Chairman Gary Gensler
Securities and Exchange Commission
100 F St NE
Washington, DC 20002

September 20, 2021

Dear Chairman Gensler,

We write to urge the Securities and Exchange Commission (SEC) to close critical reporting loopholes that are being exploited by a number of hedge funds in an effort to disguise their holdings from the public. These exceptions allow hedge funds to take outsized risks using derivative positions that go unreported. The reporting gaps pose dangers to other shareholders who may be unaware of a fund's large position and leave the management of publicly traded companies in the dark on who their shareholders are.

In general, an investor that owns more than 5% of a company's shares must file a Form 13-D disclosure with the SEC within 10 days of reaching that threshold. Yet, as the sudden implosion of family office Archegos Capital in March of this year exposed, positions built through derivatives such as total return swaps and puts that are sold are exempt from this reporting requirement. Similarly, these derivatives positions are exempt from quarterly summary holdings reporting on the SEC's Form 13-F, which large institutional investors holding more than $100 million in reportable securities must otherwise file 45 days after quarter end.

Lack of transparency poses risks for other investors and lenders and leaves regulators in the dark

This lack of transparency can have very sudden negative consequences for other investors in companies, significantly hampering capital formation. Archegos, through its total return swap positions, secretly held positions equivalent to over 10% of the total outstanding shares of CBSViacom, Discovery, GSX Techedu, and potentially others.[1] By the time the family office's prime brokers Goldman Sachs, Morgan Stanley, Credit Suisse, and Nomura were forced to liquidate Archegos's derivatives positions, an estimated $194 billion in market value was collectively lost by all shareholders of those stocks.[2] The banks themselves also took about $10

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[1] Chung, Juliet and Patrick, Margot. Wall Street Journal. What is Archegos and How Did It Rattle the Stock Market? Apr 6, 2021. https://www.wsj.com/articles/what-is-archegos-and-how-did-it-rattle-the-stock-market-11617044982
[2] Balji, Divya. Bloomberg News. Rattled Archegos Stocks Investable Again After $194 Billion Blow. Apr 9, 2021. https://www.bloomberg.com/news/articles/2021-04-09/rattled-archegos-stocks-investable-again-after-194-billion-blow?sref=f7rH2jWS

billion in losses[3] since they could not clearly see through Forms 13-F and 13-D the extent to which Archegos was also borrowing heavily from other banks, leaving all of them severely undercollateralized and forced to try to jump ahead of each other to suddenly sell.[4]

As long as the existing reporting loopholes remain open, the SEC and the Treasury's Financial Stability Oversight Council (FSOC) cannot adequately monitor:

- how leveraged certain hedge funds are and;
- how a future downturn in the financial markets could lead to significantly greater losses for these funds as well as for the global systemically important banks (G-SIBs) that lend to them.[5]

Lack of transparency makes it easier for hedge funds to demand changes that may be harmful to other stakeholders and long term company performance.

The reporting exemptions for derivative positions under Forms 13-F and 13-D also allow hedge funds to quietly amass positions, which they can then suddenly announce while demanding changes that boost the immediate value of their holdings at the longer term expense of companies and their workers.

For example, in September 2019 Hedge fund Elliott Management surprised the management of AT&T by issuing a letter saying that it had a $3.2 billion stake representing about 1% in the company and demanding that AT&T's management reduce costs and lay off workers in order to raise dividend payments and share repurchases. AT&T's then CEO Randall Stephenson signed a Business Roundtable pledge in August 2019 to serve all of the company's stakeholders, not just shareholders, but Stephenson acquiesced and eliminated 23,000 jobs (or 9% of its total workforce), raised its dividend by 2%, and bought back $7.5 billion of stock.[6]

Elliott Management's Form 13-F filing on November 14, 2019 only showed the hedge fund holding $118.25 million in stock, suggesting that the rest of its position was held through selling put options (economically equivalent to holding the stock) instead.[7] AT&T management had no visibility into the size of its positions or changes in those positions.

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[3] Patrick, Margot and Webb, Quentin. Wall Street Journal. Archegos Hit Tops $10 Billion After UBS, Nomura Losses. Apr 27, 2021. https://www.wsj.com/articles/ubs-takes-surprise-774-million-archegos-hit-11619501547
[4] Farrell, Maureen et al. Wall Street Journal. Goldman, Morgan Stanley Limit Losses With Fast Sale of Archegos Assets. Mar 30, 2021. https://www.wsj.com/articles/goldman-morgan-limit-losses-with-fast-sale-of-archegos-assets-11617062028
[5] Davies, Paul J. Wall Street Journal. Archegos Is a Warning for Aggressive Financial Markets, Says BIS. Jun 29, 2021. https://www.wsj.com/articles/archegos-is-a-warning-for-aggressive-financial-markets-says-bis-11624968000
[6] DiNapoli, Jessica et al. Reuters. Investor payouts and job cuts jar U.S. companies' social pledge. Jan 25, 2021. https://www.reuters.com/article/us-health-coronavirus-businessroundtable/investor-payouts-and-job-cuts-jar-with-u-s-companies-social-pledge-idUSKBN29U14W
[7] Securities and Exchange Commission EDGAR. Elliott Management Corp Form 13-F-HR. Nov 14, 2019. https://www.sec.gov/Archives/edgar/data/1048445/000156761919021581/xslForm13F_X01/form13fInfoTable.xml

Earlier in 2017, Elliott claimed a 9.2% stake of AthenaHealth while reporting actual stock holdings of just under 1%[8] and pushed for changes there. AthenaHealth's then CEO Jonathan Bush said operating in that context was like having a "gun to your head", and he came to regret the cost cuts he made because of the harmful effects they had on the morale of employees and overall culture of the company.[9]

Closing the 13-F and 13-D loopholes will not end hedge fund demands, but it would end the additional unfair advantage of surprise, allowing company management to understand those positions both before and following such demands.

Closing these loopholes would also end a significant distortion in corporate governance in which owners of a large percentage of shares must rightly put other shareholders on notice of their stake, but hedge funds can mask their ownership and their incentives through the use of complex financial products.

Recommendations

We urge the SEC move swiftly to close these loopholes and to cut down on the reporting lag on both Forms 13-F and 13-D so that basic reporting requirements apply no matter how positions are constructed.

Specifically:

1. Total return swaps (TRS) and contract for differences (CFDs), which do not bring voting rights, but have the same economic exposure as shares, should be required to be reported on both Forms 13-F and 13-D to give a clearer picture of how much an institutional investor owns in a stock.
2. While long options positions must be reported on both 13-F and 13-D reports, short options such as selling puts (similar to being long a stock) or selling calls (similar to shorting a stock) are not currently subject to the same requirements. Reporting should be required for these instruments as well so that funds cannot use them to avoid scrutiny.
3. Quarterly 13-F reports should be updated to require disclosure of short positions. Other investors should not be left in the dark as to which funds have vested interests against a company

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[8] Securities and Exchange Commission EDGAR. Elliott Management Form 13-F-HR. Aug 14, 2017. https://www.sec.gov/Archives/edgar/data/1048445/000114036117032006/xslForm13F_X01/form13fInfoTable.xml

[9] Farr, Christina. CNBC. Jonathan Bush's life after AthenaHealth means staying far away from activist investors. Nov 3, 2019. https://www.cnbc.com/2019/11/03/jonathan-bushs-life-after-athenahealth-and-the-battle-with-elliott.html

4. Given the significant improvements in technology since the timelines were set, both the 10-day deadline to file Form 13-D and the 45 days after quarter end deadline to file Form 13-F should be significantly shortened in order to provide investors with more up to date information

We are encouraged to see that an expansion of the Form 13-F and 13-D reporting requirements to include derivatives is on the Commission's agenda.[10] We strongly encourage the Commission to follow through and close these long running loopholes in order to create safer and more transparent public markets.

Sincerely,

Americans for Financial Reform Education Fund

Communication Workers of America

[10] Office of Information and Regulatory Affairs. Executive Office of the President. Disclosure Regarding Beneficial Ownership and Swaps. https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202104&RIN=3235-AM93