provide comments to the Securities and Exchange Commission (the "Commission" or "SEC") on the security-based swap ("SBS") position reporting requirements set forth in Proposed Rule 10B-1 under the Securities Exchange Act of 1934 (the "Exchange Act") and proposed Schedule 10B, as reflected in the above-captioned proposed rulemaking (the "Proposed Rule").[2]

INTRODUCTION AND EXECUTIVE SUMMARY

We support transparency reforms that are properly calibrated to make markets more efficient and competitive. We also believe it is appropriate for the Commission and other regulatory authorities to obtain such information about market activity as is necessary to monitor for risks to financial stability or market integrity. Regulation SBSR[3] is already intended to achieve these objectives through comprehensive reporting and public dissemination of SBS transactions. Regulation SBSR complements a comprehensive set of SBS market reforms, including margin requirements.

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1 Descriptions of the Associations are included in the attached Appendix.

2 SEC Release No. 34-93784 (December 15, 2021), 87 Fed. Reg. 6652 (February 4, 2022).

3 17 C.F.R. § 242.900 *et seq*.

Even though these reforms are not yet fully in effect, and thus their impact on the markets is not yet fully known, Proposed Rule 10B-1 would supplement them by imposing extensive requirements for any person owning an SBS position in excess of a specified reporting threshold to disclose to the Commission and the public extensive information about the reporting person, the reportable SBS position, and the person's positions in a variety of other financial instruments, all no later than one business day after executing an SBS transaction resulting in the person exceeding the reporting threshold.

Significant further consideration is needed before the Commission adopts Proposed Rule 10B-1, especially its public disclosure requirements. Rushing to implement those requirements is highly likely to result in a negative impact to the SBS markets and, importantly, to the global capital formation ecosystem that depends on vibrant SBS markets to hedge risk. Based on our members' analysis, it seems that much of the data captured by the rule would be misleading and confusing when publicly disseminated. For example, the rule would require disclosure of a large number of immaterial and non-directional positions and require such information to be updated on a daily basis. Accordingly, the primary use of such data would seem to be opportunistic traders cherry-picking the data in order to reverse engineer a market participant's trading strategy. In this way, the rule would create opportunities for front running and other opportunistic behavior, including activity that the rule is intended to address. This undesirable behavior would harm not only investors and traders in the SBS markets, but also the issuers and corporate borrowers who depend on the SBS markets for their capital-raising, hedging and other financing activity.

It is also striking that Proposed Rule 10B-1 would be the first, and only, public position reporting regime in the U.S. derivatives markets. Neither the large trader reporting rules adopted by the Commodity Futures Trading Commission ("CFTC") for the swaps, futures, and options markets, nor the large options position reporting rules administered by the Financial Industry Regulatory Authority ("FINRA"), provide for public dissemination of confidential position information. And although large positions in certain equity securities are required to be disclosed pursuant to Commission rules implementing Section 13 of the Exchange Act, Proposed Rule 10B-1 would, in a number of significant respects, require more expansive (in terms of the number of reporting parties and reportable positions), extensive (in terms of the information required to be disclosed), and rapid disclosure than Section 13.

Given that a number of key SBS regulations, including Regulation SBSR, are still taking effect, the Commission should first evaluate the impact that those reforms have on the market before rushing to adopt requirements as novel and far-reaching as Proposed Rule 10B-1. The Commission should also use the new data it can access under Regulation SBSR to conduct an accurate cost-benefit analysis. As discussed below, the Commission's current analysis significantly underestimates the extent of the reporting burden. It also focuses predominantly on direct implementation costs, with only cursory examination of market impact in terms of curtailed market activity. Most

problematically, the Commission has done no analysis of the potential adverse impact on capital formation for issuers and borrowers who would suffer from increased hedging costs due to the rule. This deficient analysis does not satisfy the Commission's burden under Sections 3(f) and 23(a)(2) of the Exchange Act.

It is also notable that the Commission recently proposed very significant revisions to its Section 13 rules, including the application of those rules to certain derivatives transactions.[4] We agree with the Commission's determination not to treat SBSs as giving rise to beneficial ownership under those rules, which is appropriate because SBSs do not provide indicia of ownership comparable to direct ownership of equity securities. However, the Commission's Section 13 proposal nonetheless is relevant to consideration of this Proposed Rule, which makes it impossible to evaluate the proposals in isolation from each other. For similar reasons, the Commission's recent short sale disclosure proposal[5] is relevant to the Proposed Rule.

We also are concerned that the brief, 45-day comment period for the Proposed Rule raises issues under the Administrative Procedure Act[6] because it does not provide market participants with a reasonable opportunity to conduct the analysis necessary to respond to the Proposed Rule. We note that the Commission's Proposed Rule proposes a range of significant changes to complicated securities laws and complex financial markets at the same time market participants are also working on responding to 19 additional rulemakings from the Commission that have comment periods that were either open for comment when the Proposed Rule was published or were introduced (or reopened) during the Proposed Rule's comment period. We and all other public commenters are thus limited in our ability to conduct a robust analysis of the proposed rule and provide fulsome feedback to the Commission, which we believe will harm the quality of the Commission's regulations and potentially lead to unintended consequences that have an adverse effect on U.S. capital markets.

This is especially the case considering the intrinsic links with the more recent Section 13 and short sale proposals noted above. At a minimum, therefore, the Commission should re-propose the Proposed Rule and the Section 13 and short sale proposals together so that the public can consider them alongside each other together with any changes the Commission considers appropriate based on the initial, truncated comment period for each.

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4 *Modernization of Beneficial Ownership Reporting*, SEC Release No. 33-11030 (February 10, 2022), 87 Fed. Reg. 13846 (March 10, 2022).

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

6 5 U.S.C. § 500 *et seq*.

If, following a more extensive public comment process and proper cost-benefit analysis that itself is made available for public review and comment, the Commission determines it appropriate to proceed with adopting Proposed Rule 10B-1, the Commission should modify the rule in the following key respects, which are designed to mitigate the rule's potential negative impact and clarify its application:

- ***Recalibrate and Clarify Reporting Threshold Amounts.*** In order to (i) focus reporting and disclosure requirements on positions that are likely to be material to the market, and (ii) eliminate "noise" in the reporting that will obscure the type of activity that the Commission aims to make transparent, the Commission should better tailor reporting threshold amounts to the different trading and liquidity characteristics of different SBSs and related securities. Also, a market participant should only trigger reporting if it has a directional position that exceeds a threshold on a *net* basis, *after excluding* certain hedging positions and inter-affiliate SBS transactions. When performing this calculation, a market participant should not aggregate positions held across independent business units or positions managed by independent account controllers. Finally, positions in an SBS referencing a portfolio or basket subject to discretionary substitution or other modification should only count towards thresholds applicable to their component securities, not the separate threshold for a narrow-based security index.

- ***Align with Section 13's Reporting Deadlines.*** To address practical and operational issues, reduce burdens on passive investors and financial intermediaries, and avoid incentives for regulatory arbitrage, the Commission should align Proposed Rule 10B-1's reporting deadline with Section 13's reporting deadlines.[7]

- ***Clarify When an Amended Report Would Be Required.*** To focus the filing of amended reports on events that involve a material change in a reporting person's trading or investment strategy, Proposed Rule 10B-1 should require an amended report only following a material acquisition or disposition relating to a previously reported SBS position.

- ***Clarify the Range of "Related" Instruments Covered by Schedule 10B.*** To avoid the risks of vague standards giving rise to inconsistent approaches, unduly complex implementation, and unnecessary breaches of confidentiality, the Commission should replace Item 8 of Schedule 10B with an expanded list of enumerated instruments required to be disclosed within Items 6 and 7.

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[7] We note that these reporting deadlines are themselves under consideration by the public as part of the Section 13 proposal noted above, thus making alignment even more critical so that the balance that should be sought by that proposal is not undermined by this one.

- ***Recalibrate Rule 10B-1's Territorial Scope.*** As proposed, Rule 10B-1 would have an extremely broad and complex extraterritorial application that would increase its costs, create competitive distortions, and conflict with policy decisions taken by foreign regulators with regards to their home markets. To address these issues, the Commission should recalibrate the rule's territorial scope to focus on positions held by or opposite U.S. persons, and positions involving companies with U.S.-listed securities, as well as adopt exceptions for certain non-U.S. market participants trading SBSs referencing non-U.S. securities and positions in foreign sovereign credit default swaps ("CDSs").

- ***Adopt Appropriate and Phased Transition Periods.*** Given the technical and operational challenges associated with implementing the necessary compliance programs, as discussed throughout this letter, a compliance period of at least 24 months is warranted and necessary. In addition, given the risks of public disclosure noted above, the Commission should defer public dissemination of position reports until after the Commission completes a study analyzing collected data and makes a determination whether further guidance, calibration of reporting thresholds, or other measures (including possibly anonymization, aggregation, or delayed dissemination) would be warranted to mitigate those risks. The Commission should complete this study within 12 months after regulatory reporting commences. If, based on this study, the Commission determines that public dissemination would be necessary and appropriate, it should provide an appropriate further public comment and transition period.

We provide further details on these recommendations below.

DISCUSSION

I. The Commission Should Conduct Further Analysis of Potential Market Impact and Implementation and Compliance Costs Before Adopting Proposed Rule 10B-1

A. The Commission Has Not Adequately Assessed the Costs of Public Disclosure of SBS Positions

The public disclosure aspects of Proposed Rule 10B-1 would reduce liquidity in the SBS markets, perhaps substantially. This impact is especially concerning given that the SBS markets, and credit derivative markets in particular, are already relatively small markets with a small number of active participants. Any rule that causes a portion of existing market participants to reduce their participation in the SBS markets is likely to have a material impact on the liquidity and viability of the SBS markets. Importantly, negative impacts will spill over well beyond the SBS markets, including by inhibiting capital formation and thereby increasing systemic risk.

At a minimum, the rule would cause market participants who have invested significant time and other resources in developing confidential and proprietary trading strategies to face the risk that others will reverse engineer those strategies following disclosure, allowing them to copy such strategies. This dynamic will manifest a host of unintended consequences. For example, it would likely spawn crowded trades, which themselves can pose a financial stability risk.

The Proposed Rule also provides for a level of disclosure about a market participant's exact SBS positions (for example, debt positions that vary by maturity) that is not required in any other market or any other product and, therefore, poses a unique risk for front running and other opportunistic strategies, anticipating future trades and driving up the costs of transactions for all market participants, including end users. The risk of front running is particularly prevalent in the context of SBS markets, where market participants frequently utilize multi-day pricing strategies to build up or wind down a hedged position. Public disclosure in the middle of the hedging process would significantly increase the cost of hedging with ramifications beyond the SBS markets, as discussed below. Avoiding these increased costs and risks will lead investors and traders to reduce the size of their positions below reporting thresholds, and perhaps exit the SBS markets entirely, thus reducing market participation and liquidity. These costs and risks would also significantly decrease the incentive for firms to conduct original research, which would result in less efficient securities and SBS markets.[8]

Capital formation is very likely to be negatively impacted by Proposed Rule 10B-1. Lenders and dealers that support debt issuances by companies rely on the CDS markets to hedge their risks and thereby increase their lending capacities and the ability of companies to effectively access capital. The increased hedging costs resulting from the front running behavior described above would either reduce lending capacity or increase borrowing costs, which would, in either case, diminish the efficiency and utility of the SBS markets while also harming the larger financial ecosystem. There is also the risk of opportunistic behavior, as third parties could use data publicly disseminated under Rule 10B-1 to infer otherwise confidential borrowing activity (*e.g.*, increased long CDS positions by financial institutions in a particular name signaling increased lending to the underlying company) and take actions in the debt or loan markets to capitalize on this information. Not only would Proposed Rule 10B-1 fail to deter this behavior, it would ironically facilitate it.

Although market participants desiring to engage in such opportunistic behavior might have sufficient incentives to develop infrastructure to gather and analyze Rule 10B-1 filings, others are unlikely to benefit from the transparency purported to be provided by those filings because of the high costs and difficulty of sifting through what

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[8] *See e.g.*, Shi, Zhen, "The Impact of Portfolio Disclosure on Hedge Fund Performance" (May 21, 2016), *WFA 2012 Las Vegas Meetings Paper*, available at https://ssrn.com/abstract=1573151; Parida, Sitikantha and Teo, Terence, "The Impact of More Frequent Portfolio Disclosure on Mutual Fund Performance" (June 22, 2011), available at https://ssrn.com/abstract=2097883.

would under the Proposed Rule be a very large volume of often-confusing information. For example, the Commission estimates receiving at most 136 reports per week across all U.S. participants in the single-name CDS markets.[9] Analysis from our members, in contrast, indicates that application of the proposed $300 million gross notional reporting threshold to just six institutions would, standing alone, result in more than *six times* that number of reports per week. This volume of reports, mostly triggered by non-directional or otherwise hedged positions, would create very significant "noise," making it virtually impossible for ordinary market participants to detect the buildup of potentially risky, concentrated positions the Proposed Rule is intended to reveal.

It is also notable that other U.S. derivatives markets have functioned well without any similar public position disclosure regimes.[10] Neither the CFTC's long-standing large trader reporting framework for futures and options positions under Part 17 of its regulations, nor the newer large swaps reporting rules adopted pursuant to the Dodd-Frank Act under Part 20 of its regulations, involve any public dissemination of position information. FINRA's large option position reporting requirements under its Rule 2360(b)(5) also does not involve public dissemination. Nothing in the Proposed Rule explains why the SBS markets are distinct from the futures, options, or swaps markets in respects that would justify such a significant policy departure.

The Proposed Rule also fails to explain the justification for its significant departures from the Commission's beneficial ownership reporting requirements under Section 13 of the Exchange Act. In particular, reporting thresholds based on notional amounts that do not vary across different SBSs, a one business day reporting and amendment deadline, and extensive disclosure of "related" positions all would discourage participation in the SBS markets relative to underlying security markets and increase implementation and compliance costs with ancillary negative ramifications for capital formation.

Similarly, the Proposed Rule would differ materially from the Commission's more recent proposal to enhance short sale disclosures. Notably, that proposal includes several protections designed to address concerns about potential retaliation against short sellers (including short squeezes), the potential chilling effects on short selling and the risks of imitative trading activity flowing from disclosure of proprietary trading strategies. While public disclosure of SBS positions raises the same concerns, the Commission offers no explanation for the differences between its short sale disclosure proposal and Proposed Rule 10B-1.[11]

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9 *See* Proposed Rule at p. 6889, n.238.

10 Also, position disclosure requirements in other jurisdictions are much more narrow than Proposed Rule 10B-1.

11 The release of the short sale disclosure rule in the middle of the Proposed Rule comment period raises other concerns as well—namely, that the Commission has not adequately considered, and

The Proposed Rule would also result in significant implementation and compliance costs that far outstrip the Commission's estimates of a one-time initial implementation cost of $101,740 per market participant and ongoing costs of $77,000 per year.[12] Many of our members estimate initial implementation costs of multiple millions of dollars, possibly into the tens of millions of dollars. They also estimate ongoing costs of several hundred thousand, and possibly more than a million, dollars per year.[13]

B. It Is Premature to Determine that the Benefits of Rule 10B-1 Would Outweigh Its Costs

It is not clear that the benefits of the Proposed Rule, on top of the likely benefits of Regulation SBSR and other SBS market reforms, would be sufficient to outweigh the adverse market impact and implementation costs described above. Regulation SBSR will, in conjunction with the Commission's requirements for SBS data repositories,[14] afford the Commission comprehensive access to SBS position data. Specifically, the Commission will have the ability to obtain and analyze data about all outstanding SBS positions in the U.S. market and take appropriate supervisory steps, without the need for any additional position reporting requirements.

Anonymized dissemination of SBS transaction data will enable the public to detect when large positions are being established, without compromising the confidentiality of individual market participants' identities or proprietary information. Significant upticks in trading volumes, especially in SBS markets, which tend to be less heavily traded, along with accompanying price changes, provide other market

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market participants have not been given adequate time to consider, the cumulative impact of all of the Commission's recent rule proposals.

12 Proposed Rule at p. 6678.

13 Our members' cost estimates differ from the Commission's estimates in a number of significant ways. First, the Commission's assumption that the technical requirements for a new reporting system could be developed by two employees in 320 hours (one senior programmer and one senior systems analyst, each working 160 hours (*see* Proposed Rule at p. 6678, n.169)) significantly underestimates the technical implementation burden that will be placed on market participants. Given the technical challenges associated with, among other things, aggregating positions across asset classes and trading desks (and therefore, multiple existing systems), our members estimate that the initial technical implementation costs would be in the range of $3-5 million on average, and upwards of $20 million for more complex builds. Second, the Commission underestimates the consulting hours and recurring costs that would be required to understand, develop, implement and maintain a compliance policy in response to a rule that drastically differs from comparable existing reporting regimes, such as the CFTC's large position reporting regime. Third, given the frequency with which reporting persons would be filing Schedules 10B and amendments (given the one day reporting requirement), on average, our members estimate that they would need a team of three to four people across IT and compliance to continuously monitor system capabilities and to ensure data quality. This would require ongoing support costs of at least $300,000 per year.

14 *See, e.g.*, 17 C.F.R. § 240.13n-5(b)(2) (requiring an SBS data repository to establish, maintain, and enforce written policies and procedures reasonably designed to calculate positions for all persons with open SBSs for which the SBS data repository maintains records).

participants with insights into market dynamics indicating a directional trading strategy; this may well be sufficient to address the Commission's market integrity objectives without needing to identify which particular party(ies) are trading.

However, given that public dissemination under Regulation SBSR did not begin until February 14, 2022, and reporting of historical SBSs will not be complete until April 14, 2022, we respectfully submit that the Commission needs more time and experience with Regulation SBSR before it can conclude that it is insufficient to address the objectives animating the Proposed Rule.

Other new requirements for SBSs are likely to address many of the same objectives as the Proposed Rule as well. In particular, margin requirements for non-cleared SBSs will significantly mitigate the potential counterparty credit risk that the Proposed Rule is intended to address. However, initial margin requirements will not begin to apply to smaller market participants until September 1, 2022, and so it is not yet possible for the Commission to assess whether a separate public disclosure regime is needed to further mitigate the default risks associated with large SBS positions.

In light of these deficiencies with the Proposed Rule's cost-benefit analysis and other justifications for adopting a novel reporting framework, the Commission should conduct further analysis of potential market impact and implementation and compliance costs before adopting Proposed Rule 10B-1.

II. The Commission Should Recalibrate and Clarify Proposed Rule 10B-1's Reporting Threshold Amounts

The Proposed Rule would establish different reporting thresholds depending on the type of SBS held by a reporting person:

> (1) SBS positions composed of CDS would be reportable where a reporting person's positions exceed the lesser of: (a) a long notional amount of CDS of $150 million (after subtracting long positions in deliverable debt obligations); (b) a short notional amount of CDS of $150 million; or (c) a gross notional amount of CDS of $300 million;[15]
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> (2) Non-CDS SBS positions based on debt securities would be reportable where a reporting person exceeds a gross notional amount of non-CDS debt SBSs of $300 million;[16] or
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> (3) SBS positions based on equity securities would be reportable where a reporting person's positions exceed the lesser of (a) a gross notional amount of $300 million of equity SBSs (or a combined $300 million consisting of

[15] Proposed Rule 240.10B-1(b)(1)(i).

[16] Proposed Rule 240.10B-1(b)(1)(ii).

at least $150 million of equity SBSs *plus* the value of underlying securities and delta-adjusted option, future and other derivative positions) or (b) a security-based swap equivalent position[17] that represents more than 5% of a class of equity securities (or ownership of a combined 5% interest of a class of securities based on at least a 2.5% SBS equivalent position *plus* ownership of underlying equity securities and shares attributable to options, futures or other derivatives).[18]

We recognize the challenges facing the Commission in establishing the reporting thresholds, given the absence of comprehensive and reliable data. In light of these constraints, the Commission should better tailor the reporting thresholds through the measures described below.

A. Reporting Thresholds Should Only Apply on a Net Basis

Proposed Rule 10B-1 is intended to address certain issues potentially raised when a large position in SBSs gives rise to certain financial incentives that could lead to actions harmful to the position holder's counterparties or others. For example, the Commission believes that the Proposed Rule would help inform issuers and others when a market participant has a large, long CDS position that gives it financial incentives to engage in "net-short debt activism."[19] Similarly, the Commission identifies the possibility that a large SBS position could give rise to incentives to engage in manufactured or other opportunistic strategies in the CDS markets.[20] A further example of a scenario where the Commission believes the Proposed Rule would be beneficial is when a counterparty has concentrated exposure to a large SBS position distributed among multiple dealers.[21]

The common thread running through these examples is that they involve situations where the large SBS position is *directional*. A market participant will not have incentives to engage in net-short debt activism if it does not have a net-short position. Similarly, a market participant will not have incentives to engage in manufactured or other opportunistic CDS strategies unless it has a net-short or net-long CDS position that would cause the person to reap financial benefits from those strategies. Incentives for a person holding an equity SBS position to engage in activist strategies with respect to an underlying company also do not exist if the person's equity SBS position is hedged.

In addition, the sort of concentrated exposure scenario envisioned by the Commission—where a large change in the price of a security referenced by a total return

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17 Security-based swap equivalent position means the number of shares attributable to all of the security-based swaps comprising a security-based swap position, as determined in accordance with paragraph (b)(4) of Proposed Rule 240.10B-1. *See* Proposed Rule 240.10B-1(b)(2).

18 Proposed Rule 240.10B-1(b)(1)(iii).

19 Proposed Rule at p. 6656.

20 *Id.* at pp. 6656-6657.

21 *Id.* at p. 6656.

swap leads to the liquidation of securities held to hedge the swap—typically involves a default by a party holding a directional position in the swap. In contrast, where a party has a market-neutral position, either with offsetting SBS positions or an SBS position offset by a position in the referenced security, it typically can use the proceeds of one position (such as margin paid by an SBS counterparty or credit extended against a security position) to pay its counterparties on the other side of the market, thus avoiding the liquidation scenario identified by the Commission.

Because Proposed Rule 10B-1 therefore focuses (or should focus) on large, *directional* positions, it would be far less relevant to parties engaged in non-directional trading strategies.

For example, Proposed Rule 10B-1 would be less relevant to parties engaged in dealing activity in the SBS market. As the Commission has observed, a dealer seeks "compensation in connection with providing liquidity involving [SBSs] (*e.g.*, by seeking a spread, fee or other compensation *not attributable to changes in the value* of the [SBS])."[22] Many dealers are also subject to proprietary trading restrictions under the regulations commonly known as the "Volcker Rule." Thus dealers are not in the business of acquiring the sorts of positions implicated by the Proposed Rule.[23] In addition, dealers are typically subject to regulatory oversight that reduces the likelihood they will engage in potentially fraudulent or manipulative market behavior, as well as capital and other prudential requirements that minimize the risk of a default. These considerations apply both for dealers registered with the Commission as well as those who operate under the SBS dealer *de minimis* threshold but are regulated in another jurisdiction.

For these reasons, requiring dealers to report using the gross notional thresholds under Proposed Rule 10B-1 is much less likely to provide useful information to the Commission or the public. In fact, because most of the Proposed Rule's proposed reporting thresholds operate on a gross basis, it is likely to result in dealers filing the bulk of the reports required by the Proposed Rule. For example, it would appear that a dealer with a long equity SBS position of $150 million offset by a short position in the underlying equity securities would trigger reporting requirements under the Proposed Rule, even though the dealer is fully hedged, has no incentives to engage in opportunistic behavior, and is highly unlikely to default as a result of a decline in the price of the referenced securities. On the other hand, given that dealers service multiple counterparties, the likelihood that a dealer would have a position of this sort is relatively high—for example, a dealer with just five counterparties seeking exposure to the

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22 *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* SEC Release No. 34-66868 (April 27, 2012), 77 FR 30596, 30617 (May 23, 2012) (emphasis added).

23 For similar reasons, dealers are highly unlikely to adjust a directionally neutral position into a directional one.

referenced equity security would only need to have, on average, $30 million of notional exposure per counterparty to trigger reporting.[24]

A further category of market participant for whom Proposed Rule 10B-1 would be less relevant is arbitrageurs. There are several arbitrage strategies that are common in the SBS markets, such as index arbitrage (where a person assumes a position in a derivative referencing a security index and offsetting positions in SBSs referencing the index's components) or arbitrage between the market for an SBS and its underlying security (*e.g.*, a position in an equity SBS coupled with an offsetting position in the underlying equity security designed to arbitrage the different financing costs embedded in the pricing for the two positions). These arbitrage strategies have several important benefits in terms of contributing to price discovery and market liquidity and typically do not result in the arbitrageur taking (or intending to benefit from) a significant, directional SBS position.

While the information required to be reported by dealers and arbitrageurs under the proposed thresholds of Proposed Rule 10B-1 is much less likely to be informative, the costs to them of implementing the Proposed Rule are quite likely to be significant. Due to the application of the Proposed Rule across commonly controlled entities, these market participants will need to develop systems capable of aggregating positions in SBSs as well as related securities and derivatives on a group-wide basis, across legal entities, geographies, and business units, at least as frequently as daily.

The most appropriate step, in our view, to address the above issues would be for the Commission to amend the reporting thresholds to permit a person to calculate its reporting threshold amounts on a net basis. Specifically, the Commission should modify Proposed Rule 10B-1(b)(1) so that, when a person calculates whether it has exceeded a reporting threshold amount, the person may net offsetting long and short SBS positions against each other, as well as long or short positions in SBSs against short or long positions in (a) the referenced securities or loans or (b) derivatives on a security index, basket, or exchange-traded fund, a component of which is referenced by the SBS.[25]

We recognize that the Commission may be concerned that adopting solely net reporting thresholds could allow parties to delay reporting by holding a large, hedged SBS position only to later liquidate the hedge position in order to obtain directional exposure.[26] However, such a strategy is unlikely in our view because doing so would

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[24] *See* Nina Boyarchenko, Anna M. Costello and Or Shachar, "The Long and Short of It: The Post-Crisis Corporate CDS Market," *Federal Reserve Bank of New York Economic Policy Review*, Vol. 26, No. 3 (June 2020), available at https://www.newyorkfed.org/research/epr/2020/epr_2020_post-crisis-cds_boyarchenko, at p. 18 (depicting the significant differences between dealers' gross versus net positions).

[25] In the case of an offsetting position in a security index derivative, the extent of the offset would depend on the weighting of the relevant component in the index.

[26] Proposed Rule at 6701.

result in significant unwanted costs (both in accumulating and in disposing of the hedge position) and take considerable unwanted time (especially for less liquid markets, such as those for corporate debt securities).

In any event, the Commission could address this concern in a more targeted manner by prohibiting a person from delaying its Rule 10B-1 report by holding an offsetting position to an SBS for the sole purpose of remaining below a reporting threshold. If it adopted this prohibition, the Commission should adopt safe harbors making clear that the prohibition would not apply to a person:

(1) engaged in activity that would fall within the definition of an SBS dealer as set forth in Exchange Act Rule 3a71-1, without regard to the *de minimis* exception set forth in Exchange Act Rule 3a71-2 or related cross-border provisions set forth in Exchange Act Rule 3a71-3(b);[27] or

(2) transacting in SBSs as part of a *bona fide* arbitrage strategy, as described above.

In any event, at a minimum, a person falling into either of these categories should not be subject to gross position reporting thresholds for purposes of Rule 10B-1.

B. The Commission Should Exclude Hedging Activity from Counting Towards Reporting Thresholds

As the Commission has noted, SBSs may be used to hedge or mitigate commercial risks, such as to manage the risk posed by a customer's, supplier's, or counterparty's potential default, to manage equity or market risk associated with

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[27] To address foreign dealers, the Commission could consider requiring that a person availing itself of this safe harbor prong be (1) registered or licensed by (i) the Commission, (ii) a regulatory authority in another G20 jurisdiction, (iii) a regulatory authority in a jurisdiction that administers capital standards consistent with the Basel Accords, or (iv) a regulatory authority in a jurisdiction subject to a substituted compliance determination by the Commission; and (2) subject to capital requirements administered by (i) the Commission, (ii) a Prudential Regulator (as defined in Exchange Act Section 3(a)(74)), (iii) a regulatory authority in another G20 jurisdiction, (iv) a regulatory authority in a jurisdiction that administers capital standards consistent with the Basel Accord, or (v) a regulatory authority in a jurisdiction subject to a substituted compliance determination by the Commission. The first condition would require that the person be subject to a Commission licensing or registration requirement (including, but not limited to, conditional SBS dealer registration with the Commission) or that of a comparable non-U.S. regulator. The first condition is intended to ensure that the person is subject to regulatory oversight mitigating the risk of the person engaging in potentially fraudulent or manipulative behavior. The second condition would seek to ensure that the person is subject to capital regulation that addresses potential concerns with the person's exposure to substantial credit risk, such as when an SBS counterparty enters into a concentrated position opposite the dealer, even though the dealer itself does not conduct such directional trading and instead hedges its exposure. In this scenario, capital regulation should provide the Commission with comfort that the dealer's credit risk is sufficiently mitigated.

employee compensation plans, or to manage equity market price risks connected with a business combination, among other examples.[28]

A party using SBSs for such hedging purposes does not have incentives to engage in the activities identified as problematic by the Commission, nor do its positions pose a systemic risk. On the other hand, requiring the disclosure of such hedging SBSs is more likely to tip off other market participants to activity in the underlying securities or loan markets, as well as to drive up the costs of the lending or other financing activities being hedged.

For example, commercial lenders often extend credit to clients that is beyond internal enterprise risk guidelines with the expectation that they can hedge their exposure down to an acceptable level of risk. This practice is particularly important in times of economic stress, where large borrowers may not have the ability to raise sufficient debt capital in the public markets. Lenders are only willing to take on this initial exposure, which can be in the tens of billions of dollars, based on an expectation that they can discreetly hedge their risks. These large-scale hedging strategies are often completed across multiple transactions and can take weeks or sometimes months to execute. In its current form, Proposed Rule 10B-1 would require lenders to disclose their SBS position well before they have completed their hedge, which would inevitably lead to front-running. Such a result would decrease market liquidity and increase the cost of CDS hedges (which would ultimately be passed on to the issuer and consumers). Further, without reasonable access to a liquid CDS market, lenders will reduce their lending capacity to individual clients, which could significantly disrupt markets in that borrowers may not be able to replace this source of borrowing in a timely and cost-effective manner.

In light of these considerations, the Commission should exclude an SBS from counting towards reporting thresholds if the SBS is either:

> (1) held for the purpose of hedging or mitigating commercial risk, as defined by Exchange Act Rule 3a67-4,[29] by a person (a) qualifying as a "commercial end user" as defined by Exchange Act Rule 18a-3, (b) subject to registration or licensing and capital requirements either by the Commission or a qualifying foreign regulator,[30] (c) subject to regulation as an insurance company by any U.S. state, or a foreign equivalent, or (d) subject to regulation as an investment company under the Investment Company Act of 1940, an employee

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28 *See* 17 C.F.R. §240.3a67-4 (definition of "hedging or mitigating commercial risks").

29 We understand that this definition generally would not include hedging of dealing activity, but consider that such hedging activity should usually net against customer-facing transactions as per our recommendations above.

30 *See* note 28, *supra*.

benefit plan under the Employee Retirement Security Act of 1974, or a foreign equivalent; or

(2) entered into by a person subject to the Volcker Rule's restrictions on proprietary trading (a) in reliance on the exemption from those restrictions for risk-mitigating hedging[31] or (b) based on the conclusion that the SBS was not entered into by the person for its "trading account."[32]

C. The Commission Should Calibrate the Reporting Thresholds for CDS and Non-CDS Debt SBSs in a Manner that Recognizes the Different Trading and Liquidity Characteristics of Different Underlying Debt Securities

As laid out above, the Proposed Rule would provide for the same notional amount thresholds across all CDS and non-CDS debt SBSs regardless of the issuer and trading and liquidity characteristics of the underlying debt securities. For example, the same $300 million gross notional amount threshold would apply to CDS referencing the debt obligations of an investment grade company with over $100 billion in debt outstanding as a high-yield company with only a few hundred million in debt outstanding.

This lack of calibration would lead to several negative consequences. For market participants transacting in CDS or non-CDS debt SBSs relating to the obligations of investment grade companies with significant amounts of debt outstanding and referenced by liquid, widely traded CDS, for example, the Proposed Rule would require reporting of positions immaterial to the market. This reporting would impose unnecessary burdens on those reporting persons and add "noise" to the reports reviewed by the Commission and those it makes publicly available. Similarly, the proposed approach does not allow for calibration with respect to positions on companies with relatively small amounts of debt outstanding or that are not the subject of widely traded CDS.

At minimum, the Commission should increase the notional reporting threshold to a level that is more appropriately tailored relative to the risk posed by owning such a position and, as discussed above, applicable on a net basis. The Commission should also adopt different debt SBS reporting thresholds based on the relative trading and liquidity characteristics of the SBS and its reference entity's debt. Further research and analysis is necessary in order to determine the best approach to categorizing different debt SBSs when setting their reporting thresholds and then calibrating those thresholds.[33] The Commission should, as described below, use

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31 *See, e.g.*, 17 C.F.R. §255.5.

32 *See, e.g.*, 17 C.F.R. §255.3(b)(1).

33 Our members informed us that the 45-day time period did not provide adequate time to fully assess the implications of different debt SBS reporting thresholds. Moving forward, we welcome

Regulation SBSR data to inform its approach in this area so as to ensure that the likely number of reporting persons and reportable positions would not obscure the information the Commission seeks to illuminate or result in undue costs or burdens. In doing so, the Commission should develop a tailored approach to debt SBS reporting so as to only require the reporting of debt SBS positions that pose a material risk to SBS markets.

D. The Commission Should Calibrate Reporting Thresholds for CDS and Non-CDS Debt SBSs Using Data Collected Under Regulation SBSR

Market participants were not required to begin reporting SBS data until the initial Regulation SBSR compliance date, which was November 8, 2021. In addition, that initial compliance date only applied to SBSs entered into on or after that date; market participants are not required to report data regarding historical SBSs until April 14, 2022. As a result, the Commission does not yet have access to comprehensive, reliable data regarding the SBS market.[34] Instead, the reporting thresholds reflected in the Proposed Rule are based primarily on an analysis of data for the single-name CDS market voluntarily reported by certain dealers to the DTCC Derivatives Repository Limited Trade Information Warehouse ("DTCC-TIW") and, for non-CDS, data reported by certain registered investment companies in Form N-PORT.

As the Commission acknowledges, this data has several limitations. With respect to CDS, the DTCC-TIW data does not provide intra-weekly CDS position information and is compiled from data submitted on a voluntary basis.[35] With respect to non-CDS, the Commission notes multiple limitations in the dataset, including that the Commission cannot analyze different types of total return swaps separately[36] and that N-PORT reporting filers are not representative of the "average" trading entity in SBS markets,[37] among others.[38]

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the opportunity to work with the Commission to assess potential alternative thresholds for debt SBS using updated data from Regulation SBSR.

34 As noted below, the Commission's data review focuses disproportionately on CDS positions, and did not include a review of available swap data repository data, which includes extensive data regarding non-CDS SBS instruments.

35 *See* Proposed Rule at p. 6683, n.220.

36 *Id.* at p. 6697, n.258.

37 *Id.* at p. 6697, n.259.

38 For example, in analyzing the size and jurisdiction of underlying entities referenced by total return swaps, equity security-based swaps, and other non-CDS, debt security-based swaps, the Commission relied on two separate datasets, Compustat and N-PORT, which do not have common identifiers, which the Commission admits could lead to potential data errors. *Id.* at p. 6698, n.261.

It is unclear why the Commission needs to rely on such limited data to inform such a significant new requirement as Proposed Rule 10B-1 when reliable and comprehensive data reported under Regulation SBSR will soon be available. Given the time it will take market participants to implement Proposed Rule 10B-1,[39] there is no reasonable prospect of the Proposed Rule taking effect until a meaningful period of time after Regulation SBSR's April 14, 2022 compliance date for historical reporting. Therefore, there is no obvious downside to the Commission waiting to calibrate Proposed Rule 10B-1's reporting thresholds based on data collected under Regulation SBSR.

E. The Commission Should Eliminate the Notional-Based Reporting Thresholds for Equity SBSs

The proposed notional-based reporting thresholds for equity SBSs are likely to result in significant over-reporting of immaterial positions, given that, for many commonly traded equity securities, $300 million is an immaterial portion of the security's market capitalization. Indeed, we estimate that the proposed $300 million threshold would constitute less than 5% of market capitalization for over 2,100 companies; further, in our experience, most trading in equity SBSs is concentrated in SBSs referencing the equity securities of large companies for which $300 million is significantly less than 5% of market capitalization. As a result, in the vast majority of instances the proposed $300 million threshold for equity SBSs would, like the parallel threshold for CDS and non-CDS debt SBSs, require reporting of positions that are immaterial to the market, do not give rise to systemic risk, and would impede the ability of the Commission and the public to identify truly material positions.

In addition, by introducing a notional-based reporting threshold for equity SBSs, the Commission would create undesirable discrepancies vis-à-vis beneficial ownership reporting under Sections 13(d) and (g) of the Exchange Act. While we agree with the Commission that any SBS disclosure regime should be separate from the Section 13 beneficial ownership reporting regime, such discrepancies between the two regimes would not only add to the implementation costs of Proposed Rule 10B-1, but also create incentives for market participants' use of certain instruments to gain exposure to the equity markets merely due to regulatory differences.

Viewed against these drawbacks, the justification for a notional-based reporting threshold for equity SBSs is thin. The Proposed Rule offers the justification that a notional threshold "provides a bright-line, absolute measure of position size and is similar to the approach proposed for CDS," without explaining why that outcome is desirable except to note that it "provides a simple and specific reporting threshold for participants."[40] However, given that participants would also need to satisfy a proposed 5% threshold relative to market capitalization, they would not be able to realize any benefit in terms of reduced implementation costs from a notional-based threshold.

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[39] *See* Part VII below.

[40] Proposed Rule at p. 6696.

Accordingly, the Commission should eliminate the notional-based reporting thresholds for equity SBSs.

F. The Commission Should Clarify and Streamline the Treatment of Related Equity Positions for Reporting Threshold Calculations

Our members are concerned that the need to identify all of the types of related equity positions identified by this prong of Proposed Rule 10B-1 would result in significant costs and burdens that outweigh the anti-evasion benefits sought by the Commission. The Commission could achieve most of the same benefits by limiting the requirement to add the value of related equity positions to the value of underlying equity securities for which the SBS position holder is deemed to be the beneficial owner pursuant to Exchange Act Section 13(d) and the rules and regulations thereunder. Streamlined in this manner, the Proposed Rule would permit market participants to rely on their existing Section 13 processes while also ensuring that a person could not stay below both the Rule 10B-1 and Section 13 reporting thresholds by maintaining a combination of SBS and equity securities positions. In contrast, the other types of positions that the Proposed Rule would capture in this calculation, most notably options positions, do not result in equivalent economic exposure and thus do not raise the same sort of evasion concerns.[41]

In addition, if the Commission does not permit netting as described above, then it should, at a minimum, clarify that the requirement that a person add the value of underlying equity securities and the delta-adjusted notional amount of other derivative instruments to its equity SBS reporting threshold amount only applies to the extent that those other positions are on the same side of the market as the person's equity SBSs. In other words, a person that has a long $150 million notional equity SBS position offset by a short $150 million position in the underlying equity security should not breach the reporting threshold amount.

G. The Commission Should Clarify How Proposed Rule 10B-1 Applies to Entities' Independent Business Units Under Common Control

Proposed Rule 10B-1's reporting requirements would apply to (1) any person, including any entity controlling, controlled by or under common control with such person, or (2) any group of persons, who through any contract, arrangement, understanding or relationship, after acquiring or selling directly or indirectly, any SBS, is directly or indirectly the owner or seller of an SBS position that exceeds the reporting threshold amount.[42] The Proposed Rule, therefore, would appear to require the aggregation of SBS positions of entities under common control for the purposes of conducting calculations in respect of the reporting thresholds, as well as with respect to

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41 We further note that the Exchange Act does not authorize the Commission to adopt a large options position reporting requirement.

42 Proposed Rule 240.10B-1(a)(1).

reporting itself. But it is not clear whether the Proposed Rule would take into account any internal informational barriers or other means of separation between such entities.

The Commission should clarify its proposed aggregated reporting approach by applying a similar disaggregation approach as is currently in place with respect to Section 13 beneficial ownership reporting. For purposes of Section 13 reporting, the Commission has recognized that "certain organizational groups are comprised of many different business units that operate independently of each other" and that "the need to aggregate [for reporting purposes] may have the effect of requiring diverse business units to share sensitive information, when it is otherwise not necessary for business purposes."[43] The Commission has therefore issued guidance noting that "where the organization structure of the parent and related entities are such that the voting and investment powers over the subject securities are exercised independently, attribution may not be required for the purposes of determining whether a filing threshold has been exceeded and the aggregate amount owned by the controlling persons."[44] Whether voting and investment powers are exercised independently depends on an analysis of the relevant facts and circumstances, including the existence of informational barriers, participation in a common compensation pool, existence of written policies and procedures regarding the flow of information and whether the entities have separate officers and directors.[45]

The Commission should follow a similar approach with respect to Proposed Rule 10B-1 and allow reporting persons under common legal control to disaggregate their SBS positions across independent business units when the appropriate separations, consistent with those enumerated in the Section 13 guidance, are in place. Disaggregation across independent business units would further the Commission's policy goals and result in more useful Schedule 10B filings. Because independent business units necessarily exercise their investment authority independently (in order to comply with Section 13), a disaggregated reporting approach would provide the market with more accurate disclosure as to which entities are, for example, actually building concentrated positions based upon their investment strategies. By contrast, an aggregated reporting approach could be misleading. For example, an entity could have dealing and asset management businesses that trade independently—if a reporting person is required to aggregate their positions for Schedule 10B disclosure, then a dealer's fully hedged SBS positions would be combined with the asset manager's unhedged, directional positions, even though the two entities do not coordinate trading and enter into the positions for

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43 *Amendments to Beneficial Ownership Reporting Requirements*, SEC Release No. 34-39538 (January 12, 1998), 63 FR 2854, 2857 (January 16, 1998).

44 *Id.* at 2857; *see also The Goldman Sachs Group, Inc.*, SEC No Action Letter (March 30, 2001), 2001 WL 314646.

45 *Amendments to Beneficial Ownership Reporting Requirements*, SEC Release No. 34-39538 (January 12, 1998), 63 FR 2854, 2858 (January 16, 1998).

different purposes. The result would be public reports that do not accurately reflect the SBS positions held by market participants.

Following this approach would also significantly reduce compliance costs by allowing market participants to rely, to a greater extent, on the position capture and reporting systems and processes that they already have in place for Section 13 purposes. It also would alleviate the risks and issues that could arise if Proposed Rule 10B-1 were effectively to require information sharing across barriers, which could possibly prevent firms from being able to rely on the information barrier defense set forth in Exchange Act Rule 10b5-1(c)(2) or possibly require them to aggregate independently controlled positions for other purposes, such as in connection with position limits administered by FINRA or the CFTC.

In addition, due to the application of Proposed Rule 10B-1 across commonly controlled entities, it is necessary that the Commission clarify the treatment of SBS positions between such entities. In our view, SBSs entered into by a person with an entity controlling, controlled by, or under common control with that person should be excluded from the reporting threshold amount. Otherwise, these inter-affiliate SBS positions, which are usually entered into for group-wide risk management purposes, would result in double-counting SBS positions, thus triggering Rule 10B-1 reporting at relatively low levels of outright market exposure.

H. The Commission Should Exclude Inter-Affiliate SBS Transactions.

If Proposed Rule 10B-1 applied to inter-affiliate SBS transactions, it would impose an unnecessary burden on the beneficial use of these transactions for risk management and other appropriate purposes. These burdens would arise for both dealers and buy-side organizations. On the other hand, reporting these positions would not further the Commission's stated public policy goal of providing transparency into high-risk SBS positions.

Entities within a single organization may enter into SBSs with their affiliates, which may reference many different underlying securities, instruments, and indices for various business purposes, such as a means to efficiently transfer the economic interests of the underlying security or instrument to an affiliate. For example, one company in the organization's group may invest in equity securities of a public issuer. This initial securities transaction would be subject to, as applicable, reporting and other requirements under Section 13 of the Exchange Act. Subsequently, the company may wish to transfer such securities to an affiliate, but for administrative ease of transfer or cash management reasons, it may be costly or inefficient to transfer the underlying securities. Thus, the company may enter into an SBS transaction with one or more affiliates in order to transfer to such affiliate the economic equivalent of an investment in the security. The Proposed Rule does not appear to provide for an exception to its reporting requirements for such inter-affiliate transactions even though, as discussed further below, disclosure of such SBS transactions would not advance the Commission's

stated goals. We respectfully submit that these inter-affiliate SBS transactions should not be subject to the Proposed Rule.

The case for exclusion is even stronger where the reference security is unlisted. Participants in the unlisted securities market are generally sophisticated investors that do not need a mandated disclosure to understand their risks. These markets are also not generally widely accessible and it is therefore unlikely that other parties would be affected by SBS activity. Additionally, subjecting SBSs on unlisted securities to public disclosure would upset the Commission's approach with respect to unlisted securities, which are generally subject to less onerous disclosure requirements (for example, these securities generally are not covered by Section 13).

We submit that excluding inter-affiliate SBS transactions would reduce costs without impacting the Commission's stated objectives. In the Proposed Rule, the Commission identifies its policy goals of providing regulators and market participants with notice that certain market participants are building large positions, facilitating risk management, and informing pricing of SBS transactions.[46] The Commission asserts that the public disclosure of large SBS positions provides notice to market participants and regulators of potential fraud and manipulation[47] and affords dealers more time to adjust their hedges or call for additional margin should an issue arise with the underlying security or the SBS counterparty's ability to pay.[48]

All of these benefits, however, are predicated upon the SBS transaction being transacted between unaffiliated entities engaging in arm's-length market transactions. A company engaging in inter-affiliate SBS transactions will have already completed the market-facing action of acquiring the underlying security (if any) and any accompanying reporting required by Section 13. The inter-affiliate transaction does not implicate any third-party market participant.

Thus, the public reporting requirements of the Proposed Rule do not produce any additional information that can help protect market participants. Instead, the public reporting of inter-affiliate SBS transactions would distort market information by double counting the information that is already reported to the market, as applicable, which would potentially distort market pricing of the referenced instruments, as well as information about the liquidity, trading and exposure of products tradeable in SBS markets.

Furthermore, despite the stated benefits of public disclosure of large SBS positions, the Proposed Rule acknowledges that SBS transactions can involve sensitive or proprietary information, especially regarding the relationship between the parties to the

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46 Proposed Rule at 6667.

47 *Id*.

48 *Id*. at 6656.

SBS.[49] Thus, the Commission has proposed that a counterparty only be required to report aggregated positions.[50] However, when both parties to an SBS are part of the same affiliate group, the entire nature of the transaction is proprietary—how a company apportions the economic exposure of its underlying security position amongst separate business units, for example, is an internal strategic decision that does not affect the market-facing risk of the aggregate position in an underlying security and need not be available to other market participants to advance the Commission's goals.

In addition, we note that current swap reporting under comparable CFTC rules treats affiliate transactions differently than other reportable swap transactions. For example, the CFTC's real-time public reporting rule excludes from the public dissemination requirements swaps between two entities that are both wholly owned by the same company.[51] We do not see any basis for the Commission to take a different approach than the CFTC with respect to the collection of inter-affiliate information under the Proposed Rule.

Simply put, inter-affiliate SBSs do not provide the market with information that furthers the SEC's stated policy goals. We believe that the public reporting of inter-affiliate swap transactions—especially with respect to inter-affiliate transactions referencing unlisted securities—does not provide the market with useful information. Instead, it would distort market information and lead to a serious risk of public confusion.

I. The Commission Should Clarify How Proposed Rule 10B-1 Applies to Positions Managed by Independent Account Controllers

It is relatively common in the SBS markets for investors to allocate funds to multiple asset managers who trade independently of each other, for example through managed account structures. In these situations, the underlying investor often only has access to position information on a periodic basis, and certainly not daily or in real time. In addition, the various independent account controllers do not have the ability, nor would it be desirable for them as competitors, to share position information with each other. Therefore there would be significant practical difficulties to requiring an investor to aggregate positions across these independent account controllers for Rule 10B-1 reporting purposes.

Nor would such aggregation help serve the objectives of the Proposed Rule. Because of the independence of trading decisions across managers, aggregating

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49 *Id*. at 6667.

50 *Id*. at 6667.

51 *See* 17 C.F.R. §§ 43.2 (definition of "publicly reportable swap transaction) and 43.3. Inter-affiliate transactions are given different treatment under (and are often exempt from) other regulatory obligations as well. *See, e.g.*, 17 C.F.R. § 50.52 (inter-affiliate exemption from the CFTC's clearing requirement).

positions across them would send confusing signals as to the incentives of any given manager to engage in trading activity with respect to the relevant SBS or underlying securities. In addition, it is relatively common for managed account structures to involve limited recourse arrangements that, from a counterparty credit perspective, would make it misleading to aggregate across accounts.

For these reasons, the Commission should clarify that an investor need not aggregate positions managed by independent account controllers, and may instead rely on its investment managers to report their independently managed positions on the investor's behalf.

J. The Commission Should Clarify the Treatment of SBSs Based on a Security Portfolio or Basket Subject to Discretionary Modification

The Commission has previously addressed the regulatory treatment of a swap on a security portfolio, basket, or index that gives one or both of the counterparties, either directly or indirectly (*e.g.*, through an investment adviser or third-party index provider), discretionary authority to change the composition of the security portfolio, which the Commission categorized as SBSs.[52] As part of this guidance, the Commission acknowledged the equivalence of this structure to an aggregation of individual SBSs.[53]

In light of this equivalence, the Commission should treat such an SBS as an aggregation of individual SBSs on the component securities of the portfolio for Rule 10B-1 purposes without also separately treating it as an SBS on a narrow-based security index. Absent this treatment, Proposed Rule 10B-1 would lead to erroneous results. For example, compare the following two trades. The first is a $300 million notional swap on a custom basket composed of equally weighted exposure to the common stock of Alphabet, Apple, IBM, Microsoft, and Netflix. The second is a series of five, $60 million notional, single-name swaps on the same common stocks. Without the clarification requested above, the first trade would be subject to reporting under Rule 10B-1, but the second trade would not, even though the two are economically equivalent. This disparity would create unwarranted incentives to use the second trade structure.

III. The Commission Should Align Proposed Rule 10B-1's Reporting Deadline with Section 13's Reporting Deadlines

The Proposed Rule would require reporting persons to file a Schedule 10B report no later than the end of the first business day following the execution of the SBS

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52 *See Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, SEC Release No. 34-67453 (July 18, 2012), 77 Fed. Reg. 48208, 48285 (August 13, 2012).

53 *See id.* at 48285, n.886.

transactions that trigger the Proposed Rule 10B-1 reporting requirements.[54] Unlike in the Section 13 context, here the Commission has made no effort to take into account the impact on reporting persons, in terms of infringement on confidential trading strategies or front running risks, from requiring disclosure so soon after the person establishes a reportable position. In addition, this one-day timeline is practically unworkable for market participants, who will be required to conduct, on a daily basis, complex analyses to assess when a particular reporting threshold has been met with respect to any of its positions and whether any such market participant holds any other related positions that would need to be disclosed. To address these issues, we recommend structuring Proposed Rule 10B-1 as a periodic reporting requirement with timelines that are consistent with Section 13 reports.

A. One-Day Filing Deadline Is Practically Unworkable

The Proposed Rule notes that a one-business-day filing requirement is consistent with the timing requirement under Rule 15Fi-2(b)[55] with respect to trade acknowledgments.[56] However, the Rule 15Fi-2 trade acknowledgment process is completely separate from the processes needed to report under Proposed Rule 10B-1, and conflating the two is not appropriate.

Under the Proposed Rule, reporting persons would have to perform complex analyses to determine whether any of their positions might exceed a reporting threshold and therefore be subject to reporting under Proposed Rule 10B-1. In all cases, reporting persons would also have to track and report several types of positions in a variety of securities and other derivatives relating to the reportable SBS position, as laid out in Schedule 10B. The proposed equity-based SBS reporting threshold is even more complex and would require a reporting person to track its positions in the securities underlying an SBS, as well as the number of shares attributable to any derivative instruments based on the same class of securities.[57] Similarly, the proposed CDS thresholds have a layer of complexity in this respect because they would require a potential reporting person to net deliverable cash positions against long CDSs, which presumably will require some form of tagging of bonds intended to be deliverable into CDS.

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54 Proposed Rule at p. 6668.

55 17 C.F.R. 240.15Fi-2(b) requires security-based swap dealers or major security-based swap participants to provide a trade acknowledgment to their counterparty within one business day of any security-based swap transaction.

56 Proposed Rule at p. 6668. The Proposed Rule further notes that, "once a security-based swap transaction reaches the point when an SBS Entity is required to deliver a trade acknowledgment of a security-based swap to its counterparty, both sides to the transaction should then have the information about the size of the transaction so that each can determine whether any applicable Security-Based Swap Position has exceeded the Reporting Threshold Amount." *Id.*

57 Proposed Rule at p. 6671.

Market participants would be required to make these calculations in the context of constantly changing positions and market prices. They also would be required to aggregate information across commonly controlled entities;[58] these calculations would be even more complex to the extent the Proposed Rule is not revised to allow for disaggregated reporting by independent business units, as discussed in Part II.G above.

Especially challenging issues would arise for reporting persons domiciled abroad. In particular, due to time-zone differences, and taking into consideration the need to aggregate information across commonly controlled entities across multiple jurisdictions on a global basis, a reporting person based in Asia would need to initiate the position calculation process just after the U.S. market close, which would fall outside of business hours in Asia.

None of these steps is necessary to satisfy the Rule 15Fi-2(b) trade acknowledgment requirement. To satisfy that requirement, all an SBS dealer or major SBS participant must do is prepare and send a document memorializing the terms of an SBS transaction. We respectfully submit that determining the terms of an SBS transaction through the trade acknowledgment and verification process should be the starting point for the calculation and information-gathering process necessary to satisfy Proposed Rule 10B-1, not the end point.

The Rule 15Fi-2 trade acknowledgment requirement is also limited to registered SBS dealers and major SBS participants.[59] In contrast, Proposed Rule 10B-1 would not be limited to these types of registered entities, but instead would apply to any person whose positions exceed an applicable reporting threshold. Accordingly, Proposed Rule 10B-1 reporting requirements would apply to many market participants that are not subject to Rule 15Fi-2. The justification of relying on the Rule 15Fi-2 regime, even were it appropriate, does not apply to these entities.

B. Aligning Proposed Rule 10B-1's Reporting Deadline with Section 13's Reporting Deadlines Would Have Several Important Benefits

The Commission should align the Proposed Rule 10B-1 reporting deadlines with comparable reporting deadlines established under Section 13 of the Exchange Act.[60] Rule 13d-1 currently requires any person who directly or indirectly acquires beneficial ownership of more than 5% of any class of equity security set forth in the rule[61] to file a Schedule 13D with the Commission within 10 days after the

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58 Proposed Rule at p. 6668.

59 17 C.F.R. 240.15Fi-2(a) is limited to "any transaction in which a security-based swap dealer or major security-based swap participant purchases or sells to any counterparty a security-based swap."

60 15 U.S.C. § 78m.

61 17 C.F.R. § 240.13d-1(i) ("[T]he term "equity security" means any equity security of a class which is registered pursuant to section 12 of that Act, or any equity security of any insurance

acquisition.[62] Certain persons, however, including registered dealers, banks and registered investment companies, currently may instead file a Schedule 13G within 45 days after the end the calendar year (or within 10 days after the end of the month if the person's beneficial ownership exceeds 10% of the class of equity securities), *provided* that, among other requirements, such person acquires the securities in the ordinary course of business and not with the purpose or effect of changing or influencing the control of the issuer.[63] Finally, Section 13(f)[64] and Rule 13f-1[65] thereunder establish a quarterly reporting requirement on Form 13F for institutional investment managers, including dealers, who exercise investment discretion with respect to accounts holding certain securities[66] having an aggregate fair market value of at least $100 million.

Schedules 13D and 13G reporting requirements effectively tailor reporting deadlines based on the reporting person's role in the market. Persons taking a directional position for the purpose of influencing control over an issuer are required to report on a more frequent basis than dealers, which are not in the business of changing or influencing the control of an issuer. Under this bifurcated approach, the market receives timely information regarding activist strategies, while allowing dealers and others that do not engage in such strategies to avoid the costs associated with unduly frequent reporting obligations.

In contrast, Proposed Rule 10B-1 applies a much shorter one-day reporting timeline—without precedent in any similar reporting regime, either as currently in effect or proposed to be revised[67]—and applies it to all persons subject to the Proposed Rule regardless of their business strategies and their relation to the types of activities that the Proposed Rule is intended to address. In doing so, the Commission does not provide a justification for why a one-day reporting period is necessary in order to achieve the Commission's goals. Unlike comparable public reporting regimes, such as Section 13(f)

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company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of the Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940; *Provided*, Such term shall not include securities of a class of non-voting securities.").

62 17 C.F.R. § 240.13d-1(a).

63 17 C.F.R. § 240.13d-1(b).

64 15 U.S.C. § 78m(f)

65 17 C.F.R. § 240.13f-1.

66 Specifically, the requirement applies to accounts holding "section 13(f) securities," defined as equity securities of a class described in Section 13(d)(1) of the Exchange Act that are admitted to trading on a national securities exchange or quoted on the automated quotation system of a registered securities association. 17 C.F.R. § 240.13f-1(c).

67 Reporting deadlines under Sections 13(d) and (g), even if shortened as recently proposed by the Commission, would not require reporting within one business day of establishing a reportable position.

of the Exchange Act,[68] the Proposed Rule does not make any attempt to balance the competing interests of market participants in preserving, at least for a period of time, the confidentiality of their proprietary trading strategies.

To better tailor the Proposed Rule to achieve its objectives and mitigate undue costs and the potential for regulatory arbitrage, the Commission should adopt a two-pronged approach to reporting deadlines. First, for a person not (a) eligible for reporting on Schedule 13G or (b) engaged in dealing, hedging, or arbitrage activity as described in Part II.A above, Proposed Rule 10B-1 should impose the same reporting timeline for Schedule 10B as Rule 13d-1 provides for Schedule 13D. For a person (a) eligible for reporting on Schedule 13G or (b) engaged in dealing, hedging, or arbitrage activity as described in Part II.A above, the Commission should follow a quarterly reporting schedule consistent with Form 13F.[69]

These timelines would allow market participants to leverage key components of existing Section 13 compliance processes, provide dealers and other qualifying passive investors with the time needed to perform the complex calculations and fulfill the very extensive ancillary disclosure requirements of the Proposed Rule, and remove inappropriate incentives to invest or trade in securities subject to Section 13 reporting as opposed to SBSs due solely to differences in reporting regimes.

IV. The Commission Should Clarify When Proposed Rule 10B-1 Requires an Amended Report

The Proposed Rule would require reporting persons to file a Schedule 10B amendment upon the occurrence of a "material change" in the facts set forth in a previously filed Schedule 10B.[70] Proposed Rule 10B-1(c) would deem any "change equal to 10% or more of a position previously disclosed in Schedule 10B" as material for the purposes of the proposed amendment requirements.[71] The Proposed Rule would also require that any amendment be filed no later than the end of the first business day following the material change.[72]

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68 *See* 15 U.S.C. § 78m(f); 17 C.F.R. § 240.13f-1.

69 For this latter group of market participants, we have proposed a quarterly reporting schedule consistent with Form 13F, instead of the schedule required for Schedule 13G, because we expect most participants falling into this group to be Form 13F reporters, and it would therefore be less costly and burdensome to align with Form 13F reporting than Schedule 13G reporting (particularly since timing for the latter currently varies depending on whether a person holds 10% or more of a class of equity securities, and this concept may not translate well to the non-equity SBS markets).

70 Proposed Rule at pp. 6672; Proposed Rule 240.10B-1(c).

71 Proposed Rule 240.10B-1(c).

72 Proposed Rule at p. 6672.

We recognize that including a requirement to revise Schedules 10B to account for changes in a reporting person's positions is needed to ensure the efficacy of the Proposed Rule. However, we believe that certain clarifications to this are necessary. Specifically, we recommend that the Commission clarify that the proposed amendment requirement would be triggered by a reporting person taking action to increase or decrease its reportable SBS position. Furthermore, we believe that the amendment filing timing should be revised to match the proposed initial Schedule 10B filing, as described in Part III, above.

A. The Commission Should Revise Proposed Rule 10B-1(c) to Require an Amendment Only Following a Market Participant's Acquisition or Disposition Related to a Previously Reported SBS Position

As noted above, the Proposed Rule would require a Schedule 10B amendment upon the occurrence of a material change to the facts set forth in a previously filed Schedule 10B. While the Commission notes that certain changes will be deemed material for purposes of the amendment requirement (as discussed in more detail below), it leaves open the possibility that other changes could also be material, therefore requiring a Schedule 10B amendment. We recommend that the Commission remove the vague "material change" standard from the Proposed Rule and instead enumerate the circumstances under which a reporting person would be required to amend a previously filed Schedule 10B. A vague and open-ended "material change" standard could result in the same over-reporting as described in Part II above and would trigger the same concerns.

Furthermore, the Commission's proposal with respect to which changes to an SBS position are automatically deemed material is itself unclear. The text of the Proposed Rule would require a Schedule 10B amendment upon the occurrence of "a *change* equal to 10% or more of a *position* previously disclosed in Schedule 10B."[73] However, the Commission's discussion of the amendment requirement specifies that an amendment would be required upon "an *acquisition or disposition* in an amount equal to 10% or more of the position previously disclosed in Schedule 10B" or "if the amount of the Security-Based Swap Position that was previously reported *increases or decreases* by 10% or more."[74] These three different standards introduce uncertainty as to when a reporting person would be required to amend a Schedule 10B, which could result in reporting persons taking different approaches.

In particular, the text of the Proposed Rule could be read to require an amendment whenever the SBS position, or potentially the underlying security, changes 10% or more without any action by such reporting person to increase or decrease its SBS position. Given that the price of a security underlying an SBS position can fluctuate significantly on a daily basis and the Proposed Rule's reporting requirements are based

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73 Proposed Rule 240.10B-1(c) (emphasis added).

74 Proposed Rule at p. 6672 (emphasis added).

on gross notional amounts, under the current Proposed Rule text, market participants could be required to amend their Schedules 10B frequently even if they have not acquired or disposed of any security-based swaps. Requiring amendments when a reporting person did not take any affirmative action to increase or decrease its SBS position would result in a number of negative outcomes, including material costs to reporting persons and confusion to the market that would make it more difficult to understand if a particular market participant is building a large SBS position.

To alleviate these issues, the Commission should take an approach similar to what it provided for in the Proposed Rule's preamble, rather than what the Commission provided for in the text of the Proposed Rule. In particular, an amendment requirement should be triggered by a reporting person's "acquisition or disposition" of a reportable SBS position equal to 10% or more of the SBS position previously disclosed on a Schedule 10B.[75] This standard would therefore only trigger amendment filings upon a discretionary action taken by a reporting person to change a previously disclosed SBS position, such as an amendment of a material term or an early termination or novation.

Additionally, to ease the operational burden on market participants, instead of using a 10% threshold it should use: (1) for equity-based SBS positions, a threshold equal to 1% of the relevant class of securities of the reference entity and (2) for debt-based SBS positions (CDS and non-CDS) a dollar notional amount threshold that is equal to 20% of the applicable reporting threshold for a newly established position. For equity-based SBSs, this would align the amendment threshold with Section 13 amendment reporting requirements and, in the case of debt-based SBSs, a 20% increase in notional debt position is the equivalent of the relevant equity-based SBS amendment threshold.

This approach would limit amendment requirements to instances where there is a material change in a market participant's relative interest in an underlying issuer. Otherwise, under the current approach, our members estimate that market fluctuations, especially for SBSs referencing more volatile securities, could result in reporting amendments on a daily or near-daily basis. The burdens of such frequent reporting would greatly outweigh any transparency benefits, especially given that a change in a position due to mere market fluctuations does not evidence any change in strategy by a reporting person.

B. The Commission Should Align the Deadline for Amending a Schedule 10B Filing with the Deadline for Initial Reporting

The Proposed Rule would require that any amendment be filed no later than the end of the first business day following the material change.[76] We believe that the amendment filing timing should be the same as that proposed for an initial

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75 *Id.*

76 *Id.*

Schedule 10B filing, as described in Part III, above. In general, the steps needed for a market participant to prepare an initial Schedule 10B filing would be consistent with those needed to prepare an amended filing, and so a consistent deadline would be appropriate. At a minimum, a market participant engaged in passive or non-directional trading and thus eligible for reporting on a quarterly basis as recommended in Part III.B above should be able to follow a quarterly schedule for reporting amendments.

V. The Commission Should Clarify the Range of "Related" Instruments Covered by Schedule 10B

The Proposed Rule would require any person with an SBS position that exceeds the applicable reporting threshold to file with the Commission a Schedule 10B containing certain information regarding the SBS position and the person making the filing. In particular, Items 6 and 7 of proposed Schedule 10B would require disclosure of the ownership of specified other positions relating to the SBS position.[77] Item 8 would further impose an open-ended disclosure requirement for:

> [o]wnership of any other instrument *relating to* the Security-Based Swap Position and/or any underlying security or loan or group or index of securities or loans, or any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of a security-based swap included in the Security-Based Swap Position, if not otherwise disclosed pursuant to Items 6 or 7 of [the Schedule 10B].[78]

As discussed below, the scope of this open-ended disclosure requirement is unclear and likely to result in over-disclosure of a variety of positions that contribute little to the Proposed Rule's objectives. Such over-disclosure would compromise the

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77 Proposed Rule at p. 6705. Item 6 of proposed Schedule 10B requires, in the case of a security-based swap position based on debt securities (including credit default swaps), that the reporting person must state: "(i) all debt securities underlying a security-based swap included in the security-based swap position, including the Financial Instrument Global Identifier (FIGI) of each underlying debt security, if applicable, and the [Legal Entity Identifier ("**LEI**")] of the issuer of each underlying debt security, if the issuer has an LEI; and (ii) all security-based swaps based on equity securities issued by the same reference entity, including the FIGI of each underlying equity security, if applicable."

Proposed Rule at p. 6705. Item 7 of proposed Schedule 10B requires, in the case of a security-based swap position based on equity securities, that the reporting person must state: "(i) all equity securities underlying a security-based swap included in the security-based swap position, including the FIGI of each underlying equity security, if applicable, and the LEI of the issuer of each underlying equity security, if the issuer has an LEI; and (ii) all security-based swaps based on debt securities issued by the same reference entity (including credit default swaps), including the FIGI of each underlying debt security, if applicable."

78 Proposed Schedule 10B(8) (emphasis added).

confidentiality of potentially unrelated trading activity by reporting persons while also significantly increasing the cost and complexity of reporting. To address these issues, the Commission should remove Item 8 from Schedule 10B while also expanding Items 6 and 7 to enumerate all related positions that the SEC believes should be reported. The Commission should also adopt an anti-evasion rule to deter market participants from structuring their transactions in order to evade disclosure.

A. Item 8 of Proposed Schedule 10B Is Vague and Ultimately Unworkable

As set forth above, Item 8 of proposed Schedule 10B mandates that reporting persons disclose "any other instrument *relating to* the Security-Based Swap Position" not otherwise disclosed pursuant to Items 6 and 7.[79] In addition, although not entirely clear, the grammar of the Item also could be read to require disclosure of any other instrument "relating to" (a) any security or loan or group or index of securities or loans underlying the SBS position or (b) any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of a security-based swap included in the SBS position.

The Proposed Rule does not provide any guidance on what characteristics would result in an instrument falling within the scope of Item 8. Does a security or derivative "relate to" an SBS position only if it is a position in or on the same reference asset or measurement? Or does "relating" have a broader meaning, covering instruments held as part of a common trading strategy with a reportable SBS or that correlate in some way to the reportable SBS? How does the requirement apply to securities that trade across international markets?[80]

As a result of this open-ended disclosure requirement, and in the absence of clearer guidance, reporting parties are likely to over-disclose on Schedules 10B in an attempt to avoid inadvertent violations of the Proposed Rule. Over-disclosure would have negative effects on reporting persons, the market and the purposes of the Proposed Rule. First, over-disclosure could compromise the confidentiality of potentially unrelated trading activity of reporting persons. Absent a regulatory requirement to disclose, market participants rely upon the fact that their positions and trading strategies will remain confidential. Market participants invest significant resources in developing proprietary trading strategies—unnecessary disclosures would directly harm those market participants and could deter or alter trading strategies solely due to the Proposed Rule's reporting requirement. As another example, if Item 8 was interpreted to require disclosure of loan positions, it would potentially destabilize the lending market given the

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79 *Id*. (emphasis added).

80 For example, currently there are a number of American depository receipts ("ADRs") being traded in the U.S. market which represent shares issued by non-U.S. companies, but it is not entirely clear whether the ADRs would be captured under Item 8 as being "relating to" an SBS position where the underlying security is the share being represented by the ADR (*i.e.*, not the ADR itself).

legitimate expectation among borrowers that their loans will be kept confidential—even a "brief description" of the loans[81] might contravene relevant confidentiality protections commonly negotiated by borrowers and cause them to restrict lenders' ability to transact in the SBS markets.

Furthermore, over-disclosure will significantly increase the cost and complexity of reporting for reporting persons while also making the reported information les useful to the Commission and the public. Absent an enumerated list of reportable positions, a reporting person would be required to, with respect to each SBS position it holds, determine what other positions might need to be reported as a related position. It would be difficult for reporting persons to fully automate such a review since a reporting person's overall trading book is constantly changing. This vague reporting requirement, combined with the one-day reporting timeline, discussed in Part III above, is ultimately unworkable for reporting persons.

B. The Objectives Underlying Proposed Item 8 Can Be Achieved by Expanding Proposed Items 6 and 7 and Adopting an Anti-Evasion Prohibition

Instead of including the open-ended requirement in proposed Item 8, the Commission can achieve the same objective of comprehensive disclosure of related positions by expanding the enumerated list of reportable positions set forth in Items 6 and 7 of proposed Schedule 10B to include the following:

- options, forwards and other derivative contracts that reference the same underlying security or loan or group or index of securities or loans (or reference the same price, yield, value, or volatility thereof) as the security-based swap included in the Security-Based Swap Position or that reference such security-based swap; and

- hybrid instruments (as defined in 7 U.S.C. 1a(29) or 7 U.S.C. 27(c)) that reference the same underlying security or loan or group or index of securities or loans (or reference the same price, yield, value, or volatility thereof) as the security-based swap included in the Security-Based Swap Position or that reference such security-based swap.

Including such a list of enumerated products would be far more workable from an operational standpoint for market participants, less open to interpretation and second-guessing, and more protective of the proprietary information of reporting persons than the vague standard for related instruments included in proposed Item 8.

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[81] *See* Proposed Rule at p. 6673. We note that the actual text of proposed Schedule 10B includes no reference to such a "brief description." At a minimum, the text of the rule should be aligned with how the Commission describes it in its preamble.

We recognize, however, that relying solely on an enumerated list could present opportunities for market participants to evade disclosure by trading instruments designed to fall outside the literal scope of such list. To address this issue without mandating an open-ended disclosure requirement that would inadvertently capture *bona fide* positions in instruments with little material nexus to a reportable SBS position, the Commission should adopt an anti-evasion rule to deter underreporting by requiring reporting on Schedule 10B of any instrument that would have been required to be reported but for the fact that it was willfully structured to evade the reporting requirements. We note that this type of anti-evasion principle has been included in similar rulemakings.[82]

VI. The Commission Should Recalibrate the Territorial Scope of Proposed Rule 10B-1

The Proposed Rule states that the reporting requirements of Proposed Rule 10B-1 would apply to all SBS positions *provided* that (1) any of the transactions that comprise the SBS position would be required to be reported pursuant to Rule 908(a) of Regulation SBSR;[83] *or* (2) the reporting person holds any amount of reference securities underlying the SBS position[84] *and* (i) the issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the United States; or (ii) such reference security is part of a class of securities registered under Section 12 or Section 15(d) of the Exchange Act.[85]

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82 For example, the CFTC's definition of "swap" includes "any agreement, contract, or transaction that is willfully structured to evade" the swaps regulatory regime. 17 C.F.R. § 1.3(definition of "swap")(6).

83 The Proposed Rule states that Rule 908(a) provides that an SBS is subject to regulatory reporting and dissemination if: (i) there is a direct or indirect counterparty that is a U.S. person on either or both sides of the transaction; or (ii) the SBS is accepted for clearing by a clearing agency having its principal place of business in the United States, and that an SBS that is not included in the above provisions is subject to regulatory reporting but not public dissemination if there is a direct or indirect counterparty on either or both sides of the transaction that is a registered SBS or a registered major SBS participant. *See* Proposed Rule at p. 6674. However, Rule 908(a) also includes several other prongs, such as for an SBS connection with a non-U.S. person's SBS dealing activity and arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office. *See* 17 C.F.R. § 242.908(a).

84 Including where the reporting person would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Exchange Act (15 U.S.C. 78m) and the rules and regulations thereunder. *See* Proposed Rule 240.10B-1(d)(2).

85 Proposed Rule 240.10B-1(d).

A. The Commission Should Narrow the Prong for Positions Comprised of SBSs Required to Be Reported Pursuant to Rule 908(a) of Regulation SBSR to Reference Solely Rule 908(a)(1)(i) or (ii)

The Proposed Rule describes the first prong, for an SBS required to be reported pursuant to Rule 908(a) of Regulation SBSR, as covering an SBS (a) in which there is a direct or indirect counterparty that is a U.S. person or registered SBS dealer or a registered major SBS participant, including a non-U.S. SBS dealer or a major SBS participant, on either or both sides of the transaction, or (b) accepted for clearing by a clearing agency having its principal place of business in the United States.[86] However, Rule 908(a) also includes several other prongs, which cover an SBS: (i) executed on a platform having its principal place of business in the United States; (ii) effected by or through a registered broker-dealer; or (iii) connected to a non-U.S. person's SBS dealing activity and arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office.[87]

By covering all of the types of SBSs reportable under Rule 908(a), the Proposed Rule sweeps too broadly. In particular, if only a single transaction comprising an SBS position was arranged by U.S. personnel, the entire position would become reportable under Rule 10B-1, even if no U.S. person or underlying U.S. security was involved. Although it remains unclear to us why the involvement of U.S. personnel necessarily should trigger *transaction* reporting under Regulation SBSR, subjecting entire *positions* to reporting due to the involvement of U.S. personnel would raise more significant issues. For example, a market participant is unlikely to know whether its counterparty reported an SBS transaction due to the involvement of U.S. personnel on the counterparty's side of the trade, but such involvement would nonetheless bring a position within scope for reporting under Proposed Rule 10B-1. Moreover, given the breadth of confidential information required to be disclosed on Schedule 10B, non-U.S. market participants would surely avoid triggering Rule 10B-1 by avoiding interactions with dealers' U.S. personnel wherever possible.

Also, the proposed cross-border scope of Proposed Rule 10B-1 would upset the balance the Commission struck in Regulation SBSR between when a transaction is subject to both regulatory reporting and public dissemination versus when it is subject only to regulatory reporting. Specifically, an SBS transaction between two non-U.S. persons one or both of which is registered as an SBS dealer is subject only to regulatory reporting (but not public dissemination) so long as neither party is guaranteed by a U.S. person, and the SBS is not executed on a platform having its principal place of business in the United States, effected by or through a registered broker-dealer, or connected to a non-U.S. person's SBS dealing activity and arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by

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86 Proposed Rule at p. 6674.

87 *See* 17 C.F.R. § 242.908(a).

personnel of an agent of such non-U.S. person located in a U.S. branch or office. However, as proposed, Rule 10B-1 would require both regulatory reporting *and* public dissemination of any position held by a non-U.S. person registered as an SBS dealer that exceeds a reporting threshold, even absent any further U.S. nexus.

To address these issues, the Commission should narrow the prong for positions comprised of SBSs required to be reported pursuant to Rule 908(a) of Regulation SBSR to reference solely Rule 908(a)(1)(i) (for transactions for which there is a direct or indirect counterparty that is a U.S. person on either or both sides of the transaction) or (ii) (for transactions accepted for clearing by a clearing agency having its principal place of business in the United States). This approach, which is consistent with the scope of this prong as described in the Proposed Rule's preamble, would help ensure that the cross-border scope of Proposed Rule 10B-1 does not create inappropriate incentives for parties to avoid transacting in the United States or undermine the territorial approach to public dissemination reflected in Regulation SBSR.

B. The Commission Should Narrow the Prong for SBSs Referencing U.S. Securities to Cover Reference Securities Issued by a Company that Has Securities Listed on a U.S. National Securities Exchange

The Proposed Rule would also apply when the reporting person holds any amount of reference securities underlying the security-based swap position *and* (i) the issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States; *or* (ii) such reference security is part of a class of securities registered under Section 12 or Section 15(d) of the Exchange Act.

Like the Rule 908(a) prong noted above, this prong would apply Proposed Rule 10B-1 too broadly. It would also introduce uncertainty as to which positions are within the scope of Proposed Rule 10B-1. The principal place of business criterion would cause particular concern in this regard because it may not be very clear to SBS market participants where the underlying companies are located. In addition, even setting aside the fact that the principal place of business standard is vague, the mere presence in the United States of the issuer of the underlying reference security, absent other facts, does not necessarily provide a sufficient nexus to the overall U.S. market to outweigh the costs of triggering position reporting requirements. Instead, we believe a clearer and more effective approach would be to maintain a modified version of the second prong, which requires the referenced security to be registered on a U.S. exchange.

Even if the Commission refuses to provide a general reporting exception for SBSs on securities not listed on public exchanges, we believe the Commission should provide a more limited exception in the case where affiliates are holding positions in SBSs referencing unlisted securities, as noted above.

C. The Commission Should Adopt a New Exception for Certain Non-U.S. Market Participants Trading SBSs Referencing Non-U.S. Securities

As proposed, Rule 10B-1 could still subject a non-U.S. person to reporting for its SBSs referencing non-U.S. securities (*i.e.*, not registered with the Commission, traded on a U.S. exchange or issued by a U.S. person) just because the non-U.S. person transacts with a U.S. SBS dealer or non-U.S. SBS dealer (including those guaranteed by a U.S. person). Such reporting would likely strongly discourage non-U.S. persons from trading such SBSs with such dealers, thus creating unwanted competitive disparities. In addition, many non-U.S. jurisdictions have adopted their own position reporting regimes for derivatives, and the overlap of U.S. reporting rules in these scenarios could lead to conflicts and confusion vis-à-vis those regimes. Furthermore, U.S. regulation of the SBS dealer in these scenarios, including capital and margin requirements, reporting under Regulation SBSR, and reporting by the dealer itself potentially under Proposed Rule 10B-1, should be sufficient to address any potential risks to the U.S. financial system.

Therefore, to prevent competitive disparities and preserve deference to non-U.S. regulators that have a greater interest than the Commission in reporting for derivatives referencing non-U.S. securities, a non-U.S. person not registered with the Commission should not be subject to reporting under Proposed Rule 10B-1 if its only SBSs giving rise to a reportable position are those covered by Proposed Rule 10B-1 solely because the non-U.S. person's counterparty is a U.S. SBS dealer or a non-U.S. SBS dealer whose obligations under the SBSs are guaranteed by a U.S. person. If the Commission does not adopt our recommendations in Part VI.A above, then this exception should also cover positions reportable because they include SBSs covered by Rule 908(a)(1)(v) or (a)(2) of Regulation SBSR.

D. The Commission Should Adopt an Exception for Sovereign CDS

Another area where it will be important for the Commission to preserve deference to non-U.S. regulators is the sovereign CDS market. Because of the relationship of that market to the foreign sovereign debt market, non-U.S. regulators in the past applied special rules to their CDS referencing local sovereign bonds, such as by restricting so-called "naked" sovereign CDS. In light of the special significance of the sovereign CDS market for the sovereign debt market, international comity demands that the U.S. government not interfere with dynamics in that market. Accordingly, the Commission should exclude sovereign CDS from Proposed Rule 10B-1.

VII. The Commission Should Provide a Sufficient Transition Period for Implementation of Proposed Rule 10B-1, Phasing in Regulatory Reporting Before Public Dissemination

We appreciate that the Commission recognizes that compliance with the Proposed Rule will require market participants to develop technological infrastructure

necessary to calculate and monitor their SBS positions.[88] Our members agree that setting up and maintaining the appropriate compliance infrastructure will require significant resources and time, and in this regard they have estimated substantially greater costs than those included in the Commission's cost-benefit analysis (as discussed in Part I above).

Given the technical and operational challenges associated with implementing the necessary compliance programs, as discussed throughout this letter, a compliance period of at least 24 months is warranted and necessary. Also, in light of the complexity of the Proposed Rule, we expect that the Commission Staff will release technical specifications and other guidance to complement any final rule, and therefore the compliance period should not begin until the Staff releases such specifications and guidance.[89]

Given the significant questions about the potential adverse market impact of public dissemination and the related need to recalibrate reporting thresholds, a staged approach is necessary to give the Commission time to analyze collected data and determine whether further guidance or calibration would be warranted to mitigate that impact. This approach would align with how the Commission approached the compliance schedule for Regulation SBSR and how FINRA approached the compliance schedule for changes to its TRACE rules for corporate bond reporting.[90]

Specifically, given the risks of public disclosure noted in this letter,[91] the Commission should defer public dissemination of position reports until after the Commission completes a study analyzing collected data and makes a determination whether further guidance, calibration of reporting thresholds, or other measures (including possibly anonymization, aggregation, or delayed dissemination) would be warranted to mitigate those risks. We recommend that the Commission complete this study within 12 months after regulatory reporting commences. The Commission can then

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88 Proposed Rule at p. 6678.

89 For example, the "Responses to Frequently Asked Questions Regarding Financial Responsibility Requirements as Applied to Security-Based Swap Activities of Broker-Dealers and Security-Based Swap Dealers" was published by the Commission Staff on October 8, 2021, two days after the compliance date for the relevant rules. This created challenges for market participants that needed to modify internal system requirements that had been in development from the start of the compliance period in order to remain compliant with the updated Staff guidance.

90 *See* Financial Industry Regulatory Authority, "2020 TRACE Fact Book" (2021), available at https://www.finra.org/sites/default/files/2021-03/Trace_Factbook_2020.pdf, at p. 5 ("Public dissemination of [TRACE] transaction information was implemented in three phases. This allowed FINRA to study the impact of transparency on liquidity in the U.S. corporate bond market.").

91 Additionally, similar to the introduction of Regulation SBSR and FINRA's TRACE rules, we expect that there will be operational and interpretive difficulties with reporting under Proposed Rule 10B-1, which might make initial reports less reliable. Providing a further transition period before public disclosure would help prevent other market participants from relying on these reports during a time when reporting persons are still addressing initial implementation difficulties.

determine whether to commence public reporting, propose revisions to Rule 10B-1 (and allow for public comment), extend the regulatory reporting period, or take an alternative approach.

* * *

We appreciate the opportunity to provide comments in response to the Proposed Rule and the Commission's consideration of our views. If you have any questions or would like additional information, please contact the undersigned.

Very truly yours,

Bridget Polichene
Chief Executive Officer
Institute of International Bankers

Scott O'Malia
Chief Executive Officer
International Swaps and Derivatives Association

Kenneth E. Bentsen, Jr.
CEO and President
Securities Industry and Financial Markets Association

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

Director Haoxiang Zhu, SEC Division of Trading and Markets
David Shillman, Associate Director, SEC Division of Trading and Markets

APPENDIX

Overview of the Associations

The **Institute of International Bankers** is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Its membership is comprised of internationally headquartered banking and financial institutions from over 35 countries around the world doing business in the United States. The IIB's mission is to help resolve the many special legislative, regulatory, tax, and compliance issues confronting internationally headquartered institutions that engage in banking, securities and other financial activities in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions.

Since 1985, the **International Swaps and Derivatives Association** has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 960 member institutions from 78 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: https://www.isda.org/. Follow us on Twitter, LinkedIn, Facebook and YouTube.

The **Securities Industry and Financial Markets Association** is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.