

March 22, 2022

Via Electronic Mail

Vanessa Countryman, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Modernization of Beneficial Ownership Reporting, File No. S7-06-22<sup>1</sup> and  
Position Reporting of Large Security-Based Swap Positions, File No. S7-32-10<sup>2</sup>

Dear Ms. Countryman:

The Healthy Markets Association<sup>3</sup> writes to offer comments on the Commission's above-referenced proposal to promote transparency and market efficiencies by modernizing the reporting of beneficial ownership information ("Proposal").

While HMA supports the objectives of the Proposal, the Proposal itself fails to achieve much of its intended objectives, in part, because it would:

1. continue to leave investors and other market participants in the dark regarding potentially significant, risk-altering, and market-moving derivative positions,
2. create uneven reporting obligations across related financial instruments that could lead to evasion of reporting obligations, and
3. continue to not require holdings disclosures in a timely manner.

Equities and the many different types of financial instruments that reference them, including those that are both physically and cash-settled, are inextricably linked. A holder of one type of derivative can engage in trading that may materially affect the values and risks of both the underlying stock and its many different derivatives – irrespective of

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<sup>1</sup> *Modernization of Beneficial Ownership Reporting*, SEC, Feb. 10, 2022, available at <https://www.sec.gov/rules/proposed/2022/33-11030.pdf> ("Proposal").

<sup>2</sup> *Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions*, SEC, 87 Fed. Reg. 6652 (Feb. 4, 2022), available at <https://www.govinfo.gov/content/pkg/FR-2022-02-04/pdf/2021-27531.pdf> ("Security-Based Swap Position Reporting Proposal").

<sup>3</sup>Healthy Markets Association ("HMA") is a not-for-profit member organization of public pension funds, investment advisers, broker-dealers, exchanges, and market data firms focused on reducing conflicts of interest and improving the transparency, efficiency, and fairness of the capital markets. As a result, HMA members would be directly impacted by the Proposal. To learn more about HMA or our members, please see our website at <http://healthymarkets.org/about>.

whether the initial holder has some subjective intent on its ownership interest or whether the derivative was cash-settled or physically-settled.

Accordingly, we recommend that the Commission revise the Proposal to: (i) interpret “beneficial owner” to cover persons who hold derivative positions that establish a direct economic exposure to the underlying security irrespective of the form of settlement of the instrument or the intent of its holder; and (ii) reduce the time delays in filing the required reports.

## Regulatory Background

Section 13(d) of the Securities Exchange Act requires “[a]ny person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered”, ... “and is directly or indirectly the beneficial owner of more than 5 per centum of such class” to file basic position reports.

Since Congress first established this requirement in 1968, it has intended to mandate disclosures by persons with “substantial or controlling blocks of the securities of publicly traded companies” for “investor protection.”<sup>4</sup> Investors, issuers, and other market participants benefit from public disclosures of large positions in equities and related derivatives.<sup>5</sup>

Neither Section 3(a) nor 13(d) of the Exchange Act define “beneficial owner.” Thus, the Commission has essentially defined it by rule.<sup>6</sup> Under Rule 13d-3(a), “a person who directly or indirectly has or shares voting or investment power is a beneficial owner.”<sup>7</sup> Further, the Commission has included “derivatives that would be settled “in-kind” or otherwise convey a right to acquire a covered class.”<sup>8</sup> Lastly, a person is “deemed” a beneficial owner of a covered class if the person:

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<sup>4</sup> S. Rep. 90-550, at 1 (1967). We note that by using the word “or” between “substantial” and “controlling blocks,” Congress clearly intended situations where the positions may not actually give rise to a direct controlling interest.

<sup>5</sup> Notably, position holdings information required to be disclosed pursuant to Section 13(f) is now frequently used by a wide array of market participants and academics. For example, in response to the Commission’s ill-advised 2020 proposal to raise the reporting threshold for many large institutions, the Commission received extensive feedback regarding how its Form 13F filings are some of the most used filings maintained by the Commission. *Reporting Threshold for Institutional Investment Managers*, SEC, 85 Fed. Reg. 46016, July 21, 2020, available at <https://www.govinfo.gov/content/pkg/FR-2020-07-31/pdf/2020-15322.pdf>. Those forms are being used by investors, research analysts, banks providing prime brokerage services and derivative exposures, academics, and more.

<sup>6</sup> *Adoption of Beneficial Ownership Disclosure Requirements*, SEC, 42 Fed. Reg. 12342 (Mar. 3, 1977).

<sup>7</sup> Proposal, at 53.

<sup>8</sup> Proposal, at 53 (citing *Acquisitions, Tender Offers, and Solicitations*, SEC, 33 Fed. Reg. 14109 (Sept. 18, 1968)).

- holds a right to acquire the covered class that is exercisable or convertible within 60 days;<sup>9</sup> or
- Holds a right to acquire the covered class that is exercisable, exchangeable or convertible at any time, if the it is held “for the purpose or with the effect of changing or influencing control of the issuer of securities.”<sup>10</sup>

Conversely, the Commission has never counted as “beneficial owners” those with derivatives that don’t entitle the holder to something *more than* the economic exposure to a covered class.<sup>11</sup>

Experts have long warned that some market participants have been able to use derivatives that are outside the reporting requirements to engage in surprise change in control or corporate engagement strategies.<sup>12</sup> Over a decade ago, the Commission was asked to expand the holdings reporting rules to cover more derivatives.<sup>13</sup> In the years since, these concerns have amplified with the dramatic increase in trading of a wide array of security-based derivatives, some of which give rise to reporting obligations, and some of which do not.

Additionally, for years, issuers of securities, their advocates (including listing exchanges),<sup>14</sup> and other market participants have raised concerns regarding a lack of timely transparency regarding those holdings.

## Concerns with the Proposal’s Treatment of Derivatives

As the recent, high-profile collapse of Archegos Capital Management has made clear, regulators, investors, and other market participants need a much better understanding

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<sup>9</sup> Proposal, at 53.

<sup>10</sup> Proposal, at 53.

<sup>11</sup> Proposal, at 53.

<sup>12</sup> See, e.g., Andrew Ross Sorkin, *Big Investors Appear Out of Thin Air*, N.Y. Times, Nov. 1, 2010, available at <https://dealbook.nytimes.com/2010/11/01/sorkin-big-investors-appear-out-of-thin-air/>; see also, Maria Lucia Passador, *The Woeful Inadequacy of Section 13(d): Time for a Paradigm Shift?*, 13 VA Law & Bus. Rev. 279, 296-99 (2019).

<sup>13</sup> See, e.g., Letter from Wachtell, Lipton, Rosen & Katz, to Elizabeth M. Murphy, SEC, at 7, Mar. 7, 2011, available at <http://www.sec.gov/rules/petitions/2011/petn4-624.pdf> (“Other forms of ownership, including through derivatives, are currently explicitly counted for purposes of the 13(d) reporting rules only where they confer upon the holder the right to acquire beneficial ownership (i.e., either voting power or investment power) over the underlying security within sixty days. This paradigm fails to adequately address many ways in which modern investors may acquire economic exposure to a security, including through the purchase of non-traditional or cash-settled derivatives.”).

<sup>14</sup> See, e.g., Letter from Janet McGinness, NYSE Euronext, et al., to Elizabeth Murphy, SEC, Feb. 1, 2013, available at <https://www.sec.gov/rules/petitions/2013/petn4-659.pdf> (petitioning the Commission to revise holdings disclosures made pursuant to Section 13(f)).

of who owns what large positions in securities and their related derivatives.<sup>15</sup> The Proposal and other recent proposals by the Commission appear intended to address this need.

However, the Proposal would include some cash-settled derivative holdings, while ignoring others. The distinguishing factor is not a function of the position itself, but rather the holder's subjective intent. Setting aside the difficulties inherent in enforcing this subjective standard, the intent of the holder may be irrelevant to investors or other market participants who may be directly and indirectly impacted by the position's existence.

In recent years, as the use of equity derivatives has expanded significantly,<sup>16</sup> investors, brokers (including prime brokers), and other market participants have sought increased information about significant equity derivative positions held by others in the marketplace. They need information about the holders of significant equity and equity derivative positions to efficiently value their holdings and manage their risks – irrespective of (i) whether the instruments are physically or cash-settled, or (ii) the subjective intent of the holder of those positions.

The price of a stock, its futures price, options on it, and swaps related to it will typically all move in tandem. Investors and other market participants benefit greatly from market efficiencies created by arbitrage trading strategies that operate across various market venues and asset classes to ensure these linkages between an equity and all of its related financial instruments. For example, suppose an investor acquires a material position in a cash-settled derivative with a notional value of hundreds of millions of dollars or a notional amount equal to six percent of a covered class. How is that position hedged? Likely, that position could be hedged by the counterparty or counterparties engaging in the cash equity market to buy an offsetting holding.

The holder of a large derivative position – whether physically or cash-settled – has investment power over the referenced security and other related derivatives. At a very basic level, he can move their prices. He can change the market and liquidity risks of those instruments, with direct and indirect impacts on the holders of those instruments. Similarly, the identity of a holder of a significant position in an equity or a related financial instrument may be important information for those seeking to provide services (e.g.,

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<sup>15</sup> See Sofia Horta e Costa, Tracy Alloway, and Bei Hu, *Billions in Secret Derivatives at Center of Archegos Blowup*, Bloomberg, Mar. 29, 2021, available at <https://www.bloomberg.com/news/articles/2021-03-29/billions-in-sective-derivatives-at-center-of-archegos-blowup>.

<sup>16</sup> See, e.g., Gunjan Banerji, *In a Wild Year for Markets, Stocks Pull Off Big Gains*, Wall St. Journal, Dec. 31, 2021, available at [https://www.wsj.com/articles/u-s-stocks-end-a-wild-year-with-big-gains-11640860206?st=ouezeziz2orhsra&reflink=article\\_copyURL\\_share](https://www.wsj.com/articles/u-s-stocks-end-a-wild-year-with-big-gains-11640860206?st=ouezeziz2orhsra&reflink=article_copyURL_share) (showing that average daily notional value of single stock options exceeded single stock equities values in 2021 for the first time).

prime brokerage) regarding that equity or its related financial instruments. Unfortunately, the Proposal ignores these important realities, and instead focuses very narrowly on control of a company.<sup>17</sup>

Further, if the original investor spread around his derivatives trading, not only could he potentially avoid reporting his holdings, but his counterparties (who may actually hold instruments that could give rise to the disclosure reports) might also stay below the reporting threshold. This could create significant opportunities for the buildup of firm and systemic risks outside of the reporting regime.

## Contrast to the Commission's Recent Security-Based Swap Position Reporting Proposal

Under the Security-Based Swap Position Reporting Proposal, holders of significant security-based swaps referencing equities would be required to file reports if they trigger either of two thresholds: "a threshold based on the notional amount of the Security-Based Swap Position, and a threshold based on the total number of shares attributable to the Security-Based Swap Position as a percentage of the outstanding number of shares of that class of equity securities."<sup>18</sup>

Importantly, the Security-Based Swap Position Reporting Proposal does not tie the reporting obligation to the subjective "intent" of the holder. Rather, the Commission determined to trigger the reporting based solely upon how much exposure the holder had to the equity. Reporting would be required if the holder generally has \$300 million, calculated on a gross basis (including both long and short positions),<sup>19</sup> or if the position translated to a significant number of shares.<sup>20</sup>

As a result, the Security-Based Swap Position Reporting Proposal would require reporting when a holder had a "Security-Based Swap Equivalent" position of more than five percent of that class of equity securities.<sup>21</sup> The Security-Based Swap Position Reporting Proposal also includes anti-evasion measures.<sup>22</sup>

These clear, objective threshold levels were established "to be low enough to capture any positions that could potentially have a significant effect on the equities markets, and

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<sup>17</sup> The Proposal expands the application to cover cash-settled derivatives, but only for those held by a person seeking to exercise control.

<sup>18</sup> Security-Based Swap Position Reporting Proposal, at 6671.

<sup>19</sup> *Id.* This threshold is also calculated using certain anti-evasion measures, such as including the values of underlying equity securities, as well as "delta-adjusted notional amount of any options, security futures, or any other derivative instruments based on the same class of equity securities." *Id.*

<sup>20</sup> *Id.*, at 6671.

<sup>21</sup> *Id.*, at 6672.

<sup>22</sup> *Id.*, at 6672.

potentially issuers of equity securities and their security holders, yet also high enough to avoid over-reporting, which could limit the effectiveness of the rule.”<sup>23</sup>

The Commission should adopt a similar approach in this Proposal – for precisely the same reasons.<sup>24</sup> Further, failure to reconcile the two proposals could distort market participant behavior as some holders may shift types of instruments they use to avoid having to make disclosures (leaving regulators, investors, and other market participants in the dark).

Investors and other market participants all need to know – for their own valuations and risks assessments: (1) that there are other market participants with significant exposures to an equity, irrespective of how that exposure is obtained, and (2) who those other significant position holders are.

The Commission should revise the Proposal to redefine “beneficial owner” to include a person who holds a derivative position that establishes a direct economic exposure to the covered class. Further, the derivative position amount should be calculated pursuant to a similar methodology as proposed by the Commission in its Security-Based Swap Position Reporting Proposal.

## Timeliness of Reporting and Treatment of Material, Non-Public Information

At a time when stock transactions are reported to the markets in fractions of seconds, and the Commission has proposed requiring investors to disclose their stock lending within fifteen minutes of effecting a loan,<sup>25</sup> we do not understand why the vast majority of market participants (including investors and issuers) are to be deliberately kept in the dark for several days regarding material, non-public information impacting their holdings and exposures.

Investors’ and market participants’ abilities to prudently manage their positions and exposures is materially undermined by the arbitrary, unnecessary, discriminatory delay in reporting. And while we do not think it is appropriate for the Commission to, at this moment, require reporting within seconds or hours, it would be appropriate for the Commission to consider further shortening the reporting periods.

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<sup>23</sup> Security-Based Swap Position Reporting Proposal, at 6671.

<sup>24</sup> We recognize that the statutory language of Section 13(d) focuses on the percentage of the class, rather than a notional dollar amount of exposure.

<sup>25</sup> *Reporting of Securities Loans*, SEC, 86 Fed. Reg. 69802 (Dec. 8, 2021), available at <https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf>.



Lastly, we do not think the proposal would “unduly chill communications between shareholders and market participants, such as investment advisers.”<sup>26</sup> Further, we would be deeply troubled if the Commission were to invent a new, extremely difficult to establish element to insider trading law, such as a requirement that the recipient of the tip have an intention of coordinating with the tipper or making its purchases in reliance on the non-public information that the tipper provided.

Alternatively, the concern that a recipient may be “unwittingly deemed a member of a group simply by virtue of the tipper’s independent communications or actions” can better be addressed by the straightforward application of existing law. If a recipient receives information that it did not solicit or otherwise welcome, the recipient likely has no duty of trust or loyalty to the provider of it. Alternatively, if the recipient solicited the information or agrees to participate in a strategy or otherwise takes action evincing a relationship with the tipper, then the recipient has a requisite duty to potentially give rise to insider trader liability.

## Format of Disclosures

We support requiring the filings to be made in structured, machine-readable format.

## Conclusion

We urge the Commission to revise the Proposal to: (i) interpret “beneficial owner” to cover persons who hold derivative positions that establish a direct economic exposure to the underlying security irrespective of the form of settlement of the instrument or the intent of its holder; and (ii) reduce the time delays in filing the required reports.

Thank you for your consideration. Please feel free to contact me by email at [REDACTED] or telephone a [REDACTED] for any follow up.

Sincerely,



Tyler Gellasch  
Executive Director

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<sup>26</sup> See Proposal, at 93.