

Approved by the Investor Advisory Committee at the June 22, 2023 Meeting

**Recommendation of the Market Structure Subcommittee of
the SEC Investor Advisory Committee on SEC Proposed Amendments to
Regulation 13D-G, Proposed Rule 10B-1, and Proposed Rule 9j-1**

On September 21, 2022, the SEC Investor Advisory Committee hosted panel discussions to discuss three proposed SEC rules: amendments to Regulation 13D-G (to accelerate Schedule 13D and Schedule 13G filings);¹ Rule 10B-1 (to require reporting of large securities-based swaps (SBS) positions; and Rule 9j-1 (to prohibit fraud, manipulation, and deception in connection with SBS transactions).²

The panelists discussed a wide range of topics related to the two SEC releases, including the historical basis for 13D-G, their views on information asymmetry caused by the current rules, and potential insider trading concerns that may arise. Despite the amended rules being proposed separately and originating from different divisions of the SEC, they touch on a common thread of decreasing informational asymmetry in the equities and securities-based swaps (SBS) market. Each proposed rule is described in relevant part below.

Proposed Changes to Regulation 13D-G.

Under existing rules, Sections 13(d) and 13(g) of the Exchange Act, together with Regulation 13D-G, require any holder exceeding five percent of a company's outstanding shares to publicly report their ownership on Schedule 13D (for active investors) or Schedule 13G (for passive investors, Qualified Institutional Investors, & Exempt Investors). Active and passive investors must make their filings within ten days of crossing the threshold, while Qualified Institutional Investors (QIIs) and Exempt Investors have until 45 days after the calendar year when they cross that threshold to file. Notably, the current deadlines for filing an initial Schedule 13D and Schedule 13G have not been updated since 1968 and 1977, respectively, despite significant changes to the markets and available technology.³

The SEC's proposed rule changes seek to modernize the reporting regime, acknowledging that technological advancements make faster reporting more feasible; to better inform company management and other shareholders about the presence of large investors; and to limit certain information asymmetries that arise from the lag in public reporting. To accomplish these goals, the SEC made several proposals, but the IAC panelists focused on three.

¹ Modernization of Beneficial Ownership Reporting. SEC Release Nos. 33-11030 and 34-94211 (Feb. 10, 2022) ("Beneficial Ownership Release").

² 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. Release No. 34-93784; File No. S7-32-10 (Dec. 15, 2021) ("SBS Release").

³ Beneficial Ownership Release at 14 and 32.

First, the SEC proposes to shorten the time lag between when an investor crosses the five percent threshold and when they must publicly disclose their position. Specifically, under the SEC's proposals, active and passive investors would be required to make their initial filings within five (calendar) days after crossing the threshold; QIIs and Exempt Investors would have five business days after the month-end in which they cross the five percent threshold.⁴

Second, the SEC proposes to treat two or more people as being part of a group if they "act as" a group. This proposed definition of a group seeks to address the potential communication of non-public information between investors who would later be obligated to make public disclosures about their holdings. The proposal aims to overcome the implication that an agreement, either expressed or implied, among group members is a necessary precondition to the formation of a group under Regulation 13D-G.⁵

Third, the SEC proposes to treat holders of cash-settled derivatives as beneficial owners for purposes of reporting on Schedule 13D if the investor has plans to influence control or engage in a change of control transaction. While the proposal excludes SBSs (which are covered under proposed Rule 10B-1, discussed below), it deems holders of cash-settled derivatives as beneficial owners, even if the investor has no right or agreement to vote, or direct the voting, of the underlying security.⁶

Proposed Rules 10B-1 and 9j-1

Leading up to the financial crisis of 2008, both the derivatives and swaps markets grew tremendously, rising on occasion to levels many times greater than the underlying assets they were referencing. Unlike large equity positions, which must be reported to the Commission quarterly or when positions exceed 5% of the outstanding shares, no such requirements exist for swaps positions, even though they give the holder similar economic exposure.

The growth of the SBS market has resulted in two developments that are of particular concern to the SEC in its proposed rules. First, as mentioned above, despite the growth of the SBS market, neither market participants nor regulators are aware of concentrated risk positions in the market. Second, in recent years, swaps counterparties have manufactured credit events to trigger credit default swaps for the benefit of swap counterparties and, in some instances, the issuer.⁷ To address both concerns, the SEC proposed two rules, Rule 10B-1 and Rule 9j-1, to enhance market transparency, improve market integrity, and strengthen the SBS market overall.

Section 10B(d) of the Securities Exchange Act of 1934, added by the 2010 Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), authorizes the SEC to establish reporting

⁴ Id. At 7.

⁵ Id. at 11.

⁶ Id. at 113-114.

⁷ SBS Release at 14-16.

requirements for large SBS positions.⁸ The Commission proposes to exercise this authority for the first time through proposed Rule 10B-1, which requires persons (or group of persons) who own SBS positions⁹ that exceed certain thresholds to publicly file required information on a new Schedule 10B within one business day of crossing the threshold.¹⁰ Additionally, any material change to SBS positions must also be filed within one business day following the change.¹¹ For proposed Rule 10B-1, the reporting threshold limits are specific dollar amounts that are calculated based on whether the type of SBS position is a CDS, debt security that is not a CDS, or an equity security.¹²

Rule 9j-1, which has previously been proposed, aims to prevent fraud, manipulation, and deception in connection with SBS transactions. To address the emergence of manufactured credit events and other opportunistic strategies, the re-proposed rule prohibits manipulation, and attempted manipulation, of the price or value of any SBS or any payment or delivery related to a SBS. Additionally, Rule 9j-1 expands insider trading liability to prohibit SBS transactions while in possession of material non-public information. Lastly, the re-proposed rule clarifies that market participants cannot effectuate a scheme to avoid liability by

⁸ 15 U.S.C. 78J-2.

⁹ Per the proposed rule, SBS positions would include all SBS based on:

- (i) A single security or loan, or a narrow-based security index, or any interest therein or based on the value thereof;
- (ii) Any securities issued by the same issuer of the securities, loans or securities included in the narrow-based index described in (i); or
- (iii) Any narrow-based security index that includes any of those issuing entities or their securities.

¹⁰ Notably, determinations of who is considered a beneficial owner of SBS positions relied on Section 13(d) beneficial ownership rules.

¹¹ According to the SEC's accompanying rule release, a change equal to ten percent is considered material.

¹² Generally, the threshold among for SBS positions are based on:

- i. For a CDS is the lesser of: (i) a long notional amount of \$150 million; (ii) a short notional amount of \$150 million; or (iii) a gross notional amount of \$300 million.
- ii. For debt securities that are not a CDS is a gross notional amount of \$300 million.
- iii. For equity securities the lesser of:
 - a. a gross notional amount of \$300 million, but if the gross notional amount of the security-based swap position exceeds \$150 million, the calculation of the security-based swap position must also include the value of all of the underlying equity securities owned by the holder of the security-based swap position (based on the most recent closing price of the underlying shares), as well as the delta adjusted notional amount of any options, security futures or any other derivative instruments based on the same class of equity securities; or
 - b. a security-based swap equivalent position that represents more than 5% of a class of equity securities, but if the security-based swap equivalent position represents more than 2.5% of a class of equity securities, the calculation of the security-based swap equivalent must also include in the numerator all of the underlying equity securities owned by the holder of the Security-Based Swap Position, as well as the number of shares attributable to any options, security futures or any other derivative instruments based on the same class of equity securities.

transacting in the underlying security, either directly or through an index, rather than the purchase or sale of the SBS that it references.¹³ We note that on June 7, 2023, the SEC adopted Rule 9j-1 with modifications to the proposed rule.¹⁴

IAC Recommendations

The IAC applauds and supports the efforts of the SEC to improve the SBS markets. The SBS markets have grown significantly over the past decade, making them integral to the overall stability and integrity of the financial markets. Further, the IAC supports the SEC in its mission to modernize the securities markets and further proscribe insider trading schemes that only serve to weaken and undermine the markets. The IAC supports the SEC's recent adoption of Rule 9j-1, which is designed to prevent fraud, manipulation and deception in connection with SBS transactions.¹⁵

The IAC makes the following recommendations to the SEC's proposals related to Regulation 13D-G and Rule 10B-1 to strengthen the SEC's proposals, bringing the Agency closer to achieving its stated objectives in proposing the above discussed rules.

1. **13D/G Deadline:** *Shorten the time required to make required filings under 13D/G to five business days, not calendar days.* While the IAC recognizes that the timeline for 13D/G has traditionally been stated in terms of calendar days, we believe that in shortening the deadline for filing, the SEC should use business days. Amending the 13D/G filing deadline to reference business days, rather than calendar days, will allow the SEC to modernize the markets and meet its other goals of reducing information asymmetry in the markets. Framing the threshold in terms of business days will also result in greater consistency across SEC regulations, many of which are framed in terms of business or trading days (not calendar days). For example, Section 16 filings on Form 4 must be filed within two business days. Similarly, a Current Report on Form 8-K generally must be filed within four business days.
2. **Shorten the Initial Schedule 13G Filing Deadline for Qualified Institutional Investors and Exempt Investors:** *Shorten the reporting period for the initial Schedule 13G filing by Qualified Institutional Investors and Exempt Investors to 45 days after the quarter (versus the proposed 5 business days after the month) from the current 45 days after the year in which the 5% threshold is crossed.* Qualified Institutional Investors (QII) include investment companies registered under the Investment Company Act of 1940, investment advisers registered under the Investment Advisers Act of 1940, insurance companies, certain qualified pension funds and employee benefit plans, which acquired the securities in the ordinary course of business with no purpose or effect of changing control of the issuer. A

¹³ SBS Release at 3 and 25.

¹⁴ See SEC Release No. 34-97656; File No. S7-32-10 available at <https://www.sec.gov/rules/final/2023/34-97656.pdf>

¹⁵ See SEC Final Rule and Press Release available at <https://www.sec.gov/news/press-release/2023-104>.

45-day after the end of a quarter filing deadline would also be consistent with the deadline for filing Form 13F.

3. **Beneficial Ownership of Cash-Settled Derivatives:** *Better align the proposed Rule 13d-3 with the requirements of proposed Rule 10B-1.* In treating investors with cash-settled derivatives as beneficial owners with reporting requirements under Regulation 13D-G, the proposed rule conflicts with proposed Rule 10B-1. This is true despite proposed rule 13d-3 (which deems holders of cash-settled derivatives as beneficial owners for purposes of 13(g) and/or 13(g)) excluding SBS from its scope. The IAC believes that subjecting cash-settled derivatives and SBS to different reporting and regulatory regimes will only serve to cause confusion in the markets and make compliance difficult for market participants. As such, any effort to require reporting on derivatives positions—whether cash-settled or SBS—should be better aligned to avoid duplicative and burdensome regulation on market participants.
4. **Rule 10B-1 Reporting:** *Change reporting thresholds for security-based swaps over equity securities to be based on percentages rather than a fixed dollar amount; align timeline with any Schedule 13D reporting requirements for cash-settled derivatives.* The growth of the SBS markets have made this segment of the financial markets particularly salient to the overall stability and integrity of the financial markets. While the IAC supports the SEC’s efforts to gain better insights into the markets and improve market transparency, we are concerned that a bright-line dollar amount may not capture true sources of risks within the SBS markets. With Schedule 13D/G, market participants’ reporting obligations are tied to a percentage of the issuer’s shares, recognizing that potential influence over the issuer is a relative question, not an absolute one. Similarly, the IAC recommends that SBS reporting requirements for equity security based swaps should be tied to a *percentage* of the issuer’s outstanding shares or economic equivalent for SBS related to the issuer. Further, as currently proposed, market actors would be required to reporting their SBS positions within one business day—a much shorter timeline than the five calendar days proposed for cash-settled derivatives. The report timing mismatch for these similar instruments should be resolved, such that reporting obligations are consistent. Additionally, while we do not recommend a specific percentage of the issuer’s outstanding shares (or economic equivalent) at which SBS positions should be reported, we believe that the reporting threshold should be better aligned with the reporting requirements of Schedule 13D, so that the ownership thresholds of Schedule 13D would not be rendered irrelevant in many cases. In addition, we believe that the reporting threshold should be based on net positions, to account for hedging strategies that reduce overall risk exposure.

No Recommendation on the Definition of “Group” (Rule 13d-5)

The IAC is not making a recommendation with respect to the proposed amendments to Rule 13d-5 because of a lack of consensus on the effects of the proposed definition of a “group” and how that would impact shareholder communication. The IAC does, however, agree with the SEC’s description of existing case-law regarding the definition of “group.” It would support the

inclusion of such description in any final rulemaking regarding Schedule 13D reporting to highlight to market participants the scope of such case law when considering the applicability of the “group” rules.