THE ASSOCIATION FOR INVESTOR RELATIONS

March 23, 2022

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

VIA ELECTRONIC MAIL
rule-comments@sec.gov

Subject: Position Reporting of Large Security-Based Swap Positions, File No. S7-32-10

Dear Ms. Countryman:

The National Investor Relations Institute ("NIRI")[1] appreciates the opportunity to provide comments regarding the rule proposal by the Securities and Exchange Commission ("SEC" or "Commission") to require any person with a security-based swap position above a certain threshold to publicly disclose meaningful information about that swap position.[2]

Current SEC rules that require public disclosure of beneficial ownership positions by institutional investors—such as Form 13F and Rules 13d and 13g—do not explicitly include security-based derivative products. This gap in the Commission's disclosure regime permits certain institutional investors to hide ownership of, or exercise undisclosed control over, large blocks of public company shares through the use of these financial instruments.

One of these instruments is called a cash-settled equity swap.[3] Under this type of swap, two parties enter into an agreement that seeks to replicate the positions of a long or short investor in a particular public company.[4] A long investor receives all of the benefits of an increase in the stock price, along with cash flows that replicate any dividends paid by the company. A short investor receives the benefits of any decline in the stock's price. Any differences are settled in cash, and the financial institution that is a counterparty to the swap often holds the underlying securities as a hedge against its position. If the swap is unwound, a long investor is usually able to immediately purchase the underlying securities, thereby rapidly increasing its ownership position and securing beneficial owner voting rights, without having to accumulate shares directly in the equity markets.

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[1] Founded in 1969, the National Investor Relations Institute ("NIRI") is the professional association of corporate officers and investor relations consultants responsible for communication among corporate management, shareholders, securities analysts, and other financial community constituents. The largest professional investor relations association in the world, NIRI's more than 2,800 members represent over 1,350 publicly held companies with more than $7 trillion in stock market capitalization.

[2] *See* 87 Fed. Reg 6,652 (Feb. 4, 2022) (hereinafter "Proposed Rule"). The Coalition is only providing comments on Proposed Rule 10B—1: Position Reporting of Large Security-Based Swap Positions.

[3] This derivative product is also sometimes called a total return equity swap.

[4] The typical counterparties to an equity swap of this type are: (1) an institutional investor, and (2) a large financial institution.

The use of equity swaps to separate or "decouple" stock voting rights from an economic ownership interest in a company was thoroughly described and documented in a series of academic articles as far back as 2006 by Henry Hu and Bernard Black.[5] NIRI and other associations representing the issuer community commented on this issue and the SEC responded at the time by noting the issue in its 2010 Concept Release on the U.S, Proxy System.[6] The Commission staff also initiated a review of its disclosure requirements for these types of financial instruments in 2010.[7]

Now that more than a decade has passed, NIRI is very appreciative of the SEC's efforts to address this regulatory gap by proposing to require the disclosure of large derivative positions that can create de facto economic ownership in a public company.

Under proposed Rule 10B-1, any person or entity would be required to publicly disclose, in a prompt SEC filing, any security-based swap position that exceeds a certain threshold. Security-based swaps would include swaps based on an individual company's equity or debt securities.

The reporting threshold for security-based swaps involving equities would be the *lesser* of one of two different thresholds. The first threshold would be the gross notional amount of the swap position. Any person or entity holding an equity swap position that meets or exceeds a gross notional amount of $300 million would be required to report such position.[8] The second

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[5] *See, e.g.*, Henry T.C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. Cal. L. Rev. 811 (2006), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=904004; Henry T.C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 Bus. Law. 1011 (2006), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=887183; Henry T.C. Hu & Bernard Black, *Hedge Funds, Insiders, and Empty Voting: Decoupling of Economic and Voting Ownership in Public Companies*, 13 J. Corp. Fin. 343 (2007), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=874098; Henry T.C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. Pa. L. Rev. 625 (2008), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1030721; and Henry T.C. Hu & Bernard Black, *Debt, Equity and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 Eur. Fin. Mgmt. 4 (2008), *available at* https://leeds-faculty.colorado.edu/Bhagat/HybridDecouplings.pdf.

[6] *See* Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982, at 43,017-43,020 (July 22, 2010) (hereinafter "2010 Concept Release"). *See also* Letter from Niels Holch, Executive Director, Shareholder Communications Coalition, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, August 17, 2009, *available at* https://www.sec.gov/comments/s7-10-09/s71009-294.pdf.

[7] *2010 Concept Release* at footnote 328 ("The staff is also working on the separate but related project of reviewing current disclosure requirements relating to holdings of financial instruments, including short sale positions and derivatives positions.").

[8] For the purpose of this calculation, a gross notional amount would include both long and short positions. Additionally, any person or entity with more than a gross notional amount of $150 million would be required to add to this amount any underlying equity securities as well as options, futures, or other derivative instruments based on the same class of equity securities.

threshold would require reporting for any equity swap that represents more than 5% of a class of equity securities.[9]

The reporting threshold for security-based swaps involving debt would be the notional amount of $150 million in a long or short position, or a gross notional amount of $300 million.

Once one of the notional reporting thresholds has been reached, a filer would also be required to disclose ownership of any other securities or financial instruments relating to the security-based swap position being reported.

NIRI strongly supports the SEC's proposed Rule 10B-1. If adopted, it would provide additional transparency in the capital markets for large, concentrated security-based swap positions. For public companies, it would also help to address a gap in the SEC's disclosure regime and provide needed visibility into the use of derivative instruments to accumulate large equity and debt swap positions that, if left undisclosed, may be detrimental to a public company and its shareholders. And, as noted in the SEC's proposal, the use of these derivative instruments can be especially impactful to mid-cap and small-cap companies, where the underlying security referenced by an equity or debt swap is more likely to be less liquid than the underlying securities of larger entities.[10]

Thank you for the opportunity to present the views of the National Investor Relations Institute regarding the SEC's proposed Rule 10B-1. Please feel free to contact us with any questions, or if additional information from NIRI and its members would be helpful.

Sincerely,

Gary LaBranche

Gary A. LaBranche
President and CEO
National Investor Relations Institute

cc: The Honorable Gary Gensler
The Honorable Hester M. Pierce
The Honorable Allison Herren Lee
The Honorable Caroline A. Crenshaw
Haoxiang Zhu, Director, Division of Trading and Markets
Renee Jones, Director, Division of Corporation Finance

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[9] The SEC's proposal also requires any person or entity with a swap position representing more than 2.5% of a class of equity securities to add to this amount any underlying equity securities as well as options, futures, or other derivative instruments based on the same class of equity securities.
[10] *See Proposed Rule* at 6,698-6,699.