March 20, 2022

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: File No. S7-32-10; Proposed Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions; Release No. 34-93784

Dear Ms. Countryman,

We are officers of the International Institute of Law and Finance ("IILF"),[1] a non-profit, non-partisan institution dedicated to promoting independent research, academic papers, teaching, discussion, and public policy initiatives in law and finance. Our comments relate to an area of our teaching and study, Release No. 34-93784 (the "Proposed Swaps Rules" or the "Release"), the proposed rules on the prohibition against fraud, manipulation, or deception in connection with security-based swaps; prohibition against undue influence over chief compliance officers; and position reporting of large security-based swap positions. We thank the Commission for the opportunity to comment on the Proposed Swaps Rules.

We also have provided support for other comment letters on the Proposed Swaps Rules by drafting those letters, with assistance from many of the people who have signed those letters.[2] In particular, we want to highlight a letter submitted by 80 law and finance professors focused on the potential impact of the Proposed Swaps Rules on shareholder activism, an important phenomenon that would be significantly impacted by the Proposed Swaps Rules yet is not even addressed in the Release.[3] Consistent with our mission, we have not formally signed that letter, but we very much endorse and agree with it.

Given the interlocking nature of the Proposed Swaps Rules and those contained in Release No. 34-94211 (the "Proposed Beneficial Ownership Rules") and Release No. 34-94313 (the "Proposed Short Selling Rules"), our comments in this letter will necessarily touch on each of these proposals. We intend to submit a comment letter on the Proposed Beneficial Ownership Rules, and we are considering submitting comments on the Proposed Short Selling Rules as well. We believe the Commission should analyze these Releases together with the benefit of all commentary.

---

[1] See iillawfin.org for a description of our mission and our role.

[2] As described more fully on the IILF website, we will receive compensation for our IILF activities, including drafting the letters described herein.

[3] Among the letters we assisted in drafting are comment letters on the potential effects of the Proposed Swaps Rules on shareholder activism, the effects of the proposed rules on labor interests, and the treatment of credit default swaps in the Release. None of the people who signed any of the letters we assisted in drafting have been compensated for the letters.

Our comments here are straightforward: we believe a flawed Commission proposal process led to rules that are substantively flawed. First, we describe some of the flaws in the Commission proposal process. Second, we describe various ways that the Proposed Swaps Rules (1) lack sufficient support from legal authorities or empirical analysis, (2) are arbitrary and unjustified, and (3) carry numerous unintended consequences, including creating incentives for problematic regulatory arbitrage. The Proposed Swaps Rules are not technical modernization changes; they are material changes to existing law, and they were made without sufficient consideration or justification by the Commission.

Flawed Process

We believe that the Commission followed a flawed process to produce and release the Proposed Swaps Rules. The Proposed Swaps Rules are inextricably interlinked with the Proposed Beneficial Ownership Rules and Proposed Short Selling Rules, yet the Commission chose to issue three separate releases at three separate times with three separate comment periods with three separate deadlines. It is not possible for commenters to effectively consider and offer feedback on the Proposed Swaps Rules without considering the Proposed Beneficial Ownership Rules, and it is not possible for commenters to effectively consider and offer feedback on the Proposed Beneficial Ownership Rules without considering the Proposed Swaps Rules.[4]

The process of staggering these rule proposals over time has created confusion. Our understanding as of today, at the due date for comments on the Proposed Swaps Rules, is that there is significant confusion among market participants as to whether the Proposed Swaps Rules potentially apply to them, or how the rules might apply. And there is also a lack of clarity about whether they should comment on the Proposed Swaps Rules during this comment period, or wait

[4] The two sets of proposed rules include overlapping and often contradictory disclosure thresholds and time periods. It is difficult for anyone commenting on the Proposed Swaps Rules to tell which of the arbitrary disclosure thresholds and time periods would apply to them, or under what circumstances. There are similar flaws in the process for the Proposed Short Selling Rules, which were published on February 25, 2022, less than a month before the deadline for comments on the Proposed Swaps Rules. The Proposed Short Selling Rules include yet another set of disclosure obligations related to short positions, and the Commission discussed there the increased costs associated with those rules, recognizing that they are interrelated to the Proposed Swaps Rules, and stating that the overlapping disclosure requirements may be "duplicative." *See* Proposed Short Selling Rules, at 157-59. For example, the definition in the Proposed Swaps Rules of "reporting threshold amount" for credit default swaps includes a description of a "short notional amount," but the definitions for security-based swap positions, based on both equity and debt securities, do not; the definitions for security-based swap positions on equity securities are especially unclear, given that they also require disclosure based on the value of underlying equity securities. *See* Proposed Swaps Rules, at 188-92. It would be helpful for the Commission to clarify how the definitions in its various rules interact, particularly to the extent someone has both long and short positions. For examples, how would the rules, in aggregate, treat someone with a $100 million short swap position who owns $150 million of shares? Or such a short swap position, but who owns call options? Or the reverse, with a long swap position, but short options or shares? The overlap between the Proposed Short Selling Rules and the Proposed Swaps Rules is particularly important to the extent market participants are likely to engage in swaps or short positions as alternatives. The Commission describes the burdens for the two rules as "similar," though the basis for this conclusion is unclear. *See* Proposed Short Selling Rules, at 80.

to comment on other related proposals. The Commission should provide clarity as to the relationship among these proposals.

For these process-related reasons, we believe the Commission should consider all of the letters from the above three comment files when evaluating the public's response to each of the three sets of proposed rules we reference above. Further, given the interlocking nature of the various proposed rules—for instance, the proposed five-day disclosure window under Section 13(d) depends on the Security-Based Swaps ("SBS") regime—the Commission should indicate in any final rules that if one rule is found invalid, all of the interrelated rules are invalid.

We next describe the substantive questions raised by the Proposed Swaps Rules.

Flawed Substance

As to substance, we believe that the flawed process led to flawed proposed rules. Specifically, the Proposed Swaps Rules that (1) lack sufficient support from legal authorities or empirical data, (2) are arbitrary and unjustified, and (3) carry numerous unintended consequences.

Insufficient Legal or Empirical Support

The Dodd-Frank Act requires that the reporting of SBS transactions be anonymized.[5] Yet the Proposed Swaps Rules would require disclose under Section 10B-1(b)(1)(iii) of both the identity of the swap counterparty and the size of positions "once a Security-Based Swaps Position based on equity meets or exceeds $300 million, calculated on a gross basis."[6] In our view, the Commission fails to identify adequate legal authority for the required disclosure of counterparty identities.[7] One possible solution involves simply requiring that parties disclose their swaps positions only to the Commission rather than publicly.[8]

Moreover, the Proposed Swaps Rules would require the disclosure, not just of swap counterparties and positions, but of equity securities positions. Proposed Section 10B-1(b)(1)(iii)(A) would require that "once a Security-Based Swap Position exceeds a gross notional

[5] Section 13(m)(C)(iii) of the Securities Exchange Act of 1934.
[6] Proposed Swaps Rules, at 77.
[7] The language relied upon by the Commission in the Proposed Swaps Release is from the anti-fraud sections of the Securities Exchange Act of 1934 (the "Exchange Act"), not the reporting sections, and the Commission fails to provide sufficient explanation as to how the Proposed Swaps Rules would "prevent fraud or manipulation." Paragraph (a) of Section 10B of the Exchange Act. The Commission does not describe how mandatory public disclosure of investors' identities might be sourced from any valid statutory authority, given the clear language regarding anonymity in the Dodd-Frank Act.
[8] In other contexts, the Commission has recognized the value of safeguarding market participants' privacy, and has emphasized the importance of not disclosing individual information or identities. For example, the Commission emphasized such privacy concerns in the discussion and adoption of the rules requiring Form PF, as well as in the recent Proposed Short Selling Rules. The Commission has protected the identity of credit rating agencies in various contexts for more than a decade. The Release does not describe any rationale for breaking so sharply from the Commission's common practice of balancing privacy concerns in the adoption and application of its rules.

amount of $150 million, the calculation of the Security-Based Swap Position shall also include the value of all of the underlying equity securities owned by the holder of the Security-Based Swap Position (based on the most recent closing price of shares), as well as the delta-adjusted notional amount of any options, security futures, or any other derivative instruments based on the same class of equity securities."[9] The Release specifies that a Schedule 10B filing be no later than the end of the first business day after the execution of a trade.[10] In applicable circumstances, any holder of an SBS position with a notional amount exceeding $150 million would be required to "include the value of all of the underlying equity securities owned by the holder."[11] There is no statutory basis for requiring such immediate disclosure for either swaps or securities.

The Release also does not include a meaningful cost-benefit analysis of the Proposed Swaps Rules as they apply to equity SBS and equity securities. The Commission selected the disclosure thresholds based on an analysis of data in the credit default swap ("CDS") and debt markets.[12] The Release's cost-benefit analysis contains no study of equity SBS or equity securities. Nor is there data or analysis supporting the choice of a one-day disclosure regime, as opposed to any other time period. The Release states that the Commission intends to consider some "newly available data in determining thresholds to use in connection with Security-Based Swap Positions based on equity securities when adopting a final rule."[13] This approach—saying the Commission will look at data for the final rule, but not for the proposal—makes it impossible for commenters to meaningfully engage with any data the Commission might ultimately use.[14]

---

[9] Proposed Swaps Rules, at 78.

[10] *Id.* at 67. Other sections of the securities laws govern the disclosure of equity securities positions. Institutional investment managers must disclose on Form 13F equity securities holdings "within 45 days after the last day of" the quarter. 17 CFR § 240.13f. Owners of more than 5% of outstanding equity securities must disclose on Form 13D equity holdings "within 10 days after the acquisition." 17 CFR § 240.13d. And officers, directors, and holders of more than 10% of the outstanding equity securities of a firm must disclose on Form 4 equity holdings "before the end of the second business day following the day on which the subject transaction has been executed." 17 CFR § 240.16a-3. The Proposed Swaps Rules would institute a new and substantially stricter equity securities disclosure regime than any of these other rules. Yet the Release fails to discuss, or even identify, statutory authority for such an expansive new equity securities disclosure requirement, particularly given the intertwined nature of these proposed requirements with the Proposed Beneficial Ownership Rules.

[11] *Id.* at 188-189. Putting meat to the bones of these requirements, the Proposed Swaps Rules would require that an investor in these circumstances disclose a 0.008% SBS position in the 5th largest company in the S&P 500, a 0.08% SBS position in the 50th largest company in the S&P 500, and a 1.9% SBS position in the 500th largest company in the S&P 500. The Commission provides no explanation justifying why investors or the market at large would require immediate disclosure of such relatively small positions.

[12] Proposed Swaps Rules, at 152, 161.

[13] *Id.* at 76.

[14] See, e.g., *Penobscot Indian Nation v. U.S. Dep't of Hous. & Urb. Dev.*, 539 F. Supp. 2d 40, 49 (D.D.C. 2008) ("In the absence of any reference in the Proposed Rule to the [relevant data] analysis and at least a summary of the specific data and methodology on which the analysis relied, plaintiffs and plaintiff-intervenors were deprived of any meaningful opportunity to comment on what became the centerpiece of the rationale underlying the Final Rule.").

The Proposed Swaps Rules could meaningfully change the functioning of the financial markets of the United States, and they would do so without any economic analysis of the likely costs and benefits of these. A non-exhaustive list of the effects that are not addressed in the Release includes:[15]

- Effects on liquidity and trading activity in the SBS and equity markets
- Effects on market valuations of SBS swaps and equity securities
- First-order effects on shareholder activism and their engagement with management[16]
- Second-order effects on companies that have responded to the prevalence of shareholder activism by improving their corporate governance, as well as shareholder and board engagement[17]
- Effects on environmental, social, and governance (ESG)-related activities
- Effects on labor interests[18]
- Effects on the retirement accounts of ordinary individuals due to increased costs levied on index and mutual funds
- Effects on frontrunning activity
- Effects on short selling

In short, the Proposed Swaps Rules Release does not provide sufficient legal authority or cost-benefit analysis for the public to be in a position to properly evaluate them or related proposed rules.

Arbitrary and Unjustified Rules

The introduction to the Release explains that the Proposed Swaps Rules address manufactured credit events and other opportunistic strategies in the CDS market, and concerns that these practices could harm the efficiency, reliability, and fairness of the markets.[19] The specific concerns about equity markets in the Release appear to be driven at least in part by events involving Archegos Capital Management, L.P. The Release states that the "the intent of

[15] The above is a non-exhaustive summary list of potential negative effects of the Proposed Rules prepared in the time allotted for the comment period. We intend to provide further analysis of these important issues in a future letter to the Commission.
[16] For a fuller discussion of this issue, see the IILF-drafted Comment Letter on Shareholder Activism.
[17] *Id.* We are particularly concerned regarding the second-order effects of a reduction in shareholder activism on our markets.
[18] For a fuller discussion of this issue, see the IILF-drafted Comment Letter on Labor Interests.
[19] *See* Gina-Gail S. Fletcher, *Engineered Credit Default Swaps: Innovative or Manipulative?*, 94 N.Y.U. L. REV. 1073 (2019).

proposed Rule 10B-1 is to alert regulators and the market, including counterparties to security-based swap trades and the companies whose securities underlie security-based swaps, that one or more market participants are amassing a large position in security-based swaps."[20] Chair Gensler has stated, "I've asked staff for recommendations on how we can put out -- with the thought of Archegos in mind -- how we can put out aggregate information about the aggregate positions in securities underlying the total return swaps."[21]

The Release does not explain, and we do not see, how the Proposed Swaps Rules might have stopped Archegos from accumulating large, hidden positions, or whether they would have ameliorated any negative effects after its collapse. The Release does not explore the timing of swap transactions by Archegos, or their magnitude over time, or the extent to which market participants were aware of these transactions. Indeed, the Commission's investigation of Archegos is ongoing, and there are still many questions about Archegos. If Archegos was indeed the inspiration for the Proposed Swaps Rules, the Commission should say so, and then explain how the Proposed Swaps Rules might prevent a similar problem in the future. Moreover, to the extent the Commission is focused on Archegos in considering rules related to swaps, it could shift its emphasis in the direction of broad oversight of risk management policies, rather than narrow rules on investors' disclosure.

Several specific details in the Proposed Swaps Rules appear similarly arbitrary and unjustified. There is no explanation as to why investors should disclose swap positions based on equities in one day, but equity positions in five days. This choice appears to be arbitrary, and a one-day disclosure requirement is likely to be impractical for many firms.

The disclosure thresholds are similarly unsupported. The $300 million equity-based SBS disclosure threshold was chosen based on data from the debt markets, not the equity markets. Yet this threshold makes little sense for large companies: a $300 million equity-based SBS represents meaningful exposure in a company with a market capitalization of $1 billion, but is a relatively small position if taken, for instance, in Apple or Microsoft. The related $150 million threshold is even more difficult to understand and calculate, given the complexity and uncertainty of the required "delta" calculations. The Commission's compliance cost estimates are also based on the CDS and debt markets, and do not take into account unique costs related to SBS and equity securities.

Unintended Consequences

We believe the Proposed Swaps Rules could have many unintended consequences that are not addressed in the Release. These include:[22]

---

[20] Proposed Swaps Rules, at 86.

[21] *See, e.g.*, Akayla Gardner, *Gensler Says SEC Plans More Swaps Disclosures Post-Archegos*, BLOOMBERG (Sept. 15, 2021) (quoting Chairman Gensler explaining, "I've asked staff for recommendations on how we can put out—with the thought of Archegos in mind—how we can put out aggregate information about the aggregate positions in securities underlying the total return swaps.").

[22] As noted earlier, the above is a non-exhaustive summary list of potential negative effects of the Proposed Rules prepared in the time allotted for the comment period. We intend to provide further analysis of these important issues in a future letter to the Commission.

- The Proposed Swaps Rules incentivize sophisticated market participants to profit from regulatory arbitrage. For example, a $100 million notional amount swap with a payout based on a multiple of the change in stock price during a period of time arguably would not trigger the disclosure requirement. Decades ago, before the Commission's rules regulating swaps, counterparties would enter into such swaps with low "notional amounts." The Proposed Swaps Rules invite a return to this kind of dysfunctional behavior.[23]

- The one-day disclosure requirement and the $300 million equity-based threshold—or sometimes, $150 million threshold—could deter many investors from acquiring meaningful stakes in large companies.

- To the extent investors take smaller positions, we expect less shareholder engagement with management, and likely higher agency costs and managerial entrenchment. As at least one other comment letter shows, there are significant benefits to such engagement, including for retail investors.[24]

- Shareholder efforts to force companies to confront ESG concerns—including improving racial and gender diversity of boards, sustainability disclosure, and minimizing emissions—could decline.

- The efforts of the labor movement could be harmed as corporate management is further insulated from accountability.[25]

- The primary beneficiaries of the Proposed Swaps Rules are likely to be corporate management, particularly officers at the largest corporations, who could more easily be able to avoid seriously addressing the concerns of shareholders and the public.

- Investors using swaps will be required to make public filings more quickly than CEOs trading in the stock of their own companies.

- Increased compliance costs could deter institutions from engaging in swaps for socially valuable purposes, including hedging and risk reduction.

- Because the Proposed Swaps Rules calculate exposures based on gross holdings, as opposed to net holdings, they create perverse non-economic incentives, including increased costs associated with respect to gross notional exposures, even when swaps are used to reduce net exposures.

- The one-day filing requirement imposes additional costs on investors, particularly those at smaller investment firms, who might be unable to make filings within one day, including religious holidays, illness (including COVID), and family emergencies.

[23] The Commission recognizes in the Proposed Swaps Rules the potential for evasive behavior, but the rules do not contemplate low or risk-adjusted notional amounts.
[24] For a fuller discussion of this issue, see the IILF-drafted Comment Letter on Shareholder Activism.
[25] For a fuller discussion of this issue, see the IILF-drafted Comment Letter on Labor Interests.

The Release does not address these potential unintended consequences. We hope the Commission will address them before proceeding with final rules.

We thank the Commission for its consideration of our concerns regarding the Proposed Swaps Rules.

Respectfully,

/s/ Robert E. Bishop

Robert E. Bishop
Senior Fellow
New York University School of Law
Institute for Corporate Governance and Finance

/s/ Frank Partnoy

Frank Partnoy
Adrian A. Kragen Professor of Law
UC Berkeley School of Law
Berkeley Haas (Affiliated Faculty)