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 ("Swaps Proposal") **[CORRECTED 8-20-2023]**

Commenter: Larry Douglas, American Investor

Dear Ms. Countryman,

Thank you for the opportunity to comment on the proposed rule 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 ("Swaps Proposal"). Please note my support for the rules as written, and the Commission's interpretation of the Exchange Act, and the jurisdiction granted them. I support adopting re-proposed Rule 9j-1, and proposed rules 10B-1 and 15Fh-4(c). I applaud the Commission's overall regulatory course and direction. It would however be good to see reporting thresholds as low as feasible, capturing as much of the overall security based swap market as is possible, and especially any over the counter swaps not centrally cleared.

It is my view that higher reporting thresholds create a need for overwhelming complexity and consideration to avoid evasion of those thresholds. Requiring all security based swap positions be reported disincentivizes this evasion, which is usually accomplished through splitting the aggregate position among various counterparties, or subsidiary firms. Though a low enough threshold should still accomplish this with respect to large concentrated positions that may have adverse effect on the market. Ideally the reporting threshold should be as low as possible, it should include all swap positions on a given reference entity or it's underlying securities by a given firm\large trader, including internationally every subsidiary or superior firm to the given firm in aggregate.

There is a deep cultural sickness present in the world of global finance, an area where the United States functions as a leader, and has the opportunity to exert a vast influence for the betterment of the markets worldwide. Fairness and transparency are not something that should be feared by any large participant, or anyone invested in the success of the American markets.

In the field of industrial hygiene after a large accident, where people may lose their lives and millions of dollars worth of equipment may be damaged, due diligence requires an investigation and a series of recommendations aimed at producing safer and more consistent conditions to hopefully avoid similar accidents in the future. Often such recommendations are intended to create a culture and environment of learning and reporting, because such a culture produces results, and the stakes are too high to adopt a course proven ineffective. These solutions suggest themselves from the problems, and the direction towards increased safety is clear. Creating a collected publicly available documentation history is often the goal

of these recommendations, because it is clearly an improvement over compartmentalized "in house" knowledge that is often left undisseminated when such dissemination is most vital. This does not disadvantage one participant over the other, because a truth available to all parties creates a common ground of ideas. General secrecy is not the way to protect proprietary access during real enterprise at the cost to the public, and outside the property rights system, a system much better suited to protecting intellectual property.

Often we hear that existence of information assymetry is not well supported in the markets. From those same commenters and participants we also hear that revealing their secret and proprietary processes would disrupt their functioning. I would submit that these positions are mutually exclusive. If no assymetry exists, then making information publicly available would have no effect on operations, as that information would be publicly available. Arguing in favor of preserving secrecy may at least be a logically consistent position, but an information assymetry must then be acknowledged.

Constructing that assymetry as secret proprietary "in house" knowledge naturally disadvantages those not "in the know" and maintaining that advantage is the entire purpose of the secrecy. Again, it's not that the position that these advantages should exist is completely untenable in a vacuum, but simultaneous arguments that this is not the case should be viewed with suspicion, especially by those who clearly benefit from such secrecy. It also is no way to run a system that the public depends on for their livelihood, or a way to manage risks to the broader system that may arise from it. Unfortunately for proponents against disclosure, under the current system the over the counter derivatives market is exactly such a system that presents exactly those kinds of risks, so they are forced to end around the issue rather than confront it directly.

Even denying there is a real and currently present risk is difficult when FINRA has been extending years of no action relief on certain swap reporting obligations, that recently was extended yet again until December 2025. CFTC's Commissioner Summer Mersinger made the problems with such temporary solutions clear in her public remarks.

"I support the continuation of staff no-action relief that is being provided through today’s extension of Commodity Futures Trading Commission (CFTC) Letter 22-05. But the extension of this relief compels me to yet again repeat my refrain: the Commission must stop using temporary and successive band-aids and work-arounds instead of doing the hard work of crafting permanent solutions to known problems.

The relief being extended today was originally issued in 2016. Instead of addressing this issue over the past six years, the Commission has repeatedly kicked the can down the road – this time until December 5, 2025. The Commission’s inaction has resulted in market participants requesting, and CFTC staff granting, extensions of this relief four times. The Commission’s failure to propose a permanent solution is a dereliction of duty."

The SEC cannot rely any longer on hope that participants will sort themselves out and comply, and that the various regulatory organizations in charge of protecting the public, and wider market, will be able to accomodate their compliance. This makes the need for something like the proposed rules clear.

Considerations and Areas of Concern

Reporting and Thresholds: Disclosure and reporting requirements are some of the least burdensome methods of increasing transparency and market integrity available to the Commission. In my view there is no such thing as an insignificant or neglible swap transaction unworthy of reporting, but I believe the Commission is best positioned to understand a practically managable threshold for reporting. Whatever would produce a volume of data they are capable of servicing. My hope would be if any greater $0 reporting threshold is adopted it is based on an aggregate position of the firms and all their subsidiaries in a given reference entity.

Still, there is heavy resistance put forward to the idea of any reporting at all by large market participants. The opposition seems centered around the effect dissemination of knowledge of these transactions would have on the value of the transactions themselves, rather than some direct cost or unfeasibility of reporting them. A common argument in the comments of these participants is that the existence of an information assymetry is unsupported by the evidence.

This seems like a disturbing and unserious argument for preserving secrecy. If no assymetry exists, then reporting and disclosure could not create the alleged hypothetical harm. My hope is that the Commission considers this when presented with such arguments. If these minimal reporting requirements would create an unwillingness of participants to engage in these transactions, this brings in to question whether these types of transactions are desirable, much less something to regulate around maintaining.

Hedging: Hedging is both a primary area of concern for security based swaps, and a considerable opportunity for large participants to manipulate the price of underlying reference securities. We have seen from the Archegos fraud, and the surrounding reports and filings, that a participant engaging in large swap transactions can use their counterparties need to hedge these transactions as a method unto itself to affect the price of the underlying. Knowing that firms that provide synthetic prime brokerage services, like swaps, prefer to maintain neutral directional exposure, a participant needs only to effect a large delta directional transaction to be reasonably certain of concurrent transactions occuring which will benefit the value of the original transaction and manipulate the price of a reference security in their favor.

This capacity for manipulation is far from merely theoretical, and there is even greater danger present in short swaps, as to hedge a short side swap the prime broker must acquire short exposure themselves. It also provides the original client plausible deniability, and another pair of hands to do the "dirty work" so to speak, keeping direct interaction with the underlying security off their books, and indeed this is one reason firms find these transactions so attractive, especially without the need for reporting the transactions themselves. As the filings from Bill Hwang's lawsuit about the Archegos incident and following indictment for manipulation say: "Any disconnect or attenuation between Archegos’s swaps and its counterparties’ hedges bears directly on the likelihood that Mr. Hwang could have affected, or did affect, the market in the manner alleged in the indictment."

This should be a primary area of concern for the SEC, and should be considered when encountering the comments from large participants engaged in these transactions. The problem is even more dire when considering the surrounding market mechanisms, and their hedge, all layered and creating feedback with one another.

Large participants can sell portfolio insurance in the form of derivatives to wealthy long side investors. Then, to hedge, engage in transactions that create net short exposure for themselves, sometimes by selling long exposure to the public and individual investors through structured products and debt securities, such as equity linked notes (a product typically marketed to "unsophisticated retail investors"), exposing those investors on the long side to massive credit risk they might not understand very well. Other times they can merely sell the reference securities short themselves. This can compound to create a systemic issue, where specific names can be targeted with concentrated positions, and, after vague unactionable and unenforcable signals between parties, be targeted with a variety of other manipulations such as "short and distort" schemes, spoofing and order manipulation with the understanding down is good. Harming anyone not hedged against such a possibility, and thereby causing more sell pressure in the affected securities, to the profit of anyone net short, and allowing even those neutrally exposed to benefit from fees and premiums collected while participating in this manipulation.

Schemes of this nature the SEC is ill-equipped to identify and remediate, and the damage done to trust and market integrity is hard to calculate. A regulatory environment based on deception and confusion also allows conspiracy theories (perhaps by the ill informed) to proliferate, which may or may not be true, and thus affect the market and attitudes surrounding it. This either damages the public, by harming their ability to make informed investment decisions, and/or causes hidden risks to become realized which can affect any manner of participation/participants. When the information that is publicly available is already cause for concern, and the public can see the SEC's reluctance to act, this undoubtedly harms trust in the markets and causes the public to question the Commission's (as well as various SROs) willingness or ability to regulate and address any possible problems.

This also harms the Commission's ability to pursue other regulatory fronts, such as cryptocurrency, as the conventional financial markets obviously currently have the problems they intend to address on those fronts, despite any incredulous denial by officials. An example would be the Chair's position that the SEC would never allow a single party to function as market maker, hedge fund, and clearing firm simultaneously in the stock market, when Citadel (a collection of private companies owned substantially by a single individual, Kenneth Cordele Griffin) indeed runs a market making firm, as well as a hedge fund trading in the market for the owner's own profit in the same securities (or investing in firms with concentrated positions themselves), while having their Head of Global Operations on the owner-member Board of Directors of the central clearing firm in a leadership role. Whether or not it's obscured by various layers of ownership and technicalities, holes in reporting requirements or misleading statements, and confusing terms, the effect on public confidence is undeniable. They are clearly part of the overall problem, (just as Credit Suisse [now UBS] is/was clearly part of the swap, and wider synthetic prime brokerage problem) yet the Commission seems more afraid of confronting them, or to be accused of some impropriety than concerned about acting on the well supported and documented assertions of the public. Even the enforcement actions the SEC and FINRA have taken against them are woefully inadequate, and don't begin to account for the tremendous profit of their fraudulent actions. The regulatory bodies could even use their own deductive and observational capacity to seriously investigate the public's claims, which seem like just the natural consequence of the current market structure. Whereas Citadel's Ken Griffin continues to maintain if he had to avoid the appearance of impropriety

he'd be out of a job.

This also makes public comment seem like an exercise in futility, where to have one's comments seriously considered you must adopt this worldview of convenience, euphemism, and political expediency. While facing the titanic opposition funded by billions obtained through these very processes. While the one's considering your comments are likely being paid considerable fees by the opposition, or lining up a job opportunity with them. The Commission should consider this when examining the gulf of difference in opinion between the public and industry insiders. If the public is ill informed, then allow them to be informed, or inform them yourself without saying "it's a secret" or "actually it's ok if they do it." Can you?

The Commission must consider what is being hedged, and how, end to end (to where those exposures are finally allowed to remain unhedged) to understand the effect it will have on the market. It needs to consider why CFTC has chosen to offer years of "no action" relief on swap reporting requirements, and to understand the nature of the relief being granted, and consider how it may benefit firms with large concentrated and poorly managed positions to not have public disclosure. To consider why it should even allow firms to obtain such positions secretly in the first place, (often in aggregate many times the size of the underlying market) and assume it will have no effect of manipulation on the market, or detriment to the protection of investors.

"Copycat trading": This concern raised by large participants seems quite minimal from my view, and swap reporting requirements seem to be an inappropriate venue to raise this concern. Indeed, the SEC requires reporting of a variety of trading positions, and to single out large positions in an exclusive product like swaps as being worthy of exemption seems strange. If a participant sincerely holds these concerns I would suggest a different avenue for guarding their trade secrets, something like the patent office. Otherwise they're just relying on some being uninformed and making poorly informed decisions for their firm's profits, which brings in to question their entire trading model, and their ability to steward important market functions properly.

Conclusion: The current framwork is not a sustainable framework for a stable market which functions to the benefit of all investors exposed at their own discretion. These reproposed, and proposed rules are a commendable step forward, and well based in the Commission's authority granted to it by Congress. I support the rights of participants to gain exposure as they desire, but not their right to manipulate the price of underlying securities and maintain unnecessary secrecy. Some solutions suggest themselves, an environment of learning and reporting even at the cost of proprietary secrets, and if those proprietary secrets are truly of value a different mechanism for protecting them like a trademark or patent, not keeping the public and regulators in the dark and at the mercy of firms with their own financial interest in mind. To allow information relevant to the safety of the public and all investors to remain compartmentalized and in shadows is a malfeasance in its own right, and introduces perverse incentives. The Exchange Act provides a broad mandate for the SEC to act in the manner described in the release and proposed rules. I suggest they act as quickly as possible to finalize and implement these proposals, with as stringent disclosure requirements and provisions against fraud and conflict as they can apply.

-Thank you, Larry Douglas, Individual American Investor