Managed Funds Association
The Voice of the Global Alternative Investment Industry
Washington, D.C. | New York

March 21, 2022

Via Electronic Mail: rule-comments@sec.gov

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

Re: Notice of Proposed Rulemaking on Position Reporting of Large Security-Based Swap Positions; File No. S7-32-10

Dear Ms. Countryman,

Managed Funds Association[1] ("**MFA**") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("**SEC**" or "**Commission**") on its proposed "Position Reporting of Large Security-Based Swap Positions" rules ("**Proposal**").[2] This letter addresses the SEC's proposed Rule 10B-1 ("**Rule 10B-1**") under the Securities and Exchange Act of 1934 (the "**Exchange Act**"), which proposes to establish reporting and disclosure requirements for security-based swap ("**SBS**") transactions. MFA's comments on the SEC's proposed Rule 9j-1, as set forth in the Proposal, are addressed in a separate comment letter.[3]

MFA respectfully urges the Commission to reconsider the Proposal, which we believe will have a significant detrimental impact on the markets, and will undermine, rather than advance, the Commission's objectives to enhance transparency in a manner that protects investors, maintains fair, orderly, and efficient markets, and facilitates capital formation.[4] With the growing role of passive and indexed investing in U.S. equity markets, price discovery and liquidity are even more dependent on active investors who invest time and resources into independent research to make investment decisions.[5] Equity SBSs, for example, can be an efficient way to gain economic

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1 MFA represents the global alternative investment industry and its investors by advocating for regulatory, tax and other public policies that foster efficient, transparent, and fair capital markets. MFA's more than 150 members collectively manage nearly $1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia.

2 Exchange Act Release No. 34-93784 (December 15, 2021), 87 Fed. Reg. 6652 (February 4, 2022).

3 Managed Funds Association, *Comment Letter re Notice of Proposed Rulemaking on the Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; File No. S7-32-10* (March 21, 2022).

4 *See* U.S. Securities and Exchange Commission, *The Role of the SEC*, available at https://www.investor.gov/introduction-investing/investing-basics/role-sec.

5 *See, e.g.*, Francesco A. Franzoni, Alberto Plazzi & Efe Cotelioglu, *What Constrains Liquidity Provision, Evidence from Hedge Fund Trades*, CEPR Discussion Paper No. DP13645 (April 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3368142; George O. Aragon & Philip E. Strahan,

exposure instead of, or while, building a cash position in the underlying securities. Public disclosure of SBS positions, especially within the time periods and at the relatively low thresholds the Proposal imposes, will further impair price discovery and liquidity in the U.S. equity markets.

We recognize that rules aimed at increasing transparency into securities markets, when framed appropriately, can advance the Commission's goals. In our view, however, proposed Rule 10B-1 will significantly burden market participants, far in excess of any potential benefit, by requiring the public disclosure of proprietary investment positions and trading strategies, and by imposing extraordinary operational compliance requirements, which many market participants will simply be unable to satisfy, particularly in light of the proposed reporting thresholds and timeline requirements. The Proposal's unreasonably burdensome disclosure obligations will not achieve any of the Commission's stated goals and instead will harm investors and other market participants, impair fair, orderly, and efficient market activity across a number of asset classes and impede capital formation.

We also have serious concerns that the Commission has not adequately considered the true costs of proposed Rule 10B-1—particularly with respect to the public disclosure requirements—as required under the Administrative Procedure Act (the "**APA**").[6] Indeed, we believe that, as written, proposed Rule 10B-1 will likely result in a significant number of SBS market participants exiting the market altogether, or limiting their use of SBSs, which will reduce liquidity and make it more costly, or impossible, for market participants to enter into essential hedging transactions. In turn, this will limit the availability, and increase the cost, of capital for issuers. The Commission has not sufficiently assessed these negative adverse consequences for SBS markets and underlying securities markets—and the participants in each—or weighed them against the purported benefits of the Proposal. If it does so, as it is required to do under the APA, we respectfully submit that it will recognize that the actual costs of the Proposal, as drafted, far outweigh any benefits.

In particular, the requirement that market participants publicly disclose their trading positions and strategies, which constitutes their most valuable proprietary intellectual property, will jeopardize their ability to generate returns for investors, diminish the value of independent research, and impair their ability to operate their trading businesses and conduct necessary hedging, by allowing others to take advantage of or impair their strategies. In addition, it will be necessary for market participants to implement and maintain extensive new compliance systems, including the infrastructure required to monitor transactions continuously, identify positions subject to the reporting requirement and update reports as necessary (which, for many market participants, will be on a daily or near-daily basis), at substantial initial and ongoing cost and burden.

Hedge Funds as Liquidity Providers: Evidence from the Lehman Bankruptcy (August 26, 2009), available at https://ssrn.com/abstract=1462315.

6 5 U.S.C. 551 *et seq*.

While we generally support the Commission's policy objectives of improving oversight over, and addressing improper activity in, the SBS markets, we believe that the Commission must better take into account the nature of the SBS markets and market participants, and particularly the fact that these markets consist of negotiated transactions between sophisticated counterparties that are designed to advance customized and complex market objectives. These parties are fully capable of obtaining from their counterparties the information they need to assess such counterparties' creditworthiness and risk exposure, including the nature and size of their market positions. Public disclosure requirements, therefore, are not necessary to achieve the Commission's stated policy goals and will serve only to disrupt and constrain the market. Instead, as described further below, we respectfully urge the Commission to adopt a more limited and appropriate approach to SBS position reporting that will further the goals of the Proposal, while avoiding the imposition of undue costs and burdens on market participants and mitigating the negative outcomes described herein.[7] Specifically, we recommend that the Commission refrain from introducing proposed Rule 10B-1 until it has conducted a sufficient cost-benefit analysis and, in any event, modify Proposed Rule 10B-1 to focus only on regulatory reporting, in a manner similar to other of the Commission's reporting regimes and the Commodity Futures Trading Commission's ("**CFTC**") large trader reporting rules, which are the closest existing analogues to the Commission's Proposal.

I. Summary

The issues presented by Rule 10B-1 are of great concern to MFA and its members and we appreciate this opportunity to share our views. The following is a summary of our positions, which are explained more fully below.

1. The Commission has not adequately considered the costs and adverse consequences of public disclosure of SBS positions on SBS and underlying securities markets, and the participants in these markets.

2. Proposed Rule 10B-1 exceeds the Commission's statutory authority under Section 10(d) of the Exchange Act.

3. If the Commission believes, after further consideration of the costs of the Proposal and other issues addressed in this letter, that a rulemaking is still necessary and appropriate, it can achieve its goals without excessive disruption of markets and the imposition of undue burdens on market

[7] In the first three months of 2022, the Commission has already proposed several significant rulemakings, with more to come. As it considers whether each final rulemaking is necessary, we urge the Commission to consider in the aggregate the additional costs and burdens on market participants. We are concerned that a significant unintended consequence of the Commission's rulemakings will be increased concentration of the industry as compliance costs become insurmountable for new and small-to-mid-size market participants. This has serious implications for capital raising and the proper functioning of markets, which the Commission needs to consider.

participants by adopting less burdensome requirements under a regulatory reporting rule similar to the CFTC's large trader reporting rules.

4. In addition, if the Commission believes, after such further consideration, that a rulemaking is still necessary and appropriate, the Commission should ensure that its approach to position reporting in the final rule takes into account all of the additional direct and indirect operational and strategic costs associated with compliance.

II. The Commission has not adequately considered the costs and adverse consequences of public disclosure of SBS positions on SBS and underlying securities markets, and the participants in these markets.

We and our members have deep concerns that the Commission has not adequately considered the significant costs to market participants, issuers and markets that will be imposed as a result of the Proposal, as it is required to do under the APA and as it has customarily done with respect to significant rulemakings. The APA stipulates that a regulatory action is unlawful if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[8] Courts have held that proposed regulations are arbitrary and capricious where the regulatory body has failed to adequately assess the economic impact of a proposed new rule.[9] For the reasons that follow, we respectfully submit that the Commission has not met this standard in its assessment of the costs and benefits associated with proposed Rule 10B-1. Specifically, the Commission has failed to consider or address the economic costs of publicly revealing confidential, proprietary investment positions and trading strategies and, more generally, has not adequately assessed potential alternatives that could achieve the same benefits without incurring such costs. Finally, the condensed comment period has not provided market participants with the necessary time to fully assess and provide feedback on the adverse effects of the Proposal, given its complexity and the other rule proposals that the Commission has promulgated.

A. Public, non-anonymized disclosure of SBSs and related positions should not be required by the Commission, as it will be seriously detrimental to SBS markets and the underlying markets and will not improve the quality of information available to market participants or enhance the integrity of the markets.

The Proposal asserts that increased transparency through the proposed disclosure regime will lead to reduced risk and increased liquidity in the SBS markets.[10] We respectfully submit that the Commission's assessment is misguided at best and that the Commission has ignored the significantly negative impact that the proposed expansive public disclosure requirements will have on the SBS markets. Without limitation, the detrimental impact includes the possibility that SBS market participants will exit the market rather than disclose their

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8 5 U.S.C. 706(2)(A).

9 *See Business Roundtable* v. *S.E.C.*, 647 F.3d 1144, 1148 (D.C. Cir. 2011).

10 Proposal, at pp. 6687-6688.

proprietary intellectual property and incur the associated extensive compliance costs, and that liquidity and access to capital will be substantially diminished as a result. The impact to liquidity will affect both the SBS markets and the underlying securities markets, as reduced hedging and trading opportunities in SBS markets will result in investors reducing their exposure to underlying securities as well.

We believe that the Commission can achieve its policy objectives without requiring any public disclosure of SBS positions. The Commission states that one of its goals is to provide transparency into positions that may indicate an intention to engage in fraudulent or manipulative behavior.[11] Public disclosure is unlikely to serve this objective since market participants are not equipped or required to, and do not seek to, monitor other market participants for such behavior, and the Commission's surveillance for this conduct can be (and is currently) undertaken without public disclosure. As discussed further in Part II.C below, to the extent that the Commission believes that further disclosure is required, we respectfully submit that disclosure to the Commission, rather than to the public, is more appropriate. The Commission will then have ample information available to it to allow it to identify and take action against improper market conduct.

We also do not believe that public disclosure is required to satisfy the Commission's stated goal of reducing market and counterparty risk by providing counterparties with this information to more accurately price counterparty risk.[12] SBS agreements are, in virtually all cases, negotiated between sophisticated counterparties that are capable of managing counterparty risk, including by requesting information as part of the due diligence process, and allocating risk and other obligations through the terms of the SBS contract. Requiring extensive public disclosure of SBS positions, in reaction to a very small number of situations in which SBS positions resulted in a default,[13] is unnecessary. As discussed further in Part II.C below, to the extent that the Commission believes that increased, mandatory transparency between counterparties is nevertheless required to reduce counterparty risk, we respectfully submit that this can be achieved without requiring public disclosure through confidential bilateral counterparty disclosure.

The Proposal could also result in market participants choosing to transact in certain other markets rather than the SBS markets due solely to the different regulatory requirements that are applicable. For example, and as discussed in Part V.B below, proposed Rule 10B-1 would require more, and more frequent, public disclosure than existing public reporting requirements

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11 Proposal, at p. 6667.

12 Proposal, at p. 6667.

13 The Proposal is generally considered to be a partial reaction to the collapse of Archegos. *See, e.g.*, Proposal, at p. 6656. We respectfully submit that the Archegos scenario was not caused by a lack of information about Archegos's SBS positions that could have been remedied by public disclosure (*see* Credit Suisse Group Special Committee of the Board of Directors Report on Archegos Capital Management (July 29, 2021), available at https://www.credit-suisse.com/about-us/en/reports-research/archegos-info-kit.html) and, in any event, did not result in systemic market risk.

under Section 13 of the Exchange Act, which is an analogous ruleset in many respects.[14] Accordingly, market participants could very well exit the SBS markets and utilize other products merely due to differing regulatory regimes. By doing so, however, market participants may be incurring greater costs and risks, and may not have the benefit of the most efficient and appropriate hedging and risk-management vehicles. The Commission should not adopt regulations that favor certain products and markets over others, allow for regulatory arbitrage and force market participants into less desirable and effective positions.

To the extent the Commission continues to believe that any new rules are required, it should revise proposed Rule 10B-1 in a way that more appropriately balances the Commission's policy goals against the significant costs associated with disclosing proprietary investment positions and trading strategies. Other regulators implementing comparable reporting regimes have considered these issues, and we urge the Commission to incorporate these alternative approaches into its rulemaking considerations. For example, the CFTC large trader reporting rules do not require public disclosure at all. The CFTC's rules reflect a balance between the CFTC's goal of "implementing and conducting effective surveillance of economically equivalent physical commodity futures, options, and swaps,"[15] while maintaining the confidentiality of market participants' proprietary investment positions and trading strategies. Similarly, in the context of the CFTC's position limit regime, reports filed with the exchanges by market participants in order to comply with the rules are confidential. In adopting its position limit rules, the CFTC expressly noted the sensitivity of information submitted by market participants and reminded the exchanges of the importance of protecting the confidentiality of this information.[16]

The Commission has recognized the importance of protecting proprietary information in its recent proposed rule regarding short position and short activity reporting by institutional investment managers.[17] In that release, the Commission notes that:

> The Commission's determination to maintain the confidentiality of the information disclosed on Form SH was based in part on the concern that requiring public disclosure may have had the unintended consequence of giving rise to imitative short selling, thereby exacerbating already extreme levels of market volatility

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[14] 15 U.S.C. 78m. It would also require more frequent reporting than what is proposed in the Commission's recently promulgated Section 13 proposal. *See Modernization of Beneficial Ownership Reporting*, SEC Release Nos. 33-11030, 34-94211 (February 10, 2022), 87 Fed. Reg. 13846 (March 10, 2022).

[15] *Large Trader Reporting for Physical Commodity Swaps*, 76 Fed. Reg. 43851 (July 22, 2011).

[16] *Position Limits for Derivatives*, 86 Fed. Reg. 3236 (January 14, 2021). The CFTC noted that "to the extent that an exchange elects to publicize descriptions of approved non-enumerated bona fide hedges, the Commission cautions that any such data published should not disclose the identity of, or confidential information about, the applicant. Rather, any published summaries are expected to be general (generic facts and circumstances)." *Id.* at 3375.

[17] *Short Position and Short Activity Reporting by Institutional Investment Managers*, Exchange Act Release No. 34-94313 (February 25, 2022).

> observed during the 2008 financial crisis. The Commission also stated that implementing a nonpublic, rather than public, disclosure requirement would help to prevent the potential for sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets.[18]

The Commission does not address in any manner in the current Proposal why it has taken inconsistent positions regarding public disclosure in these proposals or why it believes that public disclosure under proposed Rule 10B-1 would not result in similar unintended consequences, including with respect to price volatility and market disruption. Indeed, we believe that public disclosure of SBS positions would facilitate imitative transactions similar to imitative short selling that would exacerbate volatility and lead to reduced liquidity in SBS markets and underlying securities markets, thereby resulting in similar deleterious effects on these markets and their participants.[19]

Similarly, the large options position reporting rules administered by the Financial Industry Regulatory Authority ("**FINRA**") do not provide for public disclosure of market participants' options positions.[20] We also note that all of these reporting regimes have worked effectively, and there have been no negative consequences of the confidentiality of reports that any of the relevant regulators—including the Commission—have identified. The Commission has failed to consider, much less justify, this radical departure from the comparable reporting regimes that are applicable to other categories of derivative products that are traded and utilized in the same manner and for the same purposes as SBSs. Instead, without any reasonable attempt to provide such a justification, the Commission has arbitrarily proposed to impose what would be the only public reporting regime, with respect to individual entities' positions, in the derivative markets.

B. The Commission did not conduct a sufficient cost-benefit analysis, as required under the Administrative Procedure Act.

The Commission's analysis of the costs and economic impact of the Proposal largely focuses on the projected system design costs associated with implementing proposed Rule 10B-1's public reporting requirements.[21] In doing so, the Commission not only fails to accurately estimate the compliance costs for firms on an initial and ongoing basis,[22] but it also largely ignores

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[18] *Id*. at pp. 15-16.

[19] Studies show that publicly available information regarding fund flows and positions exposes funds to predatory trading strategies that can reduce liquidity and increase volatility in the securities markets. *See* Teodor Dyakov & Marno Verbeek, *Front-Running of Mutual Fund Fire-Sales*, 37 J. Banking & Fin. 4931 (September 6, 2012), available at https://ssrn.com/abstract=2170660.

[20] *See* FINRA Rule 2360(b).

[21] Proposal, at pp. 6688-6690.

[22] See Part V.B below for a discussion of the compliance cost estimates.

other more substantial costs, including those that result from the public disclosure of proprietary information. As noted above, the public reporting element of the Proposal creates significant additional costs for individual firms that will have a collateral impact on the SBS markets and underlying securities markets, as well as issuers. The Commission fails to even recognize, much less consider or justify, these costs in the Proposal's cost-benefit analysis.

Market positions constitute confidential proprietary information about a market participant's investment positions and trading strategies, which are developed through a market participant's substantial expenditure of resources into the development and implementation of such strategies. The reason for keeping such information confidential is clear and compelling—disclosure enables third parties to reap the benefit of a market participants' investment in intellectual property (the cost of which is borne by the market participants' investors), and to take actions to impair bona fide investment positions and trading strategies.[23] For this reason, market participants have historically utilized extensive security systems to maintain the confidentiality of their investment positions and trading strategies and protect the value of their intellectual property. The Proposal will eviscerate the value of this investment in strategy development and information security and will allow other traders to capitalize on or impair market participants' investment positions and trading strategies.[24] Indeed, we expect that this will be the principal use of the public reports, rather than their intended use by dealers and others to evaluate their trading counterparties' exposures. As a result, public disclosure will actually facilitate and exacerbate, rather than curtail, a variety of types of opportunistic market behaviors, such as front-running, manipulation and other disruptive trading practices by market participants already looking to engage in such behaviors that the Commission has historically sought to prevent. Furthermore, public disclosure of such confidential and proprietary information, generally, and pursuant to the Proposal's reporting timelines, will also disincentivize research and investment in the SBS markets and the underlying securities markets.[25] The result of less investment and participation is also clear—SBS markets that are less liquid and less useful for market participants and issuers. For these reasons, firms endeavor to keep such information confidential, and such concerns have been acknowledged and accommodated in other reporting requirements, as noted above. Reducing the incentive for investors to conduct proprietary market research will result in further adverse consequences in underlying securities markets. Investor returns will be negatively impacted as market participants

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[23] Studies show that these costs increase as public disclosure becomes more frequent. *See* Mary Margaret Meyers, James M. Poterba, Douglas A. Shackelford, & John B. Shoven, *Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry* (October 2001), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=293617.

[24] For this reason, we also have concerns that public disclosure, without compensation, may constitute an unconstitutional taking of firms' proprietary information.

[25] Studies show that public disclosure of proprietary investment positions and trading strategies decreases investment returns which, in turn, reduces the incentive for funds to engage in fundamental research in SBS and underlying securities markets. *See, e.g.*, Zhen Shi, *The Impact of Portfolio Disclosure on Hedge Fund Performance*, WFA 2012 Las Vegas Meetings Paper (May 21, 2016), available at https://ssrn.com/abstract=1573151; Sitikantha Parida & Terence Teo, *The Impact of More Frequent Portfolio Disclosure on Mutual Fund Performance* (June 22, 2011), available at https://ssrn.com/abstract=2097883.

abandon investment positions and trading strategies that rely on SBS positions in order to protect their proprietary information.[26]

Public disclosure of position reports will also undermine the ability of market participants to implement and maintain effective and necessary hedging programs since it would provide other market participants with the ability to identify and impair their hedging strategies and prevent them from realizing the benefits of such strategies. For example, many SBS positions are built up or wound down using a multi-day pricing strategy. If such positions were disclosed before a market participant could finalize its desired position (which is a likely scenario given the extremely low reporting thresholds), competitors will be able to actively impair legitimate hedging strategies and other trading strategies. This will result in higher costs of doing business, which will in turn be passed on to issuers and consumers. Moreover, these consequences will drive some market participants out of SBS markets altogether and cause others to significantly limit their positions. Ultimately, this will inhibit liquidity and price discovery, and the ability of market participants to utilize SBSs for important purposes that the Commission favors, such as hedging and other risk-management activities that serve to reduce the cost of capital for issuers.

In turn, reduced liquidity and increased volatility in SBS markets will have a spillover effect that causes similar adverse consequences in the underlying securities markets. This is particularly the case in debt markets, as SBSs present a valuable and efficient tool for hedging debt positions. For example, the expectation that lenders can hedge their positions with credit default swaps ("**CDS**") while they either syndicate or assign parts of the loan allows them to conduct more lending activity within their net exposure limits. This permits borrowers to quickly raise the capital they need from a single source, which is particularly important in times of economic stress when borrowers typically need to borrow large amounts of money, and to do so quickly and efficiently. If lenders are unable to hedge such a position effectively because the Proposal's public disclosure requirements impair hedging strategies, they will reduce their lending capacity. This will likely result in higher costs of capital for borrowers or increased instances of default if borrowers cannot efficiently raise capital across a broader subset of initial lenders in times of financial distress.

Beyond the adverse impact on the use of SBSs for trading, hedging or investment purposes, the public disclosure of proprietary investment positions and trading strategies and the immediate one-day reporting requirement under the Proposal (discussed further in Part V.B below)

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[26] For example, corporate bond markets are relatively illiquid in the U.S., so it can be especially difficult to locate bonds in sufficient quantity to meet investment goals, and large purchases can distort market prices in the short term. SBSs can be a valuable tool for an investor to increase their economic exposure to a security, to derive benefit from their independent research without signaling the broader marketplace and losing much of the value of their independent research. Additionally, some funds gain exposure to foreign securities by exclusively trading SBSs because of limitations on their ability to trade directly in the underliers. Similarly, some funds gain exposure to publicly traded partnerships by exclusively trading SBSs because of the onerous tax reporting requirements associated with trading directly in such entities. Such funds will likely abandon these strategies if required to disclose proprietary information regarding the particular trade and other related positions. This would ultimately limit investment opportunities and lead to less-diversified funds with lower returns.

will also impede the ability of investors to engage with issuers and will ultimately harm companies, along with their shareholders and other stakeholders. Specifically, the combination of public disclosure and immediate reporting, which requires publication of strategies, will inhibit or preclude the use of SBSs as part of an effort to engage issuers on critical topics including environmental, social and governance ("**ESG**") issues, in addition to other issues that will benefit the issuer, its stakeholders and the markets generally. Shareholder engagement with management is critical for improving corporate governance and preventing management entrenchment. Before engaging with management, an investor often accumulates a position in an issuer in order to justify the financial commitments they make with respect to researching and collaborating with an issuer's management. Such investors may use a combination of underlying securities, SBSs and other derivative products to build a sizeable position while simultaneously hedging their economic exposure. Under proposed Rule10B-1, investors would be required to disclose their underlying equity and any related positions essentially immediately upon reaching the low notional SBS reporting thresholds.[27] This would force investors to choose between either publicly disclosing their entire trading strategy with respect to a particular issuer or pursuing a riskier investment strategy without the use of SBSs. To avoid such a result, many investors will forego pursuing engagement with issuers' management altogether. This will ultimately impair corporate governance and progress on important issues, including ESG, and deny shareholders and other stakeholders of the positive benefits associated with shareholder and management collaboration.[28]

These harmful effects will be further exacerbated by the particular categories of information that will need to be disclosed pursuant to the rule. As written, proposed Rule 10B-1 would require reporting persons not only to disclose their SBS positions, but also all underlying debt and equity positions, as well any other instrument "relating to" the SBS position and/or any underlying security or loan or group or index of securities or loans.[29] Even setting aside the fact that the requirement to disclose "related" positions is vague and ultimately unworkable as drafted, this provision would, in practice, require a reporting person to disclose substantial portions of its investment positions and trading strategies, merely because the person triggered a reporting threshold with respect to one particular SBS position. This expansive required disclosure will only serve to worsen the negative market impacts noted above.

The Proposal also fails to consider the costs to individual firms of public dissemination of proprietary information and the collateral impact that it will have on underlying

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[27] As discussed further in Part V.B below, the reporting threshold would be triggered well before existing beneficial ownership reporting requirements under Section 13 of the Exchange Act.

[28] A survey of the academic literature by Denes, Karpoff and McWilliams found that hedge fund activist campaigns tended to produce a 5 percent improvement in share prices on average over the first month of activist campaigns. Specifically, they identified nine papers that had studied activist campaigns and found positive stock price effects ranging from 3.4 percent to 7.0 percent. They further document "evidence that hedge fund activism is associated with increases in operating performance." *See* Matthew Denes, Jonathan M. Karpoff, Victoria McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. Corp. Fin. 405 (2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2608085, at pp. 410-411.

[29] Proposed Schedule 10B(6)-(8).

securities markets if research and hedging opportunities are diminished. Further, the Proposal does not appear to justify these costs against any of the perceived benefits of public reporting. As discussed further in Part II.C below, if the Commission believes additional reporting is required at all, it can achieve its goals of reducing fraud and mitigating counterparty risk without mandating public disclosure; it can also achieve its goal of mitigating systemic risk by setting the reporting thresholds at a significantly higher level.[30] Indeed, the public reporting element of proposed Rule 10B-1 appears to be a reaction to a single adverse market event—namely, the collapse of Archegos Capital Management ("**Archegos**").[31] While the Archegos situation may warrant changes in risk-management practices by some market participants, we respectfully submit that the Commission inappropriately, and incorrectly, assumes that the collapse of Archegos was caused by a lack of public transparency in SBS markets or that this incident could have been prevented by public disclosure of SBS positions.[32] Examinations into the circumstances surrounding the collapse of Archegos reveal certain risk-management and procedural issues that were not caused by information asymmetries.[33] In fact, our members inform us that SBS market participants have already introduced new risk-management procedures to address the circumstances that led to the Archegos collapse. It does not appear that the Commission has considered these new measures in assessing the cost-benefit analysis under proposed Rule 10B-1. Nor has the Commission considered whether Regulation SBSR reporting requirements would be equally effective at exposing these risks without incurring the collateral costs associated with public disclosure.

The SBS markets, populated by sophisticated counterparties, are integral in supporting hedging and other risk-management activities that increase the availability, and reduce the cost, of capital in underlying debt and equity markets. Rules that could disrupt these markets need to be promulgated only after careful and full consideration of the attendant costs. By not doing so, the Commission's actions could result in unintended negative impacts on markets and market participants, in potential violation of the Commission's obligations under the APA.

C. The Commission did not adequately consider less burdensome alternative methods of achieving the desired benefits of proposed Rule 10B-1.

The cost-benefit analysis required under the APA mandates that an agency assess potential alternatives to achieving its goals while imposing lower costs on affected parties. The

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30 *See* Part V.A for a discussion of the Proposal's method of calculating the reporting thresholds.

31 For a description of the circumstances leading to the collapse of Archegos, *see Credit Suisse Group Special Committee of the Board of Directors Report on Archegos Capital Management* (July 29, 2021), https://www.credit-suisse.com/about-us/en/reports-research/archegos-info-kit.html.

32 Nevertheless, even if this were the case, the Commission's stated objective of providing more transparency to security-based swap counterparties only requires disclosure to the specific counterparties. *See* Part II.C(ii) for a further discussion of bilateral counterparty disclosure as an alternative to public disclosure of SBS positions.

33 S*ee* Credit Suisse Group Special Committee of the Board of Directors Report on Archegos Capital Management (July 29, 2021), https://www.credit-suisse.com/about-us/en/reports-research/archegos-info-kit.html.

Proposal's current analysis of alternatives is limited to a discussion of who would be required to report SBS positions, how reporting thresholds would be set, what information should be reported on Schedules 10B and whether position limits would be a more effective alternative.[34] Notably, the Proposal fails to consider whether a regulatory reporting regime, bilateral counterparty disclosure, or a combination of these or other approaches, would achieve the Commission's goals without incurring the collateral costs and seriously detrimental impact associated with public disclosure of SBS positions.

i. Regulatory Reporting

As noted above, comparable large position reporting regimes introduced by the CFTC[35] and FINRA[36] do not involve the public dissemination of non-anonymized position reports. Similarly, the SEC's recently proposed short sale disclosure rules also do not require public dissemination of a market participant's positions.[37] The standard regulatory approach to large position reporting, then, does not require fully disclosed public reporting and yet has been effective in accomplishing their regulatory purposes. Proposed Rule 10B-1 dramatically departs from this standard by introducing a one-day public reporting regime that encompasses a market participant's entire strategy and trading portfolio in relation to a reference entity on which the person has a notional SBS position above $300 million—an extremely low threshold in the context of these markets. A departure of this magnitude from existing large position reporting regimes, which would also have the effect of making public positions that are specifically kept confidential under related regulatory regimes,[38] requires a specific cost-benefit analysis that the Proposal does not provide.

Before promulgating any final rule, we recommend that the Commission revisit the Proposal and consider whether disclosure of SBS positions to the Commission would be sufficient to address its stated concerns regarding systemic risk and market abuse.[39] This would facilitate

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34 Proposal, at pp. 6699-6701

35 *See Position Limits for Derivatives*, 86 Fed. Reg. 3236 (January 14, 2021); *Large Trader Reporting for Physical Commodity Swaps*, 76 Fed. Reg. 43851 (July 22, 2011).

36 *See* FINRA Rule 2360(b). Information filed with FINRA is not routinely made public, which is consistent with the nature and purpose of position limit requirements, as noted above.

37 *Short Position and Short Activity Reporting by Institutional Investment Managers*, Exchange Act Release No. 34-94313 (February 25, 2022).

38 For example, equity option position limits and reporting requirements that are specifically not subject to public disclosure under FINRA Rule 2360(b) would become subject to public disclosure if they are related to an SBS position that exceeds the reporting threshold under proposed Rule 10B-1. Similarly, equity positions that represent less than 5% of a class of securities that are specifically not required to be published under Section 13(d) of the Exchange Act would also become subject to public disclosure if they are related to an SBS position that exceeds the reporting threshold under proposed Rule 10B-1.

39 In doing so, the Commission should consider in its cost-benefit analysis whether a similar result can be achieved at a lower cost by analyzing Regulation SBSR data.

the Commission's market oversight responsibilities, while eliminating the costs associated with public disclosure for market participants. As discussed further in Part V below, any additional public dissemination of such reports should be based on its own cost-benefit analysis, using an appropriate data set, and should include only significant positions where the risk caused by the size of the position outweighs the substantial costs and adverse market consequences of disseminating proprietary information.

ii. Bilateral Counterparty Disclosure

The Proposal specifies that one of the goals of proposed Rule 10B-1 is to inform market participants of the existence of concentrated exposures to "allow counterparties to risk manage and lead to better pricing of the security-based swaps with respect to transactions with persons holding large positions in those security-based swaps."[40] We understand that this aim is, at least in significant part, a response to the collapse of Archegos. As discussed above, we respectfully submit that the Commission inappropriately associates the collapse of Archegos with a broader lack of public transparency in the SBS markets. We believe that the appropriate response to such a one-time failure is not to mandate a sweeping public disclosure regime, but instead to ensure that SBS counterparties have in place adequate risk-management procedures. SBS market participants are sophisticated institutions that can and do manage their counterparty risk and seek disclosure through their due diligence process without any Commission intervention, as has been the case in the wake of the Archegos collapse. Indeed, the emerging market practice is for SBS dealers to require disclosure of large, concentrated positions from their SBS counterparties.[41]

Notwithstanding our view that sophisticated SBS counterparties are capable of managing counterparty risk without regulatory intervention, to the extent that the Commission believes that disclosure of additional information is required to enable SBS market participants to analyze and price counterparty risk, such disclosure should be limited to a requirement of bilateral disclosure between potential SBS counterparties. The Commission could facilitate this by codifying existing SBS market best-practices regarding counterparty disclosure. This approach would facilitate the Commission's goal of increasing transparency between SBS counterparties without requiring broad, public disclosure that would result in the adverse consequences for SBS markets and underlying securities markets described in this letter.

D. The Proposal provides an inadequate comment period, which denies market participants the opportunity to assess and comment on the potential implications of the Proposal.

The APA requires that the Commission provide stakeholders with adequate notice and an opportunity to participate in the rulemaking process.[42] The 45-day comment period under

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40 Proposal, at p. 6667.

41 This includes ongoing notification requirements if an SBS counterparty's total position exceeds a certain threshold.

42 5 U.S.C. 553.

the Proposal does not provide market participants with sufficient time to assess and comment on the impact of proposed Rule 10B-1.[43] As noted above, proposed Rule 10B-1 represents a significant departure from other derivatives market large position reporting regimes. This requires a longer comment period to allow market participants to effectively consider the implications of the Proposal—both to their firm and with respect to the SBS markets generally. This is particularly important with respect to the Proposal, as the Commission places the burden on market participants to estimate the "potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation."[44]

The Commission also proposed Rule 10B-1 together with two other significant proposed rules that could significantly affect SBS markets and market participations.[45] Further, since the Proposal was released and the comment period began to run, the Commission has introduced ten new rules[46] and reopened two comment periods.[47] Not only does this deluge of rules make it difficult for market participants to dedicate the necessary resources to adequately consider and respond to each individual proposal, but it prevents them from considering how these

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43 The delay between publication by the Commission and publication on the Federal Register does not have the effect of extending the comment period, as market participants are not provided with information on the timing of the Federal Register publication, and therefore must plan accordingly for a 45-day comment period.

44 Proposal, at p. 6702.

45 The Proposal also includes re-proposed Rule 9j-1 *Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps* and proposed Rule 15F-4(c) *Prohibition Against Undue Influence Over Chief Compliance Officers*.

46 *Rule 10b5-1 and Insider Trading*, Securities Act Release No. 33-11013 (January 13, 2022), 87 Fed. Reg. 8686 (February 15, 2022); *Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, Investment Company Act Release No. IA-5950 (January 26, 2022), 87 Fed. Reg. 9106 (February 17, 2022); *Amendments to Exchange Act Rule 3b-16 Regarding the Definition of "Exchange"; Regulation ATS for ATSs That Trade U.S. Government Securities, NMS Stocks, and Other Securities; Regulation SCI for ATSs That Trade U.S. Treasury Securities and Agency Securities*, Exchange Act Release No. 34-94062 (January 26, 2022); *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Investment Company Act Release No. IA 5955 (February 9, 2022); *Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies*, Securities Act Release No. 33-11028 (February 9, 2022), 87 Fed. Reg. 13524 (March 9, 2022); *Shortening the Securities Transaction Settlement Cycle*, Exchange Act Release No. 34-94196 (February 9, 022), 87 Fed. Reg. 10436 (February 24, 2022); *Modernization of Beneficial Ownership Reporting*, Securities Act Release No. 33-11030 (February 10, 2022), 87 Fed. Reg. 13846 (March 10, 2022); *The Commission's Whistleblower Program Rules*, Exchange Act Release No. 34-94212 (February 10, 2022), 87 Fed. Reg. 9280 (February 18, 2022); *Short Position and Activity Reporting by Institutional Investment Managers; Notice of Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail for Purposes of Short Sale-related Data Collection*, Exchange Act Release Nos. 34-94313, 34-94314.

47 *Reopening of Comment Period for Pay Versus Performance*, Exchange Act Release No. 34-94074 (January 27, 2022), 87 Fed. Reg. 5751 (February 2, 2022); *Reopening of Comment Period for Reporting of Securities Loans*, Exchange Act Release No. 34-94315 (February 25, 2022), 87 Fed. Reg. 11659 (March 2, 2022).

other proposed rules impact the substantive implications of the Proposal. The Commission has not adequately considered the cumulative effect of the multitude of disclosure rules proposed in the past two months and, by imposing a short 45-day comment period, it prevents market participants from conducting their own analysis within the allotted comment period. For example, the SEC's proposed *Modernization of Beneficial Ownership Reporting* will have a significant effect on how market participants respond to proposed Rule 10B-1, as both regimes bear on a market participant's reporting requirements with respect to securities and related products. The beneficial ownership proposal was introduced on February 10, in the course of the proposed Rule 10B-1 comment period. In doing so, the Commission altered the regulatory environment and assumptions that market participants had been relying on in assessing the impact of Rule 10B-1 and has cut back on the already limited amount of time that market participants have been given to assess and comment on the Proposal.

Collectively, these factors necessitate a longer comment period in order to provide market participants with an opportunity to consider the implications of the Proposal. By failing to provide sufficient time for market participants to consider all of the potential implications of proposed Rule 10B-1, especially in the context of the Commission's other proposals, we believe that the Commission has failed to satisfy its statutory obligations under the APA to provide for adequate notice and a sufficient comment period in connection with its rulemaking authority.

III. Proposed Rule 10B-1 exceeds the Commission's statutory authority under Section 10(d) of the Exchange Act.

The scope of proposed Rule 10B-1 is contrary to the intended purpose of the large trader reporting regime outlined in Section 10B of the Exchange Act and therefore exceeds the Commission's statutory authority.[48] Section 10B of the Exchange Act, which was enacted as part of the Dodd-Frank Act, provides the Commission with the authority to establish limits on the size of positions in SBSs and related instruments that may be held by any person, to the extent such limits are "reasonably designed to prevent fraud and manipulation."[49] It also authorizes the Commission to require aggregation of positions and to adopt exemptions from position limits.[50] The focus of Section 10B, therefore, is on the establishment and enforcement of position limits on SBSs, and the reporting provisions in Section 10B(d) must be read in that context. Accordingly, subsection (d) cannot be viewed as a general grant of authority with respect to reporting of SBSs generally, but rather as an authorization to impose reporting requirements that pertain and are necessary to the enforcement of position limits.[51] Proposed Rule 10B-1, then, clearly exceeds the authority granted to the Commission by Congress.

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48 15 U.S.C. 78j-2.

49 15 U.S.C. 78j-2(a).

50 15 U.S.C. 78j-2(a),(b).

51 Courts have declined to grant regulators general or broad authority, and have struck down regulations, when the regulator fails to ensure that the regulations are consistent with the purpose and requirements of

Section 10B(d) is entitled "Large Trader Reporting" and is intended to permit the Commission to require reports of positions in SBSs only to the extent necessary in order to apply and enforce any position limit rules that the Commission adopts, consistent with the mandate of Section 10B to prevent fraud and manipulation. Specifically, Section 10B(d) states that the Commission may require any person effecting transactions in SBSs, or related securities or loans, "as set forth in paragraphs (1) and (2) of subsection (a) under this section to report such information as the Commission may prescribe regarding any position or positions" in any SBS or related securities or loans.[52] The fact that this subsection is included in Section 10B, and expressly refers to subsections (a)(1) and (a)(2) of Section 10B, which include the grant of authority to the Commission with respect to position limits, supports the interpretation that the reporting requirement referred to in subsection (d) relates to reports in connection with position limits. The use of the term "large trader reporting" in the sub-heading is intended to limit any reporting to that necessary in order to enforce position limits, and the Commission's authority under the subsection is limited accordingly.

The purpose of position limits is to assist regulators in preventing and detecting attempts to manipulate or otherwise disrupt the markets through the establishment of limits on positions that are capable of affecting market prices. Preventing manipulation and market disruption is a core regulatory function, and the public has not generally had access to information gathered in connection with existing position limit regimes that are administered under the Exchange Act[53] or the Commodity Exchange Act and that are designed for anti-manipulation and anti-disruption purposes.[54]

Interpreting Section 10B to allow for public dissemination of SBS positions would also be inconsistent with the Commission's approach with respect to other provisions of the Exchange Act. The Dodd-Frank Act amended the Exchange Act to require reporting of SBS transactions to SBS data repositories. Those sections of the statute, however, make it clear that information that is made publicly available must be anonymized and must avoid public disclosure

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the relevant statutory provisions. *See International Swaps and Derivatives Association, et al.* v. *United States Commodity Futures Trading Commission*, 887 F. Supp. 2d 259 (D.D.C. 2012).

52 15 U.S.C. 78j-2(d).

53 We note that equity options position limits are established in FINRA Rule 2360(b) and reporting of positions to FINRA is required by FINRA Rule 2360(b)(5). Information filed with FINRA is not routinely made public, which is consistent with the nature and purpose of position limit requirements, as noted above.

54 The CFTC, as noted, was granted similar authority to impose position limits on futures and swap positions and it has exercised that authority by adopting a position limit regime with respect to futures and swaps on physical commodities. That regime includes large trader reports as well as the submission of detailed information in connection with hedge exemption requests, which can also be administered by the exchanges. The reports filed with the CFTC by market participants are confidential, and in adopting its position limit rules, the CFTC expressly noted the sensitivity of information submitted by market participants and reminded the exchanges of the importance of protecting the confidentiality of this information. *See Position Limits for Derivatives*, 86 Fed. Reg. 3236, 3375 (January 14, 2021).

of market participants' positions. Specifically, Section 13(m)(C)(iii) of the Exchange Act states that "the Commission shall require real-time public reporting for such transactions, in a manner that does not disclose the business transactions and market positions of any person."[55] Pursuant to this provision, the Commission's Regulation SBSR, governing the reporting of SBSs and the operation of SBS data repositories, specifically prohibits disclosure of information regarding the identity of any counterparty to an SBS.[56] It would obviously be inconsistent with these provisions (and Congress's intent), and would undermine the protections of confidentiality mandated by these provisions, if the Commission could nevertheless require public disclosure of position information pursuant to Section 10B that is required to be kept confidential by Section 13(m)(C)(iii). It is clear, therefore, that Section 10B provides no such authority.

Congress recognized the unique aspects of SBS markets and tailored the large trader reporting provisions as such. Congress's approach reflects the intention that large trader reporting requirements should be narrowly tailored and limited to instances where the Commission has enacted position reporting limits. It does not, as proposed Rule 10B-1 would require, reflect an intention that information about significant numbers of SBS positions should be made available to the public. As noted above, SBS arrangements are complex contractual arrangements that are customized and negotiated between sophisticated counterparties and confidentiality is of the utmost importance in enhancing the liquidity and overall functionality of the SBS markets. While we recognize that SBS markets present certain risks, we also urge the Commission to implement rules that are tailored to such risks, as intended—and required—by Congress under the Dodd-Frank Act.

IV. If the Commission believes, after further consideration of the costs of the Proposal and the other issues addressed in this letter, that a rulemaking is still necessary and appropriate, it can achieve its goals without excessive disruption of markets and the imposition of undue burdens on market participants by adopting less burdensome requirements under a regulatory reporting rule similar to the CFTC's large trader reporting rules.

The Commission has stated that its core policy goals in proposing Rule 10B-1 are to improve its oversight of, and prevent opportunistic and manipulative behavior with respect to, SBS markets, and to improve transparency between SBS counterparties to facilitate more accurate pricing of counterparty risks in the SBS markets. Given the integral role that SBSs play in the real economy, such reporting requirements, if the Commission determines that they are needed at all, must be tailored in a manner that advances the Commission's specific policy objectives without imposing undue costs on market participants or restricting the operation of the markets. We respectfully submit that Rule 10B-1, as proposed, fails to adopt such an approach. The Proposal applies a one-size-fits-all approach to the type of information that is required to be disclosed, to *whom* it is disclosed and *when* that information is required to be disclosed. This approach will result in significant costs to market participants and the SBS markets (as well as related securities

[55] 15 U.S.C. 78m(m)(C)(iii).

[56] 17 C.F.R. 242.902(c)(1).

markets) and could result in a number of market participants exiting the market or significantly reducing their SBS positions. This will in turn result in reduced liquidity in SBS markets, increased costs of capital for issuers and generally increased systemic risks as more market participants decide to hold unhedged positions rather than incur the indirect costs of participating in SBS markets under proposed Rule 10B-1.

The Commission does not appear to have considered these costs, nor has it considered alternative approaches that could achieve its goals at a lower cost to market participants. In particular, as discussed above, the Commission has not adequately considered, or considered at all, whether a regulatory reporting regime or bilateral counterparty disclosure requirements is a more effective means of achieving its goals. We therefore recommend that the Commission revisit proposed Rule 10B-1 in light of this feedback and develop a new, properly tailored proposed Rule 10B-1 that is resubmitted for comment with appropriate timelines for market participants to consider its potential impact.

If the Commission elects to proceed with proposed Rule 10B-1 without undertaking an additional cost-benefit analysis, we recommend that the Commission proceed with a rule that is substantially similar to the CFTC's large trader reporting rules.[57] The CFTC's rules provide the CFTC with the information it needs on swap transactions and large swap positions in order to exercise its market oversight functions. At the same time, it preserves the confidentiality of each market participant's proprietary investment positions and trading information so as to lessen the adverse effects of the rule on swap markets and underlying commodity markets.[58] We believe that

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[57] *See* 17 C.F.R. 15.00 *et seq.* through 17 C.F.R. 21.00 *et seq*.

[58] The CFTC explains that:

> Under the [the CFTC's Large Trader Reporting System,] clearing members, [futures commission merchants], and foreign brokers (collectively called reporting firms) file daily reports with the [CFTC] under Part 17 of the CFTC's regulations. The reports show futures and option positions of traders with positions at or above specific reporting levels as set by the [CFTC]. Current reporting levels are found in CFTC Regulation 15.03(b).
>
> If, at the daily market close, a reporting firm has a trader with a position at or above the [CFTC's] reporting level in any single futures or option expiration month, the firm reports that trader's entire position in all futures and options expiration months in that commodity, regardless of size.
>
> The [CFTC] has the discretion to raise or lower the reporting levels in specific markets to strike a balance between collecting sufficient information to oversee the markets and minimizing the reporting burden on traders that are reportable.
>
> Aggregate data concerning reported positions are published by the CFTC in its weekly Commitments of Traders reports. The data are aggregated to protect the identity of any individual reportable trader.

a similar approach to SBS position reporting would achieve the Commission's goal of improving oversight of and preventing manipulative behavior in the SBS markets.

As discussed above, since the collapse of Archegos, market participants, and in particular, SBS dealers, have been restructuring their SBS counterparty requirements to mandate disclosure by their counterparties of large, concentrated positions. We believe that this market practice is effective at mitigating systemic risk in SBS markets. However, if the Commission subsequently determines, after an appropriate cost-benefit analysis, that additional transparency is required in SBS markets, we recommend that the Commission introduce a rule that codifies existing best-practices regarding mandatory counterparty disclosure in SBS transactions without requiring public disclosure of such information.

Together, these approaches would achieve the Commission's goals of improving oversight over and preventing manipulative behavior in SBS markets, as well as reducing systemic risks by improved pricing of SBSs through increased transparency between SBS counterparties, without imposing on the SBS markets the significant costs and seriously detrimental effects of public disclosure.

V. If the Commission believes, after further consideration, that a rulemaking is still necessary and appropriate, the Commission should ensure that its approach to position reporting in the final rule takes into account all of the additional direct and indirect operational and strategic costs associated with compliance.

Regardless of the Commission's ultimate approach to SBS position reporting under proposed Rule 10B-1—but specifically if the Commission does not accept our recommendations set forth in Part IV above—the Commission should reassess certain aspects of the proposed Rule that will impose significant and unwarranted operational burdens on market participants, in addition to the costs of public disclosure.

A. The Commission failed to consider available data in setting the reporting thresholds, resulting in reporting requirements that are excessively burdensome and inconsistent with the Commission's stated goals.

Proposed Rule 10B-1 provides for different reporting thresholds based on the type of SBS position.[59] In short, with the exception of lower reporting requirements for net long and

> Since traders frequently carry futures positions through more than one broker and control or have a financial interest in more than one account, the [CFTC] routinely collects information that enables it to aggregate related accounts.

For more information, *see* Commodity Futures Trading Commission, *Large Trader Reporting Program*, available at https://www.cftc.gov/IndustryOversight/MarketSurveillance/LargeTraderReportingProgram/index.htm.

[59] Proposed Rule 10B-1(b)(1). CDSs are reportable when a reporting person has a net long or net short notional CDS position of $150 million. SBS positions in each of CDS, debt SBSs and equity SBSs are reportable upon reaching a gross notional SBS position of $300 million. In the case of equity SBSs, upon reaching a gross notional equity SBS position of $150 million, the reporting threshold calculation also

short credit default swap positions and a potentially lower percentage threshold for equity SBSs, proposed Rule 10B-1 generally provides a $300 million gross reporting threshold that applies equally to CDS, debt SBSs and equity SBSs.[60]

We respectfully submit that these proposed thresholds are extremely low, will impose undue burdens on market participants and the Commission, do not adequately take into consideration the nature of hedging or other offsetting positions and will ultimately be counterproductive as a result. In addition, the proposed thresholds are not tailored to take into account differences among SBSs and participants in these markets, which should be reflected in the Proposal. For example, the average market capitalization of an S&P 500 listed issuer is $77 billion, and the median market cap is $31 billion.[61] The proposed reporting threshold for gross equity SBS positions of $300 million therefore represents less than one-half of a percent of the average market cap of S&P issuers and less than one percent of the median market cap.[62] It is not reasonable to suggest that an SBS position on less than one percent of the outstanding securities of a large public company represents a large position or a position that could pose significant risk for issuers or other market participants. While comparable data is less readily available with respect to the other reporting thresholds, given the size of the debt markets in the United States, we have no doubt that the same concerns would arise with respect to the proposed debt SBS reporting thresholds. We also note that the proposed thresholds are far lower than those established under comparable regimes. For example, it is significantly lower than the 5% beneficial ownership reporting threshold provided for in Section 13(d) of the Exchange Act.[63] The proposed thresholds will therefore result in a large number of reports that do not reflect large or concentrated positions, which will in turn impose unnecessarily high costs on market participants and a vast number of

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includes the value of underlying securities and delta-adjusted option, future, and other derivative positions. Equity SBS positions are also reportable where the reporting person has an SBS-equivalent position that represents more than 5% of a class of equity securities (which includes underlying equity securities and shares attributable to options, futures, and other derivatives if the security-based swap position exceeds 2.5%).

60 Proposed Rule 10B-1(b)(1). Although the equity security-based swap reporting thresholds are subject to a percentage threshold test, the definition of reporting threshold contemplates the "lesser of" a percentage threshold test and a $300 million gross notional exposure test. Accordingly, a reporting person would be required to disclose a gross notional equity security-based swap position of $300 million regardless of the respective security-based swap equivalent position.

61 As of February 28, 2022 based on the S&P Dow Jones Indices, S*&P 500 (USD) Factsheet*, https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview.

62 These figures become increasingly smaller when considered in the context of an SBS position with sufficient exposure to a narrow-based basket, particularly to the extent either party has the right to change any component security. For example, an SBS position with a $300 million gross notional exposure to a narrow-based basket with multiple, equally-weighted component securities may represent no more than a truly fractional exposure to any single component security and may, over time, be entirely non-representative of exposure to any particular component security as a result of substitutions.

63 15 U.S.C. 78m(d).

Schedules 10B (which could be required to be amended on a daily basis) that do not provide any useful information and cannot be used for their intended purposes.

Furthermore, though the potential risks posed by any particular transaction depend on the type of SBS position and the reasons for entering into such positions, the proposed Rule applies the disclosure regime based on the blunt application of the reporting thresholds detailed above. For example, the Commission has not indicated how a $300 million fully hedged SBS position that references the equity of a $500 billion investment-grade issuer would present any material market risks. While the Commission notes that particular situations and events have raised concerns,[64] these situations have been extremely rare and represent at most a vanishingly small portion of the overall SBS markets. However, proposed Rule 10B-1 applies the same general reporting requirements and thresholds to all SBS positions and market participants, regardless of differences in particular transactions and reference entities.[65] Instead of tailoring proposed Rule 10B-1 to address the concerns raised by the Commission, the Proposal applies a one-size-fits-all reporting regime to all SBS market transactions and participants, which will have detrimental effects that will far outweigh any benefits from the Proposal. Put simply, the proposed thresholds are arbitrary, not aligned with the Commission's stated goal of reducing systemic risk for issuers and other investors and unjustified by the Commission's cost-benefit analysis.

We also respectfully disagree with the Commission's assertion that requiring reporting based on low thresholds is needed to ensure that market participants will have access to information about their counterparties' overall exposure to the market. SBS counterparties are sophisticated and well-equipped to manage counterparty risk through their contractual arrangements. Indeed, it is common market practice for SBS counterparties to conduct diligence before entering into SBSs and to evaluate and protect against risk exposure as deemed appropriate under the circumstances. Further, as discussed above, to the extent that the Commission nonetheless believes that required disclosure is necessary, we respectfully submit that a bilateral disclosure regime, without broad public disclosure, would be more appropriate.

We also note that the thresholds are based predominantly on gross positions, rather than net positions. Using a gross metric is inappropriate for a number of reasons. First, it artificially inflates and misstates the market exposure held by a market participant. Netting is standard market practice and, in fact, is encouraged by regulators, including the Commission, in various contexts. Basing thresholds on gross positions is also inconsistent with the fact that

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64 Proposal, at pp. 6656-6657.

65 We further note that the Proposal fails to distinguish between products within each type of SBS, some of which are not susceptible to the purported risks which the Proposal is intended to address. For example, sovereign CDS can provide a useful hedge instrument to offset sovereign credit risk in emerging markets and improve financial stability. These CDS positions are a small fraction of the total value of sovereign debt in issue and unlikely to be the impetus for a manufactured credit event. Further, they may create positive externalities for the underlying debt markets as sovereign CDS spreads may serve as a better indicator of sovereign credit risk than traditional ratings. *See* Ivan M. Rodriguez, Krishnan Dandapani, Edward R. Lawrence, *Measuring Sovereign Risk: Are CDS Spreads Better than Sovereign Credit Ratings?*, 48 Fin. Mgmt. 229 (2018).

offsetting positions cancel out market exposure. Using a gross metric will similarly result in unnecessary disclosure of SBS positions that do not represent concentrated positions. Not only will this unnecessarily increase compliance costs for market participants, but it will also make it more difficult for regulators and other market participants (to the extent public disclosure is required) to identify large positions or instances of improper behavior that proposed Rule 10B-1 is designed to address. These concerns are further exacerbated by the fact that the proposed thresholds appear to require duplicative reporting in instances where an SBS based on a narrow-based security index both exceeds the reporting threshold and such index or basket is composed of one or more securities, the weighting of which in the index exceeds the reporting threshold.[66] These issues will result in over-reporting and reports that do not provide the market or the Commission with useful information.

Accordingly, we recommend that the Commission reevaluate and recalibrate the reporting thresholds more appropriately. In order to set appropriate reporting thresholds, the Commission will need to conduct an appropriate analysis using a suitable dataset. The Commission notes that the proposed reporting thresholds are developed using a subset of data from the Depository Trust and Clearing Corporation Trade Information Warehouse ("**DTCC-TIW**") and a subsample of total return swap data from Form N-Port.[67] In fact, the Proposal itself recognizes the significant limitations associated with such datasets, but, inexplicably, relies on this admittedly inadequate data nevertheless in justifying the proposed thresholds.[68] This is particularly problematic for reporting thresholds based on equity SBSs, which the Commission acknowledges were established despite having "limited data regarding the activity of market participants in equity swaps."[69] We respectfully submit that the Commission's admissions in this regard simply underscore the fact that it has not satisfied its statutory obligations in issuing the Proposal.

Moreover, the Commission's reliance on an inadequate dataset is difficult to understand, given that it now has access to Regulation SBSR data, and that it will have access to additional historical data as soon as April 14, 2022. In order to conduct an appropriate cost-benefit analysis, the Commission should refrain from establishing reporting thresholds until it has had the opportunity to consider an appropriate dataset. We believe that the data to be received via

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66 For example, an SBS position with a $600 million gross notional exposure to a narrow-based basket, with respect to which a component security is weighted at 50% of the basket, would invite duplicative reports—one with respect to the basket and one with respect to the component security.

67 Proposal, at pp. 6670-6671.

68 *Id*. at p. 6683.

69 *Id*. at p. 6683, n.221. We also note that the Commission had access to data from swap data repositories prior to publishing the Proposal, which would have been a more suitable data source for non-CDS instruments, which it does not appear to have considered when setting the reporting thresholds.

Regulation SBSR[70] could be helpful in this regard, and the Commission should, at the very least, take this information into account before promulgating any final rule.

B. The Proposal's reporting requirements place an excessive operational burden on market participants which is disproportionate to the perceived benefits of the proposed Rule.

The Commission optimistically, and unrealistically, projects that proposed Rule 10B-1 will cost each market participant approximately $101,740 in initial implementation costs and will, in fact, increase the number of market participants in SBS markets by reducing transaction costs.[71] This assumption grossly underestimates the compliance cost burden of proposed Rule 10B-1 and overstates the potential savings due to reduced transaction costs. Instead, we respectfully submit that the costs associated with complying with the proposed Rule will not only discourage new participants in the SBS markets but are also likely to cause many current participants to reduce or eliminate their participation in such markets.

In order to comply with proposed Rule 10B-1, market participants will be required to continuously calculate their exposure to SBSs, underlying securities, security indexes, the delta-adjusted notional amount of any options, security futures and other derivative instruments and other related positions.[72] Not only will market participants be required to make such complex calculations each time they enter into a new SBS arrangement, but the Schedule 10B amendment requirement, which would be triggered upon a 10% change in a previously reported position,[73] would require market participants to constantly and continuously perform these calculations.

Specifically, these calculations will need to be run on a daily basis based on the current one-day reporting requirement for both initial Schedule 10B reports and Schedule 10B amendments.[74] No comparable reporting regime, even in the context of less complex instruments, requires compliance with these types of timelines.[75] For example, Schedule 13D reports, which only require beneficial ownership calculations across a single class of securities, provide a 10-day

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70 17 CFR 242.900 *et seq*. Data will be more readily available under Regulation SBSR following the upcoming April 2022 compliance data. *See* U.S. Securities and Exchange Commission, *Frequently Asked Questions on Regulation SBSR* (Modified October 21, 2021), https://www.sec.gov/tm/faqs-reg-sbs-implementation.

71 Proposal, at p. 6689.

72 Proposed Rule 10B-1(b).

73 Proposed Rule 10B-1(c).

74 Proposed Rule 10B-1(a)(2), 10B-1(c)

75 If the current one-day reporting requirement is even feasible, we are concerned that a significant unintended consequence of the reporting timeline will be inadvertent errors on Schedule 10B reports and Schedule 10B amendments. Such inadvertent errors will make it more difficult for regulators and other market participants (to the extent public disclosure is required) to identify large positions or instances of improper behavior that proposed Rule 10B-1 is designed to address.

reporting timeline.[76] Rule 13d-1 also provides an extended annual periodic reporting requirement for certain institutional market participants that acquire securities in the ordinary course of business with no intention of influencing the issuer.[77] Similarly, Rule 13f-1 institutional investor reporting requirements only require reporting persons to file reports 45 days after each quarter.[78]

No market participants currently have this type of compliance functionality in place. SBS dealers, which are subject to other reporting requirements, have implemented certain compliance systems, but the reporting requirements under the proposed Rule cannot be covered by existing systems.[79] Furthermore, the proposed Rule will apply to all persons involved in the SBS markets, not just SBS dealers, and will therefore represent a novel and onerous requirement on many market participants. Our members estimate that the cost of building a new reporting system to comply with proposed Rule 10B-1 would be significant multiples of the cost estimates in the Proposal.[80] For example, the Proposal estimates that the compliance infrastructure could be developed by a team of one senior programmer and one senior systems analyst, each working 160 hours, with only 20 hours of support from a Compliance Attorney and 10 and 5 hours of support, respectively, from a Compliance Manager and Director of Compliance.[81] It is unclear how the Commission established these estimates. Even minimal stakeholder engagement efforts would have revealed that each of these estimates would be wholly inadequate to build a compliance infrastructure to support a one-day reporting requirement that requires aggregation of positions across multiple trading desks. These costs present a barrier to certain firms (particularly smaller ones) from engaging in the SBS markets and will likewise discourage participation by larger participants as well. Ultimately, prohibitive compliance costs will result in reduced liquidity and ability to engage in hedging and other legitimate market activity and will increase the cost of funding for issuers.

The Commission's underestimation of the cost to build a novel reporting system suggests that its cost-benefit analysis with respect to the operational burden of proposed Rule 10B-1 is inadequate. We believe that this is partially caused by the Commission's reliance on a faulty

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76 17 C.F.R. 240.13d-1(a).

77 17 C.F.R. 240.13d-1(b).

78 17 C.F.R. 240.13f-1; *see also* Susan E. Christoffersen, Erfan Danesh & David K. Musto, *Why Do Institutions Delay Reporting Their Shareholdings? Evidence from Form 13F*, Rotman School of Mgmt. Working Paper No. 2661535, 27th Annual Conference on Financial Economics and Accounting Paper (August 15, 2015), https://ssrn.com/abstract=2661535.

79 The Proposal's requirement for SBS dealers to aggregate positions across types of securities, as opposed to reporting individual transactions, prevents them from relying on existing Regulation SBSR reporting systems to facilitate proposed Rule 10B-1 reporting.

80 As discussed in Part II.D above, the 45-day comment period did not provide market participants with sufficient time to analyze and provide exact quantifications of the estimated costs of proposed Rule 10B-1.

81 Proposal, at p. 6678, n.169.

dataset that is not representative of SBS markets.[82] Accordingly, in order to fulfill its duty to adequately consider the costs and benefits of the Proposal, we recommend that the Commission refrain from finalizing the rule and establishing reporting timelines and thresholds at least until it has had an opportunity to review Regulation SBSR data, which is more representative of SBS markets. This would also permit the Commission to assess the cumulative costs of proposed Rule 10B-1 in connection with the many other proposals that have been introduced in the past three months, many of which will involve substantial technical enhancements to existing systems.

If the Commission nevertheless moves forward with the Proposal based on the current dataset, we recommend that the Commission amend the reporting timelines to align with existing Section 13 reporting timelines. Existing public disclosure requirements under the Exchange Act are designed to mitigate costs for market participants and preserve the confidentiality of a market participant's proprietary investment positions and trading strategies, while also advancing the Commission's policy objectives. For example, Section 13 reporting requirements include reporting timelines that attempt to take into account the circumstances of various market participants. In particular, we note that institutional investors that acquire securities in the ordinary course of business with no intention of effecting change or influencing control of the issuer report on a quarterly basis on Form 13F[83] and/or an annual basis on Schedule 13G.[84] This approach reflects an understanding by the Commission that proprietary information should remain confidential to the extent that public disclosure is unnecessary to further the Commission's specific objectives so as to allow market participants to reap the benefits of legitimate investments they make into research and analysis of SBS markets. Conforming the Proposal to the requirements and procedures under other reporting regimes would also reduce initial implementation costs for market participants by allowing them to leverage their existing reporting systems in order to comply with proposed Rule 10B-1.

C. The requirements under proposed Rule 10B-1 to aggregate SBS positions across independent business units unnecessarily increases compliance costs and deters market participation.

In its current form, proposed Rule 10B-1 would require all persons under common control to aggregate their SBS positions for the purpose of calculating applicable reporting thresholds and reporting SBS positions on a Schedule 10B.[85] Unlike comparable SEC reporting

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82 Specifically, the Proposal notes that DTCC-TIW data is a "voluntary database where market participants on a voluntary basis submit transaction, and end of week holdings" and that it does not include intra-weekly CDS position information nor any information on underlying security holdings of reference entities. *See* Proposal, at p. 6683, n.220. With respect to N-Port data, the Commission notes that the subset of reporting filers "may not be representative of the 'average' trading entity in the security-based swap market and in particular, the 'average' trading entity in the total return, or total equity swap market." *See* Proposal, at p. 6697, n.221.

83 17 CFR 240.13f-1.

84 17 CFR 240.13d-1(b)(2).

85 Proposed Rule 10B-1(a)(1).

rules under Section 13 of the Exchange Act that permit independent business units with appropriate information barriers to calculate position limits and file reports separately,[86] proposed Rule 10B-1 does not provide for a similar exception. By requiring independent business units under common legal control to aggregate SBS positions despite the existence of adequate information barriers, proposed Rule 10B-1 imposes unnecessary compliance costs and will deter market participants from trading in SBS markets.

Market participants have developed intricate and effective reporting systems designed to preserve the information barriers required to disaggregate positions under Section 13's beneficial ownership reporting requirements. In its current form, proposed Rule 10B-1 would require market participants to build new reporting systems that aggregate data across systems that were previously separated by complex information security barriers. This would significantly increase the cost above the Commission's already misconstrued estimated implementation cost of $101,740.[87] Further, this aggregation requirement may jeopardize the ability of market participants to rely on the same information barriers to disaggregate positions under Section 13, as well as other safe harbors that rely on information barriers.[88]

To avoid these unnecessary costs, our members inform us that many market participants may cut back their participation in SBS markets or refrain altogether. This will disproportionately impact smaller market participants that do not conduct the necessary level of SBS activities to justify the increased compliance costs. It will also act as a significant barrier to entry for new market participants in SBS markets. Together, this will reduce liquidity and increase volatility in SBS markets. It will also lead to a greater concentration of SBS positions among a few larger participants, which ultimately increases systemic risk in the SBS markets.

To avoid these costs, the Proposal should be amended to, at a minimum, permit reporting persons to disaggregate SBS positions across independent business units that are separated by suitable information barriers. To simplify compliance, we recommend that the Commission clearly specify that the same information barriers that are applicable in the context of Section 13 also apply to proposed Rule 10B-1. We also believe that this approach will not only reduce compliance costs for market participants, but it would also further the Commission's objectives in that it would result in reports that more accurately indicate the positions of independent trading units.

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86 *See, e.g., Amendments to Beneficial Ownership Reporting Requirements*, Exchange Act Release No. 34-39538 (January 12, 1998), 63 FR 2854, 2857-2858 (January 16, 1998).

87 Proposal, at p. 6678. *See* Part V.B for a discussion of the Commission's estimated implementation costs.

88 For example, Rule 10b5-1 provides an affirmative defense to insider trading offenses in certain instances where there are appropriate information barriers between trading desks. *See* 17 C.F.R. 240.10b5-1.

D. Proposed Rule 10B-1 places U.S. SBS markets and market participants at a competitive disadvantage compared to non-U.S. SBS markets and market participants.

In its current form, proposed Rule 10B-1 would require both U.S. and non-U.S. persons to disclose their SBS positions (and related positions in underlying securities) if "*any of the transactions* that comprise the security-based swap position" would be reportable pursuant to Rule 908(a) of Regulation SBSR.[89] Therefore, any U.S. person that is directly or indirectly an SBS counterparty is subject to proposed Rule 10B-1, regardless, for example, of the jurisdiction of the SBS underlier or reference entity. The required U.S. nexus can be even more remote—for example, any SBS transaction that is merely accepted for clearing by a U.S. clearing agency would result in the SBS position being reportable under proposed Rule 10B-1, regardless of whether the reference entity or the other counterparty is a U.S. person. By contrast, if a non-U.S. person trades SBSs on a non-U.S. underlier or reference entity, the SBS position would only be reportable if one of the counterparty, clearing agent, platform or broker-dealer (if any) is a U.S. person. This would, therefore, require all non-U.S. persons active in the U.S. SBS market to continuously monitor whether a particular SBS transaction is traded with, cleared by, or executed via a U.S. counterparty, clearing agency, platform or broker-dealer, respectively.[90]

Not only is the cross-border application of the proposed Rule complex and potentially unworkable, but it also significantly disadvantages U.S. SBS markets and U.S. issuers, relative to non-U.S. market participants. To avoid the public disclosure requirements and other operational costs associated with proposed Rule 10B-1, we expect that non-U.S. counterparties will structure their SBS transactions in a manner that avoids triggering any of the Rule 908(a) reporting categories by, for example, not using U.S. clearing agencies or registered broker-dealers. As such, proposed Rule 10B-1 incentivizes foreign counterparties trading SBSs on non-U.S. reference entities to avoid U.S. SBS dealers, exchanges and clearing agencies in order to protect their proprietary investment positions and trading information. This will ultimately disadvantage U.S. market participants, reduce liquidity and increase volatility in U.S. SBS markets. It will also increase concentration risk for U.S. SBS dealers, which will increase, rather than decrease, systemic risk in the U.S. securities markets.[91] The disparate treatment of U.S. SBS parties will put them at a disadvantage compared to non-U.S. SBS parties, as the proposed Rule will require all of such U.S. participants' daily positions to be publicly reported.[92] Moreover, this will in turn permit non-U.S. SBS investors to front-run U.S. SBS investors' positions, thereby discouraging research

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89 Proposed Rule 10B-1(d)(1) (emphasis added); 17 C.F.R. 242.908(a).

90 *See* 17 C.F.R. 242.908(a)(1).

91 As foreign counterparties continue to prefer non-U.S. SBS dealers when trading SBSs referencing foreign issuers, U.S. SBS dealers' SBS positions will become increasingly concentrated with SBSs that reference U.S. issuers. This will ultimately increase their exposure to a specific geographic region, as well as potentially certain industries, which will increase systemic risks in U.S. SBS markets.

92 In contrast, non-U.S. SBS investors are able to trade without public disclosure of their SBS positions on non-U.S. underliers or reference entities.

in the U.S. SBS markets. All of these effects will adversely impact U.S. issuers as well, who will pay a higher cost of capital to compensate investors for the increased cost of hedging their investments in U.S. issuers. The Commission does not appear to have considered these costs or any potential alternatives in formulating the cross-border application of the Proposal.

E. Non-anonymized disclosure of SBS positions should be limited to regulatory and/or direct counterparty disclosure until the SEC has conducted a full cost-benefit analysis with appropriate data.

As discussed in Part II.C, we believe that the Commission's goals can be achieved by introducing targeted reporting regimes that limit SBS position disclosure to the Commission and potential SBS counterparties, as needed. At the very least, this should be the initial approach adopted by the Commission until it has conducted a full cost-benefit analysis that considers—based on an adequate dataset—the adverse consequences of the public dissemination of proprietary investment positions and trading information.

Accordingly, we recommend that the Commission refrain from finalizing proposed Rule 10B-1 until it has had the opportunity to review the impact of Regulation SBSR on SBS markets. Indeed, we believe that Regulation SBSR will provide the Commission with sufficient information to regulate SBS markets. Unless and until these rules prove to be unsuccessful, the Commission should refrain from introducing public disclosure requirements that could result in significant adverse consequences for market participants, as well as the SBS markets and underlying securities markets. In the event that the Commission proceeds with the Proposal, it should, at the very least, refrain from mandating the public dissemination of Schedules 10B in the first instance. The Commission could review the data received under Regulation SBSR and proposed Rule 10B-1 to more accurately assess the costs and the benefits of a broad public disclosure regime. If the data suggests that public disclosure is required, the Commission should re-propose a public reporting regime that is more appropriately structured to address risks that cannot be addressed by a regulatory or counterparty disclosure regime alone, as well as justified by an adequate cost-benefit analysis using an appropriate dataset that is representative of SBS markets.

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We appreciate the opportunity to provide our comments to the Commission regarding the proposed Rule 10B-1, and we would be pleased to meet with the Commission or its staff to discuss our comments. If the staff has questions or comments, please do not hesitate to call Joseph Schwartz, Director and Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jennifer W. Han

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cc: The Hon. Gary Gensler, SEC Chairman
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Allison Herren Lee, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
Mr. Haoxiang Zhu, Director, Division of Trading and Markets