Americans for Financial Reform Education Fund

April 11, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St NE
Washington, DC 20549

Re: Modernization of Beneficial Ownership Reporting (File No: S7-06-22)

Secretary Countryman,

The Americans for Financial Reform Education Fund appreciates this opportunity to comment on the Securities and Exchange Commission's ("the Commission") proposal to modernize the reporting requirements under Schedules 13D and 13G to include cash-settled derivatives and clarity on the regulations for two or more persons that constitute a "group".

The proposed rule would finally close the long- standing gap between the reporting requirements for large equity holdings and those for derivative holdings that are not currently reported, via significant changes to Regulation 13D-G and Regulation S-T. Those regulations currently require that holders of equity securities greater than 5% of an issuer's voting shares file a notice over the Commission's EDGAR system after a certain number of days.

We strongly support the Commission's proposals to:

- Amend Rule 13d-3 to include cash-settled derivatives in large position reporting that are currently exempt, even though they are economically similar to stock holdings
- Shorten the reporting period for an activist investor who crosses the 5% of outstanding share threshold to file a Schedule 13D within five days versus 10 days
- Clarify that reporting revisions to Schedule 13D "promptly" means with one business day
- Shorten the reporting period for "passive investors" who hold more than 5% of an issuer's shares to five days from anywhere from 10 to 45 days currently for positions greater than 10%, one day after crossing that threshold

The Sudden Implosion of Archegos Capital Underlines the Need to Modernize Derivatives Reporting Rules

Had the Commission's proposals already been in place, many bank lenders, investors, and companies would have been able to see that one family office - Archegos Capital - was aggressively driving up the prices of their shares in 2020 and adjusted their investments accordingly. In the event, they only found out when it was far too late to respond, after media reports indicated the family office was forced by its prime brokers to suddenly liquidate several of its holdings.

The sudden implosion of family office Archegos Capital in March 2021 showed how the loopholes in derivatives reporting allowed a family office to build sizeable positions across several stocks without reporting them; those positions ultimately led to billions of dollars in losses for several Globally-Systemically Important Banks (G-SIBs) that lent it money.

Schedule 13D requires that any investor that holds a position greater than 5% of a company's total shares file within 10 days a disclosure to the Commission, but derivatives positions such as total return swaps are not currently subject to this disclosure requirement.[1] Separately, Schedule 13-F requires investment managers with more than $100 million in exchange traded stocks, options, and warrants to report their long holdings 45 days after every quarter.[2]

Archegos Capital, which was a family office, quietly built-up stakes using Contract-for-Differences (CFDs) and total return swaps rather than the shares of the stocks themselves, amassing stakes representing more than 10% of the outstanding shares of companies such as ViacomCBS, Gaotu Techedu, Discovery, and others.[3] Because they were CFDs and total return swaps, the positions did not need to be reported.

When some of Archegos's positions started losing money, prime brokers such as Goldman Sachs, Morgan Stanley, Credit Suisse, UBS, Nomura, and MUFG were caught off guard by how much Archegos Capital had borrowed from other banks to purchase the same stocks.

G-SIBs collectively lost close to $10 billion from their lending to what had until then been a relatively unknown family office. Credit Suisse lost over $5 billion while Nomura took $3 billion in losses, Morgan Stanley $1 billion, UBS $774 million, and MUFG $270 million.[4]

Executives and shareholders at a number of firms were left to wonder if the sharp declines in their own shares were a result of Archegos's positions being unwound by the banks or of other unrelated causes.[5] Some stocks that were well known to be held by Archegos Capital such as ViacomCBS saw shares fall over 50% from $85/share to $48/share in a matter of days once it was revealed that banks that had lent to Archegos Capital were forcibly selling them.[6]

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[1] Zarb, Frank and Rambo, Louis. Proskauer Rose LLP. A Practical Guide to the Regulation of Hedge Fund Trading Activities. Dec 4, 2019. https://bit.ly/344nq24

[2] Securities and Exchange Commission. Frequently Asked Questions about Form 13F. Feb 24, 2020. https://www.sec.gov/divisions/investment/13ffaq.htm

[3] Natarajan, Sridhar and Burton, Katherine. Bloomberg News. Bill Hwang Made a Huge, Secret Bank Bet Before Archegos Collapse. Nov 17, 2021. https://www.bloomberg.com/news/articles/2021-11-17/bill-hwang-made-secret-bank-bet-before-20-billion-loss-archegos-collapse

[4] 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

[5] Wursthorn, Michael and Rudegair, Peter. Wall Street Journal. Executives Wonder if Their Stock Selloffs Were Linked to Archegos. Apr 21, 2021. https://www.wsj.com/articles/executives-wonder-if-their-stock-selloffs-were-linked-to-archegos-11618997403

[6] Picker, Leslie and Frost, Wilfred. CNBC. Morgan Stanley and Goldman Sachs' roles in volatility of ViacomCBS raise questions. https://www.cnbc.com/2021/04/01/viacomcbs-stock-sales-amid-archegos-debacle-raise-questions-for-banks.html

Had these revisions to Schedule 13G been in place as the Commission is now proposing through amendments to Regulation S-T, other shareholders would have been able to see that Archegos Capital's aggressive derivatives purchases were a major driver of the higher prices of their shares.[7] Timely 13G filings would also have shown how exposed other shareholders were to Archegos's forced liquidation.

The proposed new requirement that all investors, including those with cash-settled derivative positions, report their holdings to the Commission will close a loophole, and make sure that large positions that are functionally the same as their underlying stock holdings, but structured differently, are properly disclosed to other investors and company management.

Sharing material, non-public information related to future 13D filings that disadvantage others should trigger classification as a "group"

We support the Commission's proposal to amend Rule 13d-5 to include a provision that clarifies what activity should constitute being classified as a "group" under Section 13(d)(3) and requiring that the group jointly file a Schedule 13D or separately file 13Ds that reflect the stake of the entire group when exceeding 5% of a company's outstanding shares.

As the Commission notes the very act of sharing material, non-public information with another party related to exceeding the 5% threshold, but not yet having filed a Schedule 13D, is a clear signal of cooperation.

Both parties sharing such material non-public information with one another stand to benefit from doing so. The tipper benefits from potential additional share purchases by the tippee while the tippee may have an opportunity to purchase more shares between the time when the tipper exceeds the 5% threshold and the 13D is filed, sending the stock higher upon such disclosure.

The market reacts with a bump of about 7% in stock prices around the time a Schedule 13D is filed.[8] The share price of consumer goods giant Unilever for example recently rose 6% upon the initial disclosure of prominent activist investor Trian Partners building a stake in the company.[9] Or in the case of web hosting company GoDaddy, shares jumped upon activist hedge fund Starboard Value disclosing a 6.5% stake.[10]

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[7] Chmielewski, Dawn. Forbes. Hedge Fund Stock Dump Crushes The Soaring Fortunes of ViacomCBS' Shari Redstone. Mar 29, 2021. https://www.forbes.com/sites/dawnchmielewski/2021/03/29/hedge-fund-stock-dump-crushes-the-soaring-fortunes-of-viacomcbs-shari-redstone

[8] Alon Brav, Wei Jiang, Frank Partnoy, and Randall S. Thomas, "Hedge Fund Activism, Corporate Governance and Firm Performance," The Journal of Finance (2008), *available at* https://law.duke.edu/sites/default/files/centers/gfmc/session_3/2_brav_et_al-hedge_fund_activism-2008.pdf; Ulf Von Lilienfeld-Toal & Jan Schnitzler, "What is Special About Hedge Fund Activism? Evidence from 13-D Filings," 2, 25 (Swedish House of Finance Research Paper No 14-16, June 4, 2014), *available at* http://ssrn.com/abstract=2506704.

[9] Aripaka, Pushkala and aidu, Richa. Reuters. Activist investor provides twist in Unilever soap opera. Jan 24, 2022. https://www.reuters.com/business/retail-consumer/unilever-shares-gain-after-activist-investor-peltz-builds-stake-2022-01-24/

[10] Baccardax, Martin. TheStreet. GoDaddy Stock Leaps As Activist Investors Staboard Reveal $800 Million Stake. Dec 27, 2021. https://www.thestreet.com/markets/godaddy-stocks-leaps-as-activist-investors-starboard-reveal-stake

Under the current regime, where an investor has ten days after crossing the 5% ownership threshold before they are required to file a Schedule 13D, there is plenty of time for both the investor to build their ownership stake well beyond 5% and for others the investor informed about their impending filing to acquire significant stakes before any public disclosures are required. This means that certain investors in the know, who have access to the material, non-public information that is the impending filing of the Schedule 13D, are able to reap significant gains just from the fact of a Schedule 13D filing regardless of the long-term impacts of the activism. This happens while other investors lose out, particularly those who sell their shares before the Schedule 13D filing at arguably discounted prices under conditions of information asymmetry. Longer-term investors may also lose out, as discussed in more detail below. Hedge funds that file Schedule 13Ds tend to exit their investments quickly—one study found 266 days to be the median[11] and another found it to be 369 days.[12] It is not surprising, then, that hedge fund activism is associated with increased leverage, increased shareholder payouts (including through stock buybacks), reduced long-term investment in research and development,[13] wage stagnation, and layoffs.[14] These types of changes tend to benefit short-term investors over long-term ones, as they forego longer-term investments that contribute to innovation and sustainable financial growth over time.[15] While hedge fund activism is associated with short-term increases in shareholder value, the evidence is much more mixed on the question of whether hedge fund activism results in long-term gains.[16]

Numerous media reports have chronicled "idea dinners" in which various hedge fund managers pitch investment ideas and share information with one another. For well over a decade, hedge funds have been known to share information related to the positions they are betting on or betting against at such idea dinners.[17] In some cases, those dinners are formally organized by firms where a set group of hedge fund investors often share ideas with one another, and the

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[11] Alon Brav, Wei Jiang, and Hyunseob Kim, "Hedge Fund Activism: A Review," Foundations and Trends in Finance (Feb. 2010), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1630481.

[12] Alon Brav, Wei Jiang, Frank Partnoy, and Randall S. Thomas, "Hedge Fund Activism, Corporate Governance and Firm Performance," 1769, The Journal of Finance (2008), available at https://law.duke.edu/sites/default/files/centers/gfmc/session_3/2_brav_et_al-hedge_fund_activism-2008.pdf.

[13] John C. Coffee, Jr. and Darius Palia, "The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance," 549, The Journal of Corporation Law (2016), available at https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=2929&context=faculty_scholarship.

[14] Alon Brav, Wei Jiang, and Hyunseob Kim, "The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation and Labor Outcomes" (Jan. 19, 2015), available at http://ssrn.com/abstract=2022904.

[15] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, available at https://hbr.org/2014/09/profits-without-prosperity; William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, available at https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[16] John C. Coffee, Jr. and Darius Palia, "The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance," 584-85, The Journal of Corporation Law (2016), available at https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=2929&context=faculty_scholarship.

[17] Anderson, Jenny. New York Times. Potluck a la Wall Street: 'Idea dinners'. May 24, 2005. https://www.nytimes.com/2005/05/24/business/worldbusiness/potluck-la-wall-street-idea-dinners.html

early purchasers of certain companies may benefit from finding additional buyers of the same companies they tout at these dinners, driving the shares higher.[18]

Such activities have already led the Commission to investigate certain managers in the summer of 2010, leading a prominent hedge fund manager at the time to comment that his fund would no longer discuss investments with other funds prior to public filings. Although some hedge fund managers are voluntarily choosing to no longer share material non-public information about sizeable positions with one another, the Commission in amending the definition of a “group” under Section 13(d)(3) and requiring those who continue to share such information with one another, file joint Schedule 13D or 13G filings collectively, will ensure that all other shareholders who are not privy to such discussions are not unfairly disadvantaged in their trading.

Rule 13d-6(c) should clarify that shareholders who coordinate to make and pass Rule 14a-8 proposals do not create a “group.”

Question 69 of the proposed rule asks whether “the proposed Rule 13d-6(c) exemption [is] broad enough to exempt activity by shareholders who coordinate to make non-binding proposals under 17 CFR 240.14a-8 or otherwise, or [if] an express exemption [is] needed for shareholders who act together in introducing such proposals.” Although we believe the proposed rule would exempt Rule 14a-8 coordinated activity from disclosure requirements related to group formation because non-binding proposals cannot, by themselves, influence control of the issuer, it appears there is some confusion around this question. Therefore, in an abundance of caution, we recommend the Commission make it explicit that this activity is part of the Rule 13d-6(c) exemption.

We also support the recommendations outlined in the comment letter submitted by the Council of Institutional Investors, calling on the Commission to clarify the Rule 13d-6(c) exception to ensure it covers launching and participating in “vote no” campaigns and communications with Schedule 13D filers post-filing.

The Commission should be cautious not to include in its definition of “group” shareholder cooperation that seeks to improve the long-term standing of a company where other investors who do not participate are not disadvantaged. This sort of activity, which is a natural part of shareholder engagement with companies, should be acknowledged as distinctly different from the intentional selective sharing of material non-public information over large positions that have yet to be publicly filed.

The current beneficial ownership regulatory structure incentivizes short-termism in corporate governance, prioritizing immediate payouts over long-term investments.

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[18] Strasburg, Jenny and Pulliam, Susan. Wall Street Journal. Pack Mentality Grips Hedge Funds. Jan 14, 2011. https://www.wsj.com/articles/SB10001424052748704361504575552462233274960

Critics of the proposed rule worry that shortening the Schedule 13D filing window, including cash-settled derivatives in reporting requirements, and clarifying the definition of "group" will have detrimental effects on corporate governance because hedge funds will no longer have the requisite financial incentives to engage with the issuer in ways that improve financial performance. As a result, they argue, all shareholders will lose out from hedge funds' value-increasing interventions. However, a closer look at the incentives created by the current beneficial ownership regulatory structure suggests that the interests of activist hedge funds may not be aligned with those of other shareholders.

Some observers also worry that the effects of hedge fund activism may reverberate well beyond the targeted firms. The concern is that the mere possibility of becoming a hedge fund target compels the boards and management teams of public companies to forego long-term investments in favor of maximizing short-term shareholder returns.[19] If this is the case, hedge fund activism could be contributing to the current emphasis on short-term gains over sustainable, long-term growth that benefits longer-term investors. Notably, one of the largest asset managers has expressed concern that the strategies of "activist" hedge funds are too short-term oriented to the detriment of long-term value creation.[20]

The proposed common-sense regulations would both make markets more fair and efficient and contribute to sound corporate governance.

While the regulatory changes in the proposed rule would not prevent shareholder activism, they would greatly reduce information asymmetry amongst market participants and potentially moderate the sudden, abrupt changes in corporate governance that often occur in targeted firms. They may also decrease the likelihood of non-targeted firms taking preemptive steps—such as overspending on short-term shareholder payouts and foregoing investments necessary for long-term financial health and growth— to avoid becoming targets.

Shortening the Schedule 13D filing window from ten days to five days would decrease information asymmetry amongst market participants that unduly benefits a select few investors who obtain material, non-public information at other investors' expense. The shortening of this window, as well as the one for Schedule 13G filings, would also benefit shareholders and other market participants by facilitating sound corporate governance. For example, more timely disclosures of beneficial ownership would help investors ensure their asset managers are fulfilling their fiduciary duties. Additionally, these disclosures would help inform the education and advocacy efforts of those with a stake in proxy contests, shareholder resolutions, and other important votes. To maximize these benefits, the Commission should consider cutting the window even further. Indeed, in the U.K., beneficial ownership must be disclosed within two

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[19] *Id*. at 552.

[20] Andrew Ross Sorkin, "BlackRock's Chief, Lawrence Fink, Urges Other C.E.O.s to Stop Being So Nice to Investors," The New York Times (Apr. 12, 2015), *available at* https://www.nytimes.com/2015/04/14/business/dealbook/blackrocks-chief-laurence-fink-urges-other-ceos-to-stop-being-so-nice-to-investors.html.

trading days after surpassing a 3% ownership threshold.[21] In Germany, Hong Kong, and Australia, the requirements range from two to four trading days.[22]

Including cash-settled derivatives in the reporting requirements and refining the definition of "group" would serve similar ends, as the use of derivatives and "wolf packs" currently serve as ways to avoid triggering beneficial ownership reporting requirements. As discussed above, increased and timely beneficial ownership transparency would make markets fairer and more efficient and facilitate sound corporate governance.

We appreciate the Commission for this opportunity to provide comment on this important issue. For additional questions please contact Andrew Park at andrew@ourfinancialsecurity.org and Natalia Renta at natalia@ourfinancialsecurity.org.

Sincerely,

Americans for Financial Reform Education Fund

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[21] David A. Katz, "Section 13(d) Reporting Requirements Need Updating," Harvard Law School Forum on Corporate Governance (Apr. 12, 2012), *available at* https://corpgov.law.harvard.edu/2012/04/12/section-13d-reporting-requirements-need-updating/#12.

[22] *Id*.