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October 31, 2022

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

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

Ladies and Gentlemen:

Pursuant to the reopened comment period for the Securities and Exchange Commission's Release 34-93784 (the "Swaps Release"), this October 31 letter supplements my comment letter dated March 21, 2022 on the Swaps Release and, if possible, my comment letter dated April 11, 2022 on Release 33-11030/34-4211 (the "13D Release").

I hold the Allan Shivers Chair in the Law of Banking and Finance at the University of Texas Law School and was the inaugural Director of the SEC's Division of Economic and Risk Analysis (2009-2011).

Both SEC Releases address certain aspects of the "decoupling" phenomenon. Over the past 15 years, I was the lead or sole author of ten academic articles on the phenomenon.[1] The reason for this October 31 letter is that I have a forthcoming article centered on these Releases: **Governance and the Decoupling of Debt and Equity: The SEC Moves** will soon appear in the *Capital Markets Law Journal* (published by Oxford University Press). A draft is downloadable at http://ssrn.com/abstract=4241269

A brief summary is set out below. (The paper itself is roughly 30,000 words.) This article is the first to:

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[1] Three 2006 articles focused on "equity decoupling." *See* Henry T. C. Hu & Bernard Black, *The New Vote Buying: Empty Voting and Hidden (Morphable) Ownership*, 79 S. CAL. L. REV. 811 (2006) ("Hu & Black,-*Decoupling I*"); Henry T. C. Hu & Bernard Black, *Empty Voting and Hidden (Morphable) Ownership: Taxonomy, Implications, and Reforms*, 61 BUS. LAW. 1011 (2006); Henry T. C. Hu & Bernard Black, *Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting and Hidden (Morphable) Ownership*, 13 J. CORP. FIN. 343 (2007). Subsequent articles extended the analysis to "debt and hybrid decoupling." *See, e.g.*, Henry T. C. Hu & Jay L. Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321 (2007); Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions*, 156 U. PA. L. REV. 625 (2008) ("Hu & Black, *Decoupling II (Penn)*"); Henry T. C. Hu & Bernard Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications*, 14 EUR. FIN. MGMT 663 (2008) ("Hu & Black, *Decoupling II (EFM)*"); Henry T. C. Hu, *Financial Innovation and Governance Mechanisms: The Evolution of Decoupling and Transparency*, 70 BUS. LAW. 347 (2015) ("Hu, *Innovation and Governance*"); Henry T. C. Hu, *Corporate Distress, Credit Default Swaps, and Defaults: Information and Traditional, Contingent, and Empty Creditors*, 12 BROOK. J. OF CORP. FIN. & COM. L. 5 (2018) ("Hu, *CDS Abuses*"). *See also* Henry T. C. Hu, *'Empty Creditors' and the Crisis*, Wall St. J., Apr. 10, 2009, at A13 ("Hu, *Empty Creditors and the Crisis*"); Henry T. C. Hu, *Reform the credit default swap market to rein in abuses*, FIN. TIMES, Feb. 24, 2019 ("Hu, *Reign in CDS Abuses*")

(1) analyze various recent decoupling-related SEC proposals as a whole (focusing on the Swaps Release and the 13D Release), propose significant changes, and offer ideas for enhancing the proffered cost-benefit analysis; and

(2) situate the prospective SEC role with the roles that substantive law authorities (such as Delaware courts and legislature), private ordering, and foreign regulators are already playing.

The article relies in part on the analytical framework for decoupling and associated terminology introduced in a 2006 article that I lead co-authored.

> "Decoupling"—the unbundling of the rights and obligations of equity and debt through derivatives and other means—has posed unique challenges for corporate and debt governance. Corporate governance mechanisms, including those related to shareholder voting and blockholder disclosure in control contests, have faced "empty voting with negative economic ownership" and "hidden (morphable) ownership" issues. Classic contract-based interactions of debtors and creditors have faced "empty crediting with negative economic interest," "hidden interest," and "hidden non-interest" issues. In 2006, the initial version of an analytical framework for decoupling was introduced. In that decade, foreign regulators, Delaware and other substantive law authorities, and private ordering started responding.
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> In 2021 and 2022, the Securities and Exchange Commission (SEC) voted out proposals directed at decoupling, as well as other proposals that may affect decoupling. Using the analytical framework, this Article is the first to: (1) analyze the SEC proposals as a whole; and (2) consider how the possible SEC role relates to the roles already played by substantive law authorities and private ordering.
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> As for (1), the Article proposes a variety of fundamental changes to the proposals and shows how such changes as well as judicial findings and actions of foreign jurisdictions can enhance the robustness of the SEC's cost-benefit analysis to potential court challenges.
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> One set of changes the Article proposes is regarding two SEC proposals relating to the hidden (morphable) ownership strategy for avoiding blockholder disclosure rules under Section 13(d) of the Securities Exchange Act of 1934. Because of Dodd-Frank Act Section 766 "security-based swap" constraints, the SEC proposed a bifurcated disclosure architecture, one for holdings of cash-settled equity swaps (aka total return equity swaps) (per a new Schedule 10B) and one for holdings of other cash-settled synthetic equity (per a revised Schedule 13D). The proposed architecture has two core weaknesses. First, the "situs" of cash-settled equity swaps within the architecture and the architecture's "silo" mindset would upset the vital balance between enhancing market transparency and efficiency and incentivizing shareholder activism important to corporate governance. Second, startling, unjustified asymmetries in regulatory treatment would arise across categories of synthetic equity and between synthetic equity and direct equity. The Article offers a solution that, despite Dodd-Frank Section 766, would better incentivize activism and reduce the asymmetries.
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> Another set of changes the Article proposes is regarding an SEC proposal directed at empty creditors with negative economic interest. The Article shows, for example, that the proposed disclosure requirements could be triggered when empty crediting is impossible even in theory. This is because merely holding credit default swaps in the requisite amount could require disclosure even absent any

holdings of the debt or equity that carry with them the control rights essential to undermining the company's viability. The Article proposes changes.

The SEC's proposals might be challenged in court on cost-benefit grounds. For example, broadly speaking, some market participants question the existence of the hidden (morphable) ownership phenomenon. The Article shows how judicial findings in related litigation involving U.S. persons or U.S. courts can help address this claim. Similarly, it shows that all foreign jurisdictions examined (Australia, Canada, France, Germany, Hong Kong, Ireland, Italy, Netherlands, Switzerland, and the United Kingdom) have adopted measures to address hidden (morphable) ownership.

As for (2), the Article begins by showing that Delaware and other state substantive law authorities have used the analytical framework and exhibited aversion to empty voting. It also shows how private ordering is addressing both debt decoupling (via, e.g., "net short" provisions in debt agreements) and equity decoupling (via, e.g., "morphable ownership" provisions in poison pills). Certain SEC proposals are potentially helpful to such Delaware and private ordering efforts.

I am delighted that the SEC is addressing decoupling issues in both Releases and elsewhere. The decoupling phenomenon has private and social benefits but also presents complexities for debt governance, corporate governance, market integrity, and systemic risk.

I appreciate the opportunity to comment. I would be happy to discuss any questions the Commissioners or the staff may have. My email is hhu@law.utexas.edu.

Thank you.

Sincerely,

/s/ Henry T. C. Hu

Henry T. C. Hu
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cc:
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