September 16, 2025

Via Electronic Mail

Jamie Selway
Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Recommendations for Reforming Regulation M to Enhance Capital Formation

Dear Director Selway:

MFA[1] sent a letter to Chairman Atkins in May with several recommendations for ways in which the Securities and Exchange Commission ("**SEC**" or "**Commission**") could promote capital formation, improve regulatory efficiency, and reduce waste.[2] As a follow up to that letter, we are providing you with more detailed recommendations for revising Rule 105 of Regulation M ("**Rule 105**" or the "**Rule**") under the Securities Exchange Act of 1934 ("**Exchange Act**") to promote capital formation.[3]

We understand an important goal of Rule 105 is "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity."[4] However, many institutional investment managers ("**Investment Managers**") have become either unable or reluctant to commit capital to participate in securities offerings by issuers and selling shareholders that are subject to Rule 105 ("**Covered Offerings**"), in part because of the way in which the SEC has interpreted and enforced Rule 105. On behalf of Investment Managers, we would like to work with the SEC to obtain "common sense" relief or guidance that will restore Rule 105 back to its original purpose and facilitate capital formation, as described below.

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1 Managed Funds Association ("**MFA**"), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

2 *See* Letter from Bryan Corbett to Chairman Paul Atkins (May 11, 2025), available at: MFA-letter-to-OMB-re.-Deregulation-5.11.25-2.pdf.

3 17 CFR § 242.105.

4 Securities Exchange Act Release No. 56206 (Aug. 6, 2007), 72 Fed. Reg. 45094, 45096 (Aug. 10, 2007) (the "**Adopting Release**").

I. The Application of Rule 105 Results in Detrimental Impacts to Capital Formation

Prior to 2007, Rule 105 was designed to prevent market participants from selling short in advance of a public offering of securities for cash and then covering such short sales with securities purchased in the public offering, an activity that the SEC believed could "artificially depress market prices which can lead to lower than anticipated offering prices, thus causing an issuer's offering proceeds to be reduced."[5] In 2007, the SEC amended Rule 105 to establish a bright-line test that was intended to "promote investor and issuer confidence in pricing integrity and in the offering process, which should facilitate capital formation."[6] Specifically, the Rule was amended from prohibiting "covering" of short sales effected during the "restricted period" with securities received in an offering to imposing an outright "prohibition" on purchasing in a Covered Offering where short sales of the offered securities were effected during the applicable "restricted period," subject to certain exceptions.

While MFA appreciates that the Commission's goals in adopting the 2007 amendments were to address "strategies used to disguise Rule 105 violations" and "attempts to obfuscate the prohibited covering," the amendments are not narrowly tailored to that purpose. As a result, it has caused a significant chilling of the ability or willingness of market participants to commit capital in Covered Offerings, to the ultimate detriment of issuers and selling shareholders. There are at least three primary reasons why Investment Managers are either unable to, or reluctant to, participate in Covered Offerings.

First, Rule 105 prohibits a person from participating in a Covered Offering if the person was deemed to sell short the offered securities during the applicable "restricted period," even if such short sales occurred before the offering was made public. As a result, in many situations especially involving "overnight" or "bought" deals, Investment Managers are unable to participate in Covered Offerings due to any restricted period short sales, even in very small amounts, in the offered security effected even before the offering was announced.

Second, even though Rule 105 provides certain exceptions, in particular the "Bona-Fide Purchase" and "Separate Account" exceptions, these exceptions are very specific in certain respects while vague and ambiguous in others. Ambiguity in the operation of these provisions has made it difficult for Investment Managers to confidently rely on their application, and we have witnessed the SEC staff take expansive interpretations to find "strict liability" violations even for activity that would not seem to fulfill the policy objectives behind the Rule. In addition, while the Rule's "restricted period" ends with pricing, it can be difficult for an Investment Manager to pinpoint when pricing has definitively occurred.

Third, despite ambiguity in the application of the Rule provisions, strict liability is imposed for Rule violations (even where conduct is consistent with the policy objectives), and the SEC Enforcement staff has taken a draconian approach to disgorgement calculations, even for violations that stem from inadvertent mistakes or very small amounts of short sales during the restricted period.

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5 Securities Exchange Act Rel. No. 54888 (Dec. 6, 2006), 71 Fed. Reg. 75002, 75002 (Dec. 13, 2006).

6 *Id.* at 75002.

II. Recommendations for Reforming Rule 105

a. Revise the Definition of the "Restricted Period" to Commence Upon Offering Announcement

Rule 105 is intended to prevent artificial downward pressure on offering prices by prohibiting persons from purchasing offered securities if they sold short the same security during a "restricted period" before the offering's pricing. Under the current definition, the restricted period commences upon the later of: (i) the five "business days" prior to the pricing of the Covered Offering; or (ii) the *initial* filing of the registration statement (in the case of a covered offering that is a registered offering) or notification on Form 1-A or 1-E (in the case of a covered offering that is a Regulation A or E offering, respectively). As a result, the restricted period can include short sales that are effected before the investor is even aware that a Covered Offering is occurring.[7]

We firmly believe that the Rule 105 restricted period should never commence earlier than the point at which investors learn about an offering – namely, at the announcement. Short sales that are effected prior to the time investors are notified of the offering fall outside the SEC's stated objectives of the Rule:

> *Generally, the offering prices of follow-on and secondary offerings are priced at a discount to a stock's closing price prior to pricing. This discount provides a motivation for a person who has a high expectation of receiving offering shares to capture this discount by aggressively short selling just prior to pricing and then covering the person's short sales at the lower offering prices with securities received through an allocation. Covering the short sale with a specified amount of registered offering securities at a fixed price allows a short seller largely to avoid market risk and usually guarantee a profit.*[8]

Therefore, short sales that are effected prior to public announcement of a Covered Offering could not be based on an intent to capture such "offer price discount." Furthermore, the current formulation of the restricted period, which includes pre-announcement short sales, is unnecessary in light of existing Section 10(b) and Rule 10b-5 prohibiting trading based on material nonpublic information, including where a buy-side investor has been wall-crossed.[9] Thus, re-defining the restricted period to commence at announcement of the Covered Offering would more closely align to the SEC's stated policy goals, while

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7 For example, in instances where the securities offered are off a registration statement filed long prior to the Covered Offering, the restricted period for the Covered Offering is the full five business day period prior to pricing. However, it is common for Investment Managers to not learn about an "overnight" or "bought deal" Covered Offering from an underwriter or other broker-dealer participating in such offering until after market close on the night the offering is being priced. In such instances, the Investment Manager could have unknowingly sold short during the Rule's "restricted period" (*i.e.,* if by coincidence it had entered into a short sale in the offered security in the days immediately preceding announcement of the offering).

8 Securities Exchange Act Rel. No. 56206 (Aug. 6, 2007), 72 Fed. Reg. 45094, 45096 (Aug. 10, 2007).

9 *See* SEC Charges Morgan Stanley and Former Executive Pawan Passi with Fraud in Block Trading Business, U.S. Securities and Exchange Commission (Jan. 12, 2024), available at: https://www.sec.gov/newsroom/press-releases/2024-6#:~:text=The%20SEC's%20orders%20find%20that,of%20the%20upcoming%20block%20trade.

restricting fewer investors from participating in the offering due to unrelated market activity prior to becoming aware of the offering. This increase in participating investors facilitates overall capital raises for issuers and selling shareholders, without sacrificing any of the protections that the Rule is designed to address.

Rule 105 contains an exception, the Bona-Fide Purchase exception, that allows a person to participate in a Covered Offering even though such person sold short during the restricted period if they purchase shares at least equivalent in quantity to the amount of the restricted period short sales prior to pricing, subject to certain requirements. Although the express purpose of the Bona-Fide Purchase exception was to provide "an opportunity for a trader who had no knowledge of an offering at the time of his short sale to participate in the offering" to "cure" such short sales prior to pricing, the Bona-Fide Purchase is not available for overnight deals due to the requirements of the exception that the purchase "occur no later than the business day prior to pricing" and "during regular trading hours."[10] Thus, to the extent that the Investment Manager even shorts one share during the restricted period, they are unable to purchase any shares in the Covered Offering. Such a result defies logic and negatively impacts capital raising efforts by issuers and underwriters by reducing the number of Investment Managers who can participate in Covered Offerings.[11]

In support of our suggested approach for the Rule 105 restricted period to begin at the time of announcement, the SEC has adopted other rules designed to calibrate the time of "announcement" as a trigger for certain restrictions. For example, Rule 14e-4, which is meant to address manipulative activity in connection with partial tender offers, requires a person to consider, in calculating their net positions for purposes of tendering, any in-the-money standardized call options written after the offer "is first publicly announced or otherwise made known by the bidder to holders of the security to be acquired."[12] We believe the post-announcement approach in Rule 14e-4 is appropriate and the SEC should apply a similar standard in Rule 105.

Therefore, to promote investor participation in overnight shelf offerings and confidentially marketed registered Covered Offerings, while maintaining consistency with the core regulatory objectives of Rule 105, we recommend that the Commission initiate a rulemaking to amend Rule 105, or otherwise provide exemptive relief, to provide that the restricted period does not begin prior to the public disclosure of an offering. We recommend amending the second prong of "restricted period" definition in Rule 105(a) to read (deleted language in strike through italics; new language in bold and underline):

> Beginning with the ~~*initial filing of such registration statement or notification on Form 1-A or Form 1-E*~~ **time at which the offering is first publicly disclosed** and ending with the pricing.

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10 Adopting Release, 72 Fed. Reg. at 45097.

11 An alternative way to address this illogical result could be to amend the Bona-Fide Purchase exception, so as to delete the requirements that the purchase needs to occur "during regular trading hours" and "no later than the business day prior to the day of pricing" (i.e., this would allow bona-fide purchases to be effected in the after-hours market after the announcement of an overnight deal).

12 17 CFR § 240.14e-4.

b. Clarity Is Needed to Promote Capital Formation

i. Clarity Around Timing of Pricing of Covered Offering

We believe there should be clarity concerning Investment Managers' reliance on information concerning the timing of "pricing" of an offering. It is notable that, while the Rule 105 restricted period technically ends with "pricing" of the offering, in practice it is often very challenging for Investment Managers to determine the exact time when such pricing occurs, as this is controlled by the issuer and the underwriters, and not the potential investors. While marketing of Covered Offerings in connection with overnight deals generally occurs after the close, it is often very difficult to secure information concerning the exact moment of "pricing," and issuers may wait until the next day to publish any information concerning the pricing of the offering. Notwithstanding, the underwriters may have priced the Covered Offering sometime after the close on the prior day. This uncertainty concerning the exact timing of pricing results in difficulties for Investment Managers with respect to determining whether "short sales" may have occurred prior to pricing. This is exacerbated by interpretations provided by the SEC staff in connection with enforcement settlements, including that assignment of call options in certain situations may result in "short sales."[13] Such involuntary assignments may not be known to the Investment Manager until late in the evening, or even the next business day, and thus raise challenges for Investment Managers when determining whether they are deemed to have engaged in "short sales" of the offered security during the restricted period, *i.e.*, before the offering is priced.[14]

We believe that the SEC should provide clarity that Investment Managers are entitled to reasonably rely on information provided by underwriters and/or broker-dealers concerning the timing of pricing of a Covered Offering, which can be memorialized in written documentation between buy-side investors and underwriters. In addition, to the extent options exercises or assignments occur during the Rule 105 restricted period, they should not be treated as "short sales" for purposes of Rule 105, even if they result in the establishment of a short position. This would be consistent with the approach taken in connection with the 2007 Rule 105 Adopting Release to not deem short positions established through derivatives to be subject to Rule 105. Moreover, we note that exercises and assignments of options are not "trades" that are subject to FINRA trade reporting, and thus would not have the depressing impact on the stock price in advance of offerings that the Rule is designed to address. Notably, exercises and assignment of options have been exempted from other short sale restrictions, including the "bid test" of Rule 201 of Regulation SHO, which is designed to prevent manipulative short selling activities.

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13 *See* In the Matter of Contrarian Capital Management, L.L.C., Securities Exchange Act Rel. No. 99578 (Feb. 21, 2024), available at: https://www.sec.gov/files/litigation/admin/2024/34-99578.pdf.

14 Among other things, Investment Managers may need to try and determine their net long or short position in the underlying security at the time of assignment, and otherwise determine if delivery on assignment will be made with borrowed securities. In certain instances, Investment Managers who have sold call options have declined to participate in Covered Offerings, due to the uncertainties of whether assignment may result in "short sales," combined with the strict liability nature of the Rule.

ii. Clarity Regarding the Operation of Separate Account Exception

We recommend clarity with respect to the operation of the Separate Account exception, which is designed to permit the purchase of offered securities in an account of a person where such person sold short during the restricted period in a separate account, if decisions regarding securities transactions for each account are made separately and without any coordination of trading or cooperation among or between the accounts. In the 2007 Adopting Release, the SEC outlined six "indicia of separateness," *i.e.*, criteria which were designed to demonstrate that different Separate Accounts were operating without coordination of trading or cooperation, namely:

1. Having separate and distinct investment and trading strategies and objectives from the other accounts under management;
2. Personnel for each account do not coordinate trading among or between the accounts;
3. Information barriers separate the accounts, and information about securities positions or investment decisions is not shared between accounts;
4. Each account maintains separate profit and loss statements;
5. There is no allocation of securities between or among accounts; and
6. Personnel with oversight or managerial responsibility over multiple accounts in a single entity or affiliated entities, and account owners of multiple accounts, do not have authority to execute trades in individual securities in the accounts and in fact, do not execute trades in the accounts, and do not have the authority to pre-approve trading decisions for the accounts and in fact, do not pre-approve trading decisions for the accounts ("**Indicia 6**").

Although in the Adopting Release the SEC stated that accounts not satisfying each of the aforementioned conditions may nonetheless fall within the exception if the accounts are separate and operating without coordination of trading or cooperation, in practice market participants have observed that the SEC Exam and Enforcement staff treat *each* of the six indicia as *required* elements for reliance on the exception.

Moreover, questions have arisen with respect to the sixth indicia of separateness. The 2007 Adopting Release had provided additional guidance, recognizing that Indicia 6 "is designed to ensure non-coordination by a single person with control over multiple accounts. Thus, such person may neither direct an account to sell short during the restricted period, nor direct another account to purchase securities in an offering." Investment Managers have carefully constructed processes, policies and procedures to enable them to both meet their fiduciary obligations and simultaneously comply with the Separate Account exception. With respect to Indicia 6, senior management may generally engage in oversight and risk management across the separate accounts. Senior management, in the ordinary course of business, is not involved in specific trading decisions for the separate accounts or the specific decisions to participate in a Covered Offering. Moreover, while senior management may receive certain information for the purposes of managing the risk of the separate accounts, they are strictly prohibited from sharing any information learned in the course of their functions and activities with respect to any separate account.

While MFA believes that the 2007 Adopting Release clearly delineates the scope of permissible activities by senior managers and other individuals who have access to information of multiple separate

accounts as part of their oversight responsibilities, we are concerned about the possibility that the SEC Exam and Enforcement staff could take a broader interpretation of Indicia 6 that would not be supported by the guidance issued by the Commission. In addition, we believe that such an interpretation would be inconsistent with President Trump's Executive Order 14219, which instructs agencies such as the SEC to generally refrain from engaging in rulemaking through enforcement.[15] Notwithstanding, the fear of defending against a costly and time-intensive enforcement investigation, coupled with the significant exposure associated with a "strict liability" violation, has had a chilling impact on Investment Managers' willingness to engage in activities that would provide real benefits to their investors, and a willingness to participate in Covered Offerings that benefit issuers and selling shareholders.

MFA therefore requests that the Commission issue interpretive guidance clarifying that, consistent with the 2007 Adopting Release, the indicia for the Separate Account exception, including Indicia 6, should be properly read such that "decisions regarding securities transactions for each account are made separately and without coordination of trading or cooperation among or between the accounts" should be in the context of one account not being directed by senior management to sell short during the restricted period for a specific Covered Offering, and by senior management directing another account to purchase in such Covered Offering. Stated another way, the separate account indicia, including Indicia 6, should be narrowly tailored to the actual language from the Rule and the guidance from the Adopting Release, and should not be interpreted more broadly to apply to other activity by senior management that is unrelated to the particular Covered Offerings in question. Properly defining the scope of the Separate Account exception and indicia would allow senior management to utilize strategies, including in "individual securities," which are generally designed to deploy capital in an efficient and cost-effective manner, and consistent with their fiduciary duties to investors.

c. Reconsideration of Approach to Disgorgement Calculations

Ambiguity in the Rule's operation, combined with outsized disgorgement calculations, has substantially deterred investors from participating in Covered Offerings. SEC Enforcement staff has taken an excessively harsh approach to the application of strict liability and disgorgement calculations, even though the vast majority of settlements involve violations of Rule 105 that stem from inadvertent mistakes, rather than any manipulative activity. Specifically, the SEC has generally employed the following calculation

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[15] A recent Presidential Executive Order states that "agencies shall preserve their limited enforcement resources by generally de-prioritizing actions to enforce regulations that are based on anything other than the best reading of a statute and de-prioritizing actions to enforce regulations that go beyond the powers vested in the Federal Government by the Constitution. *See Exec. Order No. 14219, 90 Fed. Reg. 10583 (Feb. 25, 2025); see also* Fact Sheet: President Donald J. Trump Directs Repeal of Regulations That Are Unlawful Under 10 Recent Supreme Court Decisions (Apr. 9, 2025), https://www.whitehouse.gov/fact-sheets/2025/04/fact-sheet-president-donald-j-trump-directs-repeal-of-regulations-that-are-unlawful-under-10-recent-supreme-court-decisions/. President Trump's Fact Sheet memorandum implemented Executive Order 14219, Ensuring Lawful Governance and Implementing the President's "Department of Government Efficiency" Deregulatory Initiative, and directed departments and agencies to review rules for legality under recent "watershed" Supreme Court decisions. The memorandum specifically addresses *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369 (2024), and states, "agencies are to repeal any regulation that is not consonant with the 'single, best meaning' of the statute authorizing it."

of profits: (i) the difference between the price of the amount of securities sold short during the restricted period and the price of such amount of securities purchased in a Covered Offering; and (ii) an "overage" calculation, which takes the difference between the price of the remaining amount of securities purchased in the covered offering and: (A) where the Covered Offering was priced pre-open, the volume-weighted average price ("**VWAP**") on the day of the pricing; and (B) where the Covered Offering was priced post-close, the VWAP on the next trading day after the pricing. Such punitive disgorgement calculation is generally the reason why SEC Enforcement actions for violations of Rule 105 reach eight and nine figures.

MFA feels strongly that the Commission's calculations of disgorgement in Rule 105 settlements significantly overstate the actual profits received by Investment Managers. Disgorgement is a remedial sanction that is "intended to prevent unjust enrichment"[16] by "depriving the wrongdoer of the benefit of his misconduct."[17] Since it is not punitive, disgorgement awards should seek to do no more than to disgorge the "financial benefit" that results from the misconduct, that is, the amount of "profits" that are actually "*received*, directly or indirectly, as a result of the misconduct." Put simply, disgorgement is a "profit-based remedy"[18] meant to deprive a wrongdoer only of net profits wrongly obtained as a result of a violation of securities laws. Notwithstanding, the SEC Enforcement staff's traditional calculations of disgorgement for Rule 105, especially with respect to the "overage" calculations, is punitive as it significantly overstates the amount of actual profits received.

We believe it is appropriate for the SEC to reevaluate its enforcement approach to take into account the market participant's conduct in light of the policy objectives of the Rule. We believe that the changes and additional guidance proposed above will result in a more optimized market with enhanced clarity for investors.

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16 *In the Matter of Vungarala*, Rel. No. 34-90476 at 21 (Nov. 20, 2020) (quotation marks and citation omitted).

17 *In the Matter of Kimberly Springsteen-Abbott*, Rel. No. 34-88156 at 21 (Feb. 7, 2020) (quotations and citation omitted).

18 *Liu v. SEC*, 140 S.Ct. 1936, 1947 (2020).

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MFA appreciates your consideration of our recommendations. We look forward to working with the Commission to improve securities regulation to protect investors, support U.S. economic growth, and promote capital formation. We would be pleased to discuss our recommendations in further detail. Please do not hesitate to reach out to Matthew Daigler or the undersigned at (202) 730-2600 with any questions regarding this letter.

Respectfully yours,

/s/ Jennifer W. Han

Jennifer W. Han
Chief Legal Officer & Head of Global Regulatory Affairs
MFA

cc:

Paul S. Atkins, Chairman
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