BANK POLICY INSTITUTE

August 21, 2023

Via Electronic Mail to *rule-comments@sec.gov*

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

Re: Reopening of Comment Period for Position Reporting of Large Security-Based Swap Positions, File No. S7-32-10

Dear Ms. Countryman:

The Bank Policy Institute[1] welcomes the opportunity to respond to the reopening of the comment period for proposed Rule 10B-1 by the Securities and Exchange Commission to require reporting and public disclosure of positions in security-based swaps ("SBSs") that exceed specified size thresholds.[2] Our comments herein focus on bringing the Commission's attention to the significant negative impact that the public disclosure provisions of proposed Rule 10B-1 would have on banks' ability to utilize the SBS market for risk management purposes in connection with their corporate lending and other customer-facing businesses.

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1 The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

2 The Commission originally issued proposed Rule 10B-1 in December 2021. *See* SEC Release No. 34-93784 (Dec. 15, 2021), 87 Fed. Reg. 6652 (Feb. 4, 2022). The Commission subsequently reopened the comment period for proposed Rule 10B-1 on June 20, 2023, along with releasing a memorandum from the SEC Division of Economic and Risk Analysis providing supplemental data and analysis related to the anticipated economic effects of the proposed Rule 10B-1. *See* SEC Release No. 34-97762 (Jun. 20, 2023), 88 Fed. Reg. 41338 (Jun. 26, 2023); *see, also* Memorandum of the Staff of the Division of Economic and Risk Analysis, Supplemental data and analysis regarding the proposed reporting thresholds in the equity security-based swap market (June 20, 2023), *available at* https://www.sec.gov/comments/s7-32-10/s73210.htm.

In order to provide access to credit and manage risk, banks frequently enter into single-name and narrow-based index credit default swaps ("CDSs"), which qualify as SBSs that would be subject to proposed Rule 10B-1. We are concerned that banks' ability to utilize the market for those CDSs will be jeopardized if those CDSs become unduly costly or if they are not available as a result of a diminished CDS market. We believe that these consequences will occur if, in the context of what is already a limited CDS market, the Commission requires banks and dealers to make almost instantaneous public disclosure of their positions. The resultant risk to the dealers from front-running will make them reluctant to provide CDSs, or at least increase the cost substantially.

In addition, there is a risk to banks that disclosure of their current positions (and directly or indirectly the names of their borrowers) would confront banks with the dilemma of violating either an SEC rule or confidentiality obligations to borrowers. In the future, borrowers who value confidentiality would be forced to turn to lenders who do not use the CDS market to hedge (such as non-bank lenders who do not have capital or risk management constraints) or simply not borrow at all (thereby curtailing expansion).

These consequences would result from proposed Rule 10B-1's requirement for public disclosure of individual, position-level information shortly after a market participant exceeds a position reporting threshold. As described in greater detail below, the Commission should instead take a more balanced approach to public disclosure of SBS positions, which would not give rise to these issues.

I. CDSs Are an Important Tool to Promote Effective Bank Risk Management and Expand Lending Capacity

Banks frequently make use of the CDS market to transfer risk efficiently and cost-effectively, which helps expand lending capacity by ensuring that banks can continuously accept new credit exposure to their customers while maintaining compliance with their risk appetite, safety and soundness considerations and capital requirements. Research by staff of the Federal Reserve Board supports this view that banks use CDSs for efficient risk transfer and to comply with risk limits, including in situations where other risk mitigation tools (such as loan sales) are not optimal.[3] Banks use CDSs for hedging purposes in compliance with relevant capital regulations and overall safety and soundness.

As an example, during early 2020 many corporations needed to obtain funds to keep their businesses running and jobs afloat despite the significant reduction in economic activity at the beginning of the COVID-19 pandemic. As public debt markets largely shut down, issuers commonly accessed bank loans and revolving credit facilities to obtain this liquidity. Banks'

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3 *See* Cecilia Caglio, R. Matt Darst, and Eric Parolin, "Half-full or Half-empty? Financial Institutions, CDS Use, and Corporate Credit Risk" (Jan. 9, 2020), *available at* https://www.federalreserve.gov/econres/feds/half-full-or-half-empty-financial-institutions-cds-use-and-corporate-credit-risk.htm.

ability to make these funds available depended on their ability to access the CDS market so that they could hedge their ensuing credit risks. Without such access, banks likely would have needed to increase the interest rates at which they made those funds available or, worse, curtailed their lending activity, which would have had a lasting economic impact. In addition, when those borrowers came back to the corporate bond market to fund themselves weeks and months later, they were able to do so at materially better levels due to the ability for institutional investors to access hedges in the CDS market. In short, CDS market liquidity played an important role in supporting market and economic resilience during that critical period.

II. Proposed Rule 10B-1 Would Have a Significant Negative Impact on Banks' Use of CDSs for Risk Management Purposes

Proposed Rule 10B-1 would have a significant negative impact on banks' use of CDSs for risk management purposes because it would impose public disclosure requirements on banks and their dealer counterparties. Specifically, proposed Rule 10B-1 would require a person whose single-name or narrow-based index CDS position exceeds a specified size threshold[4] to report the person's identity and details of its CDS position and any related positions (including loans hedged by the CDSs) to the Commission's public EDGAR database. A person would be required to report even if its CDS position was solely a hedge to a non-CDS position or otherwise fully offset by other positions. These reports would be due one business day after a person exceeded the threshold. Whether it was the bank itself or its dealer counterparty who triggered this disclosure requirement, the bank and, ultimately, its borrower customers, would face significant issues as a result of such public disclosure.

A. Requiring Dealers to Disclose their CDS Positions Publicly Would Impair Market Liquidity

A bank's CDS dealer counterparties typically manage the risk they assume when entering into CDSs with the bank by entering into offsetting transactions in the market. However, due to the small number of dealers active in the CDS market and low levels of trading activity,[5] it frequently can take a dealer multiple weeks to enter into offsetting transactions or otherwise manage the risk it assumes from a bank buying CDS protection from the dealer.

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[4] The thresholds would be set at relatively low levels of notional exposure ($150 million of long notional amount (minus long positions in debt securities deliverable into the CDS), $150 million of short notional amount, or $300 million of gross notional amount).

[5] Data released by DTCC for the single-name CDS market shows that, for the top 1,000 single-name CDSs, on average there were only 2.2 dealers trading per name per month during the second quarter of 2023. *See* DTCC, "Top 1000 Single Names March – June 2023," *available at* https://www.dtcc.com/repository-otc-data/top-1000-single-names-3-25-2023-through-6-23-2023. The same data also shows that, on average, those CDSs only trade 3.6 times per day, with only 63 names averaging 10 or more trades per day.

Disclosure of the dealer's CDS position opposite the bank just one business day after the parties execute it would accordingly not give the bank's dealer counterparty enough time to enter into these offsetting transactions before third parties could use the public information about the position to front run those transactions. Given the limited depth of CDS market liquidity today, these issues would still exist even if public disclosure under proposed Rule 10B-1 was delayed several days or a week.

This dynamic would make it more difficult and costly for dealers to provide credit risk protection to banks (and ultimately more difficult and costly for banks to hedge). The end results would likely be to reduce credit availability and push lending activity further outside the banking sector to less regulated, non-bank lenders who do not face capital or risk management requirements necessitating hedging activity.

B. Requiring Banks to Disclose their CDS Positions (and Related Loan Positions) Publicly Would Harm Borrowers

If a bank's CDS position triggered reporting under proposed Rule 10B-1, the bank would be required to disclose information about its related loan positions in addition to information about the CDS. Given the generally confidential nature of the corporate loan market, such disclosure would present significant confidentiality concerns for banks and their ultimate borrowers. Such disclosure would in some instances violate confidentiality obligations owed by the bank to those borrowers. Such disclosure may also negatively impact a bank's client relationships, as borrowers may view a bank's CDS position as indicative of the bank trading against the borrower's interest, even if this is part of a prudent risk management strategy.

Even public disclosure of a bank's purchase of a CDS, standing alone and without disclosing related loans, and even on a delayed basis, is likely to be sufficient to raise confidentiality issues given the ability for market participants to infer lending activity from CDS activity. To the extent there is concern about credit quality with respect to an entity, having public information about changes in CDS exposure may actually increase systemic risk as a result of incomplete information about the entity on which the bank is buying protection. For example, the mere fact that a bank is buying CDS protection on a borrower does not necessarily indicate that it shares these credit concerns—indeed, the bank may merely be buying CDS to comply with credit concentration limits or similar prudent risk management practices.

Finally, although an exclusion from public disclosure requirements for banks' CDS hedges would help mitigate these issues, requiring banks' dealer counterparties to disclose their own positions opposite banks, including the identity of the companies underlying those CDSs, would indirectly present many of the same issues relating to increased hedging costs and indirectly disclosing confidential loan market activity. Third parties could use public information about those dealers' positions to front run the dealers' efforts to enter into offsetting transactions, and they could infer new lending to a borrower from public disclosure of new CDS positions relating to that borrower.

III. Alternatives to Position-Level Public Disclosure Can Address the Commission's Regulatory Objectives With Less Significant Negative Consequences

Public disclosure of individual, position-level information is not needed to address relevant regulatory objectives, which can be addressed in a different way. In particular, reporting of SBS position information confidentially to the Commission solely for regulatory purposes would provide the Commission with the tools necessary to identify potentially significant concentrated risk exposures or market misconduct. Industry groups have also provided input to the Commission about how it can modify the content of the reports to be more useful for those purposes.[6]

The Commission could then use this information to fashion a gradual and calibrated approach to any public disclosures, similar to the way the official sector has approached public transparency requirements in other securities markets, such as the Treasury market[7] and the Commission's 2022 short interest reporting proposal.[8] In this regard, the Commission could consider publication of aggregated, anonymized information on an appropriately delayed basis, similar to what takes place in other derivatives markets (such as the CFTC's reports relating to futures),[9] which would also help market participants, including banks, monitor for potentially significant concentrations or trends without having the same impact as individual, position-level disclosure. Before the Commission published any such information, it would first need to assess carefully how to mitigate potential adverse market impact given the state of CDS liquidity as described above.

We understand that the Commission opted instead to propose public disclosure of individual firms' SBS positions due, in part, to a desire to reduce the potential risk of further

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6 *See, e.g.*, Comments from SIFMA, ISDA, and IIB, dated Mar. 21, 2022, *available at* https://www.sec.gov/comments/s7-32-10/s73210-20120774-272955.pdf.

7 After data on secondary market transactions in Treasury securities began to be reported to regulators in 2017, in 2018 Treasury conducted extensive market outreach and analysis on the potential benefits and risks of public transparency, which led to publication of aggregated volume information starting in 2020, and subsequent requests for comment by Treasury and other authorities in 2022 about potential transaction-level, anonymized disclosures.

8 *See* SEC Release No. 34-94313 (Feb. 25, 2022), 87 Fed. Reg. 14950, 14955 (Mar. 16, 2022) ("Proposed Rule 13f–2 would result in the publication of certain short sale related data, which would provide additional transparency to market participants, but data would be aggregated across all reporting Managers for each reported equity security prior to publication. The Commission believes that publicly disclosing the identity of individual reporting Managers may not currently be necessary to advance the policy goal of increasing public transparency into short selling activity, and that aggregating across reporting Managers would help safeguard against the concerns noted above related to retaliation against short sellers, including short squeezes, and the potential chilling effect that such public disclosure may have on short selling").

9 On a weekly basis, the CFTC releases aggregated, anonymized information about open positions in certain futures and options on futures contracts. For more detail, see https://www.cftc.gov/MarketReports/CommitmentsofTraders/index.htm.

counterparty defaults similar to the Archegos situation. Following that event, to improve counterparty credit risk management and ensure safe and sound banking practices, firms are already enhancing their efforts to receive adequate disclosures from counterparties about their exposures at other institutions.[10] Specifically, firms are enhancing confidential disclosure requirements for levered investment funds at the time of onboarding and during continuous monitoring, and are standardizing confidential information required from counterparties regarding risks, positions, and concentrations. Those efforts, which are consistent with the Federal Reserve Board staff's December 2021 guidance reminding firms of safe and sound practices for counterparty credit risk management in light of the Archegos default,[11] obviate the need for public disclosure pursuant to proposed Rule 10B-1.

In light of these considerations, we think the Commission should (a) start with confidential regulatory reporting to the Commission only, with appropriate enhancements to those reports reflecting industry input and (b) defer a determination of whether to require public dissemination of position reports (and on what basis) until after it 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 necessary to address the issues public dissemination presents.

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10 In addition, detailed review of the Archegos situation at one firm showed that the main cause of that firm's losses was not a lack of publicly available information about Archegos's positions, but rather lapses in prudent counterparty credit risk management practices. In particular, a report commissioned by a Special Committee of the Board of Directors of Credit Suisse ("CS") Group AG concluded that, "The Archegos-related losses sustained by CS are the result of a fundamental failure of management and controls in CS's Investment Bank" and "[t]here were numerous warning signals—including large, persistent limit breaches—indicating that Archegos's concentrated, volatile, and severely under-margined swap positions posed potentially catastrophic risk to CS." *See* CS Group Special Committee of the Board of Directors Report on Archegos Capital Management (Jul. 29, 2021) at p. 1-2, *available at* https://www.credit-suisse.com/media/assets/corporate/docs/about-us/investor-relations/financial-disclosures/results/csg-special-committee-bod-report-archegos.pdf.

11 *See* SR 21-19: The Federal Reserve Reminds Firms of Safe and Sound Practices for Counterparty Credit Risk Management in Light of the Archegos Capital Management Default (Dec. 10, 2021), *available at* https://www.federalreserve.gov/supervisionreg/srletters/SR2119.htm.

BPI appreciates the opportunity to comment on the proposal. If you have any questions, please contact the undersigned by phone at [redacted] or by email at [redacted].

Respectfully submitted,

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