April 11, 2022

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: File No. S7-06-22; Modernization of Beneficial Ownership Reporting; Release Nos. 33-11030; 34-94211

Dear Ms. Countryman,

We are officers of the International Institute of Law and Finance ("IILF"),[1] a non-profit, non-partisan institution dedicated to promoting independent research, academic papers, teaching, discussion, and public policy initiatives in law and finance. Our comments relate to an area of our teaching and study, Release Nos. 33-1103; 34-94211 (the "Proposed Beneficial Ownership Rules" or the "Release"), the proposed rules on "modernization" of beneficial ownership reporting. We thank the Commission for the opportunity to comment on the Proposed Beneficial Ownership Rules.

We also have provided support for other comment letters on the Proposed Beneficial Ownership Rules by assisting in drafting those letters, with assistance from many of the people who have signed those letters.[2] In particular, we want to highlight the Comment Letter of 65 Law and Finance Professors, which focuses on the potential impact of the Proposed Beneficial Ownership Rules on shareholder activism, an important phenomenon that would be significantly impacted by the Proposed Beneficial Ownership Rules. The Commission considered some but not all of the available data and academic literature cited in that letter. Consistent with our mission, we have not formally signed that letter, but we very much endorse and agree with it.

We previously submitted a comment letter on the proposed rules contained in Release No. 34-93784 (the "Proposed Swaps Rules").[3] Given the interlocking nature of the Proposed Beneficial Ownership Rules with the Proposed Swaps Rules, we believe the Commission should analyze these Releases together with the benefit of all commentary. We refer to both rules collectively as the "Proposed Rules."

The public response to the Proposed Rules is truly unprecedented, not only in scope and substance, but also in the diversity of commentators. The institutions and individuals who oppose various aspects of the Proposed Rules range from labor interests to free speech advocates to

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[1] See https://iillawfin.org for a description of our mission and our role.
[2] As described more fully on the IILF website, we will receive compensation for our IILF activities, including drafting the letters described herein. Among the letters we assisted in drafting are comment letters on the potential effects of the Proposed Beneficial Ownership Rules on shareholder activism, labor interests, expressive conduct, and environmental, social, and governance ("ESG") concerns. None of the people who signed any of the letters we assisted in drafting have been compensated for the letters.
[3] *Available at* https://www.sec.gov/comments/s7-32-10/s73210-20120934-273057.pdf.

board diversity proponents to free market-oriented economists to mainstream progressives to ESG experts, in addition to various trade associations and financially interested parties. Many of the comments are focused on the untenable "group" proposal in the Release, but as the Comment Letter of 65 Law and Finance Professors describes, the Release fails to provide sufficient support for the various proposals it sets forth.

In this comment letter, we provide an overarching perspective on the Proposed Rules and various comment letters, including comment letters we have been involved in drafting. We start with an overview of some context and background, including our recommendations. Then we turn to a historical description of some aspects of the Commission's views on beneficial ownership reporting, to show how significantly the Proposed Rules depart from past practice and policy. Finally, we address the lack of evidence supporting the Proposed Rules, particularly with respect to assertions about "information asymmetry," and we report, as one example of analysis the Commission could have conducted but did not, results from a statistical study of retail investors based on data available to the Commission. That study shows that there is no empirical support based on this data for a conclusion that retail investors have been harmed in the ways the Release suggests in its assertions about "information asymmetry." Before we turn to history and evidence, we begin with our recommendations.

Recommendations and Context

At the outset, we lay our cards on the table: we believe there are only two viable options for the Commission with respect to the Proposed Rules. First, the Commission could simply table or withdraw both the Proposed Swaps Rules and the Proposed Beneficial Ownership Rules and postpone any action while its staff engage more seriously in efforts to study and address the myriad problems raised by commentators. We would be happy to facilitate such efforts, and to work with the Commission to gather data and engage with academic researchers who are interested in helping the staff study these issues.

Alternatively, the Commission could carefully consider the various comment letters it has received and then, instead of finalizing new rules, recommend that Congress address the concerns that appear to have motivated the Proposed Rules. In particular, the Proposed Rules seem designed to address concerns about "information asymmetry" or "horizontal equity" with respect to different groups of investors.[4] We understand that some practitioners, academics, and policymakers have expressed concerns about these issues, and a handful of publications raising these concerns occupy substantial space in the Release. However, any new rulemaking efforts focused on such concerns would be a substantial departure from past regulatory policy, including the Commission's own positions over time. Instead of attempting such an abrupt policy pivot, the Commission instead could simply ask Congress to consider addressing these concerns with hearings of the type that predated the Williams Act of 1968.

Those are the two best options in our view: table or withdraw the Proposed Rules, or propose that Congress consider a new version of the Williams Act focused on particular issues highlighted in the Release. In our opinion, adopting final rules based on the Proposed Rules as

[4] The Release includes several unsupported assertions about "information asymmetry." *See* Release, at 109, 118-19, 121-123, 125, 142, and 150.

drafted would be a serious mistake. Any final Commission rules based on the Proposed Rules would (1) generate significant costs and uncertainty for market participants, (2) create incentives for regulatory arbitrage transactions, and (3) spawn a wave of litigation that likely would end with the same unfavorable result as the Commission's ill-fated attempt to expand proxy ballot access in 2009.

Indeed, the parallels to 2009 are striking: a very substantial number of comment letters, serious opposition from a wide range of constituencies, concerns about statutory authority, a partisan split at the Commission, a failure to examine important data and evidence, dubious projections about future behavior, and insufficient cost-benefit analysis, all echoes of the "arbitrary and capricious" findings from just over a decade ago with respect to the Commission's proposed proxy rules.[5] The Proposed Rules seem similarly doomed, potentially replacing the proxy access proposal as the rules raising "the most controversial regulatory issues in the Commission's history."[6]

The Commission apparently anticipated potential legal challenges based on the absence of data or quantitative analysis in the Release, because instead of referencing data it already has, or working with market participants to engage in quantitative analysis, the Commission simply asserts in the Release that there are no such data and that therefore it will rely instead on "qualitative assessment."[7] But merely saying "qualitative assessment" is not enough, and in any event the Release lacks "qualitative assessment" as well.

Although the Release asserts that the Commission faces "data limitations,"[8] in fact the Commission has access to data, as well as extensive research based on data, regarding many areas where it says it cannot engage in quantitative analysis.[9] The Commission also has access to

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[5] *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). *See also D.C. Circuit Finds SEC Proxy Access Rule Arbitrary and Capricious for Inadequate Economic Analysis*, 125 HARV. L. REV. 1088, 1088-89, https://harvardlawreview.org/wp-content/uploads/pdfs/vol125_business_roundtable_v_SEC.pdf.

[6] *See* Reply Brief of Petitioners Business Roundtable and Chamber of Commerce of the United States of America, *Bus. Roundtable*, 647 F.3d 1144 (No. 10-1305), 2011 WL 2014801, at 16 (Feb. 25, 2011).

[7] *See, e.g.*, Release, at 110 ("Where we are unable to quantify the economic effects of the proposed amendments, we provide a qualitative assessment of the potential effects and encourage commenters to provide data and information that would help quantify the benefits, costs and potential impacts of the proposed amendments on efficiency, competition and capital formation.").

[8] Release, at 122 ("As discussed in Section III.A, we are not able to quantify the potential harm to investors due to data limitations.").

[9] *See, e.g.*, Release, at 140 ("We are unable to quantify the potential increase in costs related to the proposed shortened Schedule 13D and 13G filing deadlines due to the lack of data. For example, we lack data to estimate how the proposed amendments would affect blockholders' ability to initiate corporate change because such ability would depend on their target share accumulation level, the liquidity of their target stocks and their acquisition plans."; Release, at 144 ("We are unable to quantify these costs related to beneficial ownership disclosure, because we lack data on the current use of cash-settled derivative securities to provide reasonable estimates on how such use would change."); Release, at 148 ("We are unable to quantify the costs of our amendments related to group formation. Because we lack data on how many groups may not be reporting beneficial ownership because of the misimpression that an agreement is required, we cannot provide reasonable estimates on how such reporting practices would change.").

relevant and recent publications from market participants.[10] In this respect, the Release resembles the Commission's efforts on proxy access. Many of the questions for investors in the Release read more like an attempt to satisfy Administrative Procedure Act review than a genuine search for data; the questions include broad, open-ended requests for information that in other settings would be requested privately or in anonymized format, not as part of public comments.[11]

There is one striking difference between the proxy access fiasco and today's failures. In 2009, the Commission was on the side of investors, advocating against pro-business interests. **Today, the opposition to the Proposed Rules is overwhelmingly from investors of all kinds**, representing millions of individuals and trillions of dollars.[12] As noted above, investors are joined by many unlikely allies, who also have submitted detailed comments opposing various aspects of the Proposed Rules. It is striking that, at a moment of extreme polarization in American political life, labor interests, ESG advocates, and other progressives find themselves in agreement with pro-business interests, pro-management trade associations, and financial institutions—and vice versa.[13] This unity would be heartening, except that it arose only because the Commission proposed unwise rules contrary to its mission.

Who is on the Commission's side? Not many. Nor are there many allies cited in the Release, particularly with respect to its most controversial elements, the proposed "group"

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[10] *See, e.g. Lazard's Annual Review of Shareholder Activism—2021*, Jan. 19, 2022, https://www.lazard.com/perspective/lazards-annual-review-of-shareholder-activism-2021/ (describing 2021 shareholder activist campaign activity).

[11] *See, e.g.*, Release, Question 22 ("Do costs other than routine filing and preparation costs exist that we should consider in setting the initial Schedule 13G filing deadlines? If any such costs exist, please identify and quantify to the extent practicable."); Question 92. ("Would the proposed amendments shortening Schedule 13D filing deadlines negatively affect shareholder activism? If yes, are there any other reasons for such effects besides the ones we have discussed? Would such effects be more or less significant than our assessment? Would the benefits justify the costs? Are you aware of any data or methodology that could help us quantify the effects?"); Question 96 ("Would the proposed amendments affirming our view on group formation have negative effects on shareholder activism, engagement and communication? Would such effects be more or less significant than our assessment? Are there any other economic effects associated with these proposed amendments that we have not discussed? Would the benefits justify the costs? Are you aware of any data or methodology that could help quantify the costs?"; Question 99 ("Would the proposed amendments affect efficiency, competition and capital formation as we have discussed? Would such effects be more or less significant than our assessment? Are there any other effects on efficiency, competition and capital formation that are not identified or are misidentified in the above analysis? Are you aware of any data or methodology that can help quantify these effects?").

[12] For example, the Council of Institutional Investors has articulated serious concerns about the Release's language regarding "group." *See* Council of Institutional Investors Comment Letter, Apr. 8, 2022, https://www.cii.org/files/issues_and_advocacy/correspondence/2022/April%208%202022%20Modernization%20of%20Beneficial%20Ownership%20Reporting%20(finalF).pdf.

[13] Before the comment deadline for the Release, an internet search for "Kristen Malinconico" (Director, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce) and "Andrew Stern" (Former President, Service Employees International Union) generated zero results; today, they are just two examples of unlikely allies who have signed comment letters opposing the Proposed Rules. *See* U.S. Chamber of Commerce Comment Letter, Mar. 21, 2022; Andrew Stern Comment Letter, Apr. 11, 2022.

amendments.[14] The two most-cited references in the Release are a few paragraphs from one six-year-old law review article (which included only tentative conclusions and admonished that "[t]his is an unexplored area, and we express no firm conclusion"),[15] and a few pages from one six-year-old letter from a law firm known for representing the interests of corporate managers against shareholder activists.[16] The only thing stranger than the bedfellows opposing the Proposed Rules are the strange (and few) bedfellows who support them.

Not every proposal in the Release is far-reaching, and reasonable people might disagree about some of them.[17] But other rules are sufficiently complex and costly that they would create incentives for regulatory arbitrage. For example, the Release states that "Rule 13d-3(d)(1)(i), proposed paragraph (e)(1) also would include a provision stating that any securities that are not outstanding but are referenced by the relevant cash-settled derivative security will be deemed to be outstanding for the purpose of calculating the percentage of the relevant covered class beneficially owned by the holder of the derivative security. Those reference securities, however, will not be deemed to be outstanding for the purpose of any other person's calculation of the percentage of the covered class it beneficially owns."[18] Such a rule could be difficult and costly

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[14] Although the Release references reducing "information asymmetry" as a potential benefit to investors and market participants related to the "group" amendments, *see* Release, at 150, it does not reference the vast academic literature related to this concept or analyze the purported benefit based on data or the academic literature.

[15] John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 596 (2016).

[16] *See* Wachtell, Lipton, Rosen & Katz to Elizabeth M. Murphy, Sec'y, U.S. Sec. & Exch. Comm'n (Mar. 7, 2011) ("Wachtell Petition") at 1-7, *available at* http://www.sec.gov/rules/petitions/2011/petn4-624.pdf. The Wachtell Petition followed a period of significant comment from practitioners about the potential dangers of shareholder activism, including several publications cited in both these publications and the Release. *See id.* at nn. 16, 19, 88, 210, 241, 262 (citing petition from Wachtell, Lipton, Rosen & Katz); *see also* Coffee & Palia, *Wolf at the Door*, 41 J. CORP. L. at 594 (citing the same Wachtell petition). As noted in the Comment Letter from 85 Law and Finance Professors, the cited law review article discussed the potential issue that activists "may" work together (in the same way as is suggested by the use of the word "may" in the Release), but cautioned against any firm conclusion. *Id.* at 596. Moreover, also as noted in the Comment Letter from 85 Law and Finance Professors, there is no evidence cited in the Release of shareholder activists, or anyone, using swaps to engage in the kind of "reciprocity" suggested in this article. *See id.* at 595 (suggesting that activists "may prefer to share the gains among themselves by using an organizational structure that unites a number of funds into a loosely knit organization (i.e., the 'wolf pack') that may acquire 25% or more of the target."). Likewise, the law review comment cited in the Release does not introduce new data or quantitative analysis, but instead relies on an early draft of the cited law review article, along with some of the other literature cited in the Comment Letter from 85 Law and Finance Professors. We note that the practitioner authors of the publications most frequently cited in the law review article, the law review comment, and the Release did not submit comments on the Proposed Swaps Release.

[17] For example, commentators reasonably disagree about whether to reduce the 10-day filing window under Schedule 13D, and whether to measure that window with calendar or business days. A one-day reporting period seems obviously too short; one day would be unfair relative to other rules, and would create logistical challenges. But it does not seem unreasonable to reduce the 10-day period somewhat. In contrast, we do not believe there can be reasonable disagreement about the chilling effects of the Commission's proposed amendments to the "group" rule.

[18] Release, at 58

to administer in practice, and could create incentives for regulatory arbitrage transactions to create positions that are economically equivalent to the upside of a position in shares, but with complex payout profiles, contingencies, or triggers that result in relatively low delta calculations. The proposed rule also creates a "denominator problem" for assessing derivatives, particularly in the context of a group, where it could be unclear what the value of securities outstanding would be for purposes of calculating the percentage owned by the group. For example, counterparties could avoid the implications of the illustrations in the Release simply by reducing the notional amount of any swap transaction.[19]

We are confident that other comment letters will address such details and many other issues in depth. In the remainder of our letter, we want to focus on two points we think might not be sufficiently emphasized in other comments. First, the Proposed Rules do not "clarify or affirm" anything, as the Release suggests.[20] Instead, the Proposed Rules are a significant departure from past Commission statements and policy, as expressed in amicus briefs, guidance, and references to case law. The departure from past policy is a serious one, not unlike the departure from past policy in the 2009 proxy access rules, where a record of flip-flops exposed the Commission to judicial scrutiny. The history of past statements and policy raises the bar for the Commission to be more precise in justifying the Proposed Rules.

Second, the Proposed Rules contain assertions about "information asymmetry" that are inconsistent with available evidence and law. As noted above, concerns about "information asymmetry" and "horizontal equity" appear to have motivated various aspects of the Proposed Rules, even though eliminating "information asymmetry" is not a fundamental aspect of the securities laws: "toeholds" are permitted, acquisition proposals need not be disclosed, properly obtained material non-public information can be used, and major investors (e.g., Warren Buffett) are permitted to buy securities secretly, even though sellers do not know about their trades or intent. It is not clear under the *Basic, Inc. v. Levinson* whether the intent to file a Schedule 13D is material non-public information,[21] yet the Release is resolute about inhibiting trading based on such information, even analogizing these concerns to insider trading, and using "tipper-tippee" language to describe and justify the Proposed Rules.[22]

As the Comment Letter of 85 Law and Finance Professors showed in detail, the academic research the Commission cites as supporting these assertions demonstrates that concerns about "information asymmetry" or "horizontal equity" are unsupported; instead, Schedule 13D filings are unambiguously associated with positive returns for investors overall.[23] Some people at the Commission might have an intuitive concern about investors who might be disadvantaged by selling during the window before such filings,[24] but the academic research cited in the Release

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[19] *See* Release, at 60.
[20] *See, e.g.* Release, at 1 ("clarify and affirm").
[21] *See, e.g.*, *id.* at 81, 88, 103, and 159 (using the term "tipper-tippee").
[22] *See Basic, Inc. v. Levinson*, 485 U.S. 224 (1988).
[23] *See* Comment Letter of 85 Law and Finance Professors, at 3-7.
[24] *See, e.g.*, Release, at 122 ("Therefore, during any delay between a market-moving event and the Schedule 13D filing, securities are likely to be mispriced relative to a full-information benchmark, and information asymmetry between Schedule 13D filers and those with whom they share the information,

contradicts this concern. Moreover, as we show below in a new empirical analysis not previously published, any assertion that retail investors in particular are damaged during this window is contrary to statistical evidence, based on data that are available to the Commission.

The Release is especially perplexing given recent trends. According to a 2022 practitioner review, the impact that shareholder activists are having on corporate America is modest and in decline: last year, activists replaced less than one board member per campaign on average.[25] Meanwhile, the most significant trend related to activism is the recent proliferation of ESG as "a key plank in activists' platforms."[26] Given these trends, a more pressing concern for the Commission would be to encourage new forms of activism, not suppress them. Moreover, as the Release recognizes,[27] given the development of poison pills, public company boards are no longer monitored by hostile takeovers, so activism is the remaining recourse. It is important not to inhibit it.

Some History: The Proposed Rules Do Not "Clarify or Affirm"

The Commission asserts that the Proposed Rules would "clarify and affirm" the application of its regulations.[28] But the strong reaction of investors to the Release demonstrates the opposite. The Proposed Rules are a significant departure from the Commission's historical positions and guidance with respect to issues raised in the Proposed Rules. In the past, the Commission has followed an iterative "common law"-style approach based on broad principles, not specific rules. The past approach relied on judicial decisions and feedback from market participants, and a "facts and circumstances" examination of each situation. Such an approach is wise and practical, with a reliable and well-articulated pedigree. Yet the Release explicitly jettisons this approach, in favor of "new" requirements under the Proposed Rules.[29]

When the SEC first began formulating permanent rules under Section 13(d), it explicitly invited public comment on whether the definition of "beneficial owner" should include "a person who has the right to receive economic benefits from securities."[30] Initially, the SEC answered yes, proposing a definition of "beneficial owner" that included any person "who has or shares the power to direct the receipt of dividends or proceeds from the sale of the securities."[31] But when the final rules were adopted, the "most significant modification" of the rules as originally

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and the rest of the market, is greater than otherwise. The prolonged delay could, therefore, harm the investors who happen to sell their shares during the 10-day window. As discussed in Section III.A, we are not able to quantify the potential harm to investors due to data limitations.").

[25] *See Lazard's Annual Review of Shareholder Activism—2021*, at 2 (describing the number of board seats secured by activists as "lower than in recent years"); *see also id.* (describing the number of activist campaigns in 2021 as "in line with 2020's slower pace").

[26] *Id.*

[27] Release, at 107.

[28] The Release uses "clarify" or "affirm" language more than a dozen times. *See* Release, at 1, 4, 12, 67, 86, 95, 97-98, 144-46, 148, and 150.

[29] The Release uses the word "new" 69 times.

[30] Exchange Act Release No. 34-11003 (Sept. 9, 1974), 39 Fed. Reg. 33837.

[31] Exchange Act Release No. 34-13291 (Feb. 24, 1977), 42 Fed. Reg. 12343 (referencing Exchange Act Release No. 11616 (Aug. 25, 1975), 40 FR 42212).

proposed was the elimination of economic interest as a basis for finding beneficial ownership.[32] As the Commission later explained: "[T]he possible [e]ffect on control is the aspect of beneficial ownership of greatest interest to issuers and investors. Accordingly, the traditional economic interest in securities, i.e., the right to receive dividends and the right to receive proceeds upon sale, have not been included as criteria for defining beneficial ownership."[33]

Over time, the Commission has taken positions consistent with a "common law" evolutionary approach,[34] and inconsistent with the Proposed Rules. For example, the Commission has submitted amicus briefs taking different positions on both "group" formation[35] and the definition of beneficial ownership[36] than those represented as "clarifying and affirming" in the Release.[37] Market participants have relied on past Commission's statements, and a final rule with this flip-flop would generate uncertainty and chill investor communications and action.

At minimum, the Commission should explain precisely in any final rules how the Proposed Rules are consistent, or not, with its previous commentary and amicus briefs related to the concept of "group". Investors have long relied on the Commission's prior guidance in this

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[32] Exchange Act Release No. 34-13291 (Feb. 24, 1977), 42 Fed. Reg. 12344.

[33] Filing and Disclosure Requirements Relating to Beneficial Ownership, Exchange Act Release No. 34-14693 (April 21, 1978), 43 FR 18502.

[34] Commission interpretations have followed a fact-specific and flexible "Q+A" format. *See, e.g.*, https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm.

[35] *See, e.g.*, Brief of Securities and Exchange Commission, *Amicus Curiae*, *Morales v. Quintel Entm't, Inc.*, No. 99-9374 (2d Cir. Mar. 2000), at p. 27 ("Whether a lock-up provision constitutes an agreement for the purposes of creating a Section 13(d) group depends on the facts and circumstances of any given case."). In that case, the court adopted the Commission's view and held that while a lock-up agreement "may bear upon" the question of whether a group exists, evidence of coordination and testimony demonstrating that parties joined together to acquire, hold, or dispose of securities are more likely to demonstrate the existence of a group. *Quintel Entm't*, 249 F.3d 115, 127 (2d Cir. 2001); *see also Hallwood Realty Partners*, 286 F.3d 613, 618 (2d Cir. 2002) (affirming decision finding no group based on record that included evidence of prior relationships between parties, trading patterns, discussions, and other circumstantial factors). *See also* Brief of Securities and Exchange Commission, *Amicus Curiae, Lowinger v. Morgan Stanley & Co.*, No. 14-3800-cv (2d Cir. Aug. 2015), at p. 17 ("A typical lock-up agreement, standing alone, is insufficient to establish a group for Section 13(d) or Section 16(b) purposes.").

[36] When Judge Kaplan halted the trial in the *CSX* case to ask Commission staff for a letter regarding issues related to swaps and beneficial ownership, Brian Breheny—at the time, the Deputy Director of the Division of Corporation Finance—responded that "the presence of economic or business incentives that the [swap counterparty] may have to vote the shares as the other party wishes" is insufficient to create the beneficial acquisition of voting power in respect of such shares. Securities and Exchange Commission Letter in *CSX Corp. v. The Children's Inv. Fund Mgmt, L.L.P.*, 08-Civ. 2764, at 2 (S.D.N.Y. June 4, 2008).

[37] The Commission also should explain how and why it might favor one court holding over another—and where it derives authority to do so. For instance, the Commission favorably cites the Second Circuit's holding in *GAF Corp. v. Milstein*, F. 2d 709 (2d Cir. 1971) on group formation, and notes that the Second Circuit refused to follow the Seventh Circuit's ruling in *Bath Indus., Inc. v. Blot*, 427 F.2d 97 (7th Cir. 1970). *See* Release, at 70. The Commission also fails to address far more recent caselaw reaching different conclusions. *See, e.g.*, *Edelson v. Ch'ien*, 405 F.3d 620 (7th Cir. 2005).

area, and the new approach would upend and be inconsistent with the basic principles the Commission has articulated over time.

Moreover, we believe the supposed "clarification" would create serious uncertainty around whether otherwise common and socially beneficial investor behavior would violate the Proposed Rules. What would future Commission officials say about whether the following communications and activities were sufficient to form a "group"?:

- Investor discussion in support of diverse board candidates
- Investor discussion in support of climate change initiatives at a company
- Investor discussion of a so-called "vote no" campaign
- Discussions between pension funds and other investors in support of workers and labor interests
- Activities between investors and shareholder activists related to ESG reforms at a company
- Activities by investors that later appear to have been consistent with the purpose and objectives of shareholder activists
- Activities by investors who later unite with shareholder activists with respect to campaigns to reduce the externalization of costs at a company
- Communications or activities involving investors and any institution that has a reputation for holding managers accountable
- And so on

The Commission has long relied on an iterative approach based on broad principles for the topics covered by the Proposed Rules. It should return to those principles to avoid inducing market turmoil and uncertainty.

The Evidence about "Information Asymmetry"

As noted above, the Commission repeatedly asserts that "information asymmetry" is a justification for the Proposed Rules. These assertions appear to suggest that retail investors might be harmed by selling during the window before prices fully reflect information set forth in a Schedule 13D. However, the Release cites no data or empirical support for these assertions.

Instead, with respect to "information asymmetry," the Release simply states that the Commission has a "belie[f]"[38] that the Proposed Rules "could"[39] or "would"[40] benefit investors,

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[38] *See, e.g.*, Release, at 109 ("Overall, we believe the proposed amendments would benefit investors and market participants by providing more timely information relating to significant stockholders as well as potential changes in corporate control, facilitating investor decision-making and reducing information asymmetry in the market. We also recognize that these amendments could increase costs for investors and issuers. For example, the amendments could increase costs for blockholders seeking to influence or control an issuer, and therefore potentially inhibit shareholder activism and the improvement of corporate efficiency."); *id.* at 118 ("Overall, we believe the proposed amendments to Regulation 13D-G would benefit investors and market participants by providing more timely information relating to significant stockholders as well as potential changes in corporate control, facilitating investor decision-making, reducing information asymmetry and improving price discovery in the market.").

[39] *See, e.g.*, Release, at 119 ("More timely disclosure of such market-moving information could improve transparency, reduce information asymmetry and mispricing in the market, and allow investors to make more informed investment decisions."); *id.* at 121 ("Thus, by shortening the deadline for initial Schedule 13D filings, the proposed amendment could improve the timeliness of beneficial ownership reporting, benefiting investors and other market participants through improved transparency and reduced information asymmetry in the market."); *id.* at. 122 ("Therefore, during any delay between a market-moving event and the Schedule 13D filing, securities are likely to be mispriced relative to a full-information benchmark, and information asymmetry between Schedule 13D filers and those with whom they share the information, and the rest of the market, is greater than otherwise. The prolonged delay could, therefore, harm the investors who happen to sell their shares during the 10-day window. As discussed in Section III.A, we are not able to quantify the potential harm to investors due to data limitations."); *id.* at 142 ("As discussed above, information related to a potential change in corporate control is material to the market, and withholding the information could lead to information asymmetry and mispricing in the market").

[40] *See, e.g.*, Release, at 123 ("More timely reporting would facilitate price discovery in the market, reduce information asymmetry and mispricing, and therefore allow investors to make more informed investment decisions."); *id.* at 125 ("Therefore, timely reporting of value-relevant information would facilitate price discovery and reduce information asymmetry and mispricing in the market, benefiting investors and other market participants similar to our proposed shortening of the initial Schedule 13D filing deadline."); *id.* at 150 ("By shortening Schedule 13D and 13G filing deadlines, expanding the scope of beneficial ownership to include holders of certain cash-settled derivative securities, and, clarifying and affirming that an actual agreement is not needed for the formation of a group, the proposed amendments could help ensure that large shareholders, including groups, comply with the reporting threshold, and therefore improve disclosure regarding material information related to potential changes of corporate control. More timely and enhanced disclosure would reduce information asymmetry and mispricing in the market, thereby improving liquidity and market efficiency. More efficient prices and more liquid markets help allocate capital to its most efficient uses. By making material information available to the public sooner, and reducing the differential access to information, the proposed amendments could increase public trust in markets, thereby aiding in capital formation. Finally, we believe that the proposed amendments could promote competition in that those who delay reporting would not have an advantage over similarly situated shareholders who report earlier. Furthermore, lowering information asymmetry could also increase competition among market participants. For example, if blockholders selectively reveal information, this gives some market participants advantages over others. On the other hand, we recognize that some aspect of the proposed amendments could increase the costs of accumulating large blocks of shares. If some investors choose not to trade when they otherwise might have, capital formation, and therefore market efficiency, could be harmed. However, this cost would be offset by increased liquidity that arises from reducing information asymmetry.").

citing the term "information asymmetry." At one point, the Release cites an academic article in support of its "information asymmetry" assertions,[41] but this important 1985 article, which focused on liquidity, does not include any data or analysis in support of the Commission's assertion about benefits of "increased liquidity" arising from the Proposed Rules. The Commission does not demonstrate that liquidity is harmed during the relevant windows, or that the Proposed Rules would improve liquidity.

There are numerous empirical tests that Commission staff could run to see if the above assertions about "information asymmetry" are supported by any evidence. We now demonstrate one such test. If the Commission remains serious about moving forward with the Proposed Rules, it should back its assertions by running tests such as the one we describe next, based on data the Commission already has.

Using publicly available data, we ran a straightforward test that shows that **retail investors are not net sellers during the 10-day Schedule 13D window**. This finding directly contradicts the central assumptions about "information asymmetry" and "horizontal equity" in the Proposed Rules.[42]

The Proposed Rules raise an empirically testable question of whether investors are systematically harmed from sales prior to the disclosure of activist campaigns, so that activist gains "come at the expense" of investors.[43] Specifically, one question is this: who is selling during Schedule 13D windows? The answer matters crucially to the "information asymmetry" assertions in the Release. Yet the Release does not show that any investors actually are harmed overall due to such sales, or that any such harm outweighs other gains related to activism. The Release does not analyze which categories of investors are unlikely to be sellers during Schedule 13D windows (e.g., indexed or long-term investors) or address whether investors that are more likely to be sellers during Schedule 13D windows (e.g., blockholder sellers or algorithmic traders) are unlikely to face the kind of "information asymmetry" that the Release asserts is problematic.

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[41] *See* Release, at 123 ("Additionally, academic studies have shown that information asymmetry has a first-order effect on liquidity. Thus, the proposed amendment, by reducing information asymmetry, would provide incremental benefits to investors in general through the increased liquidity of the shares of the companies subject to Schedule 13D filings.") (citing Lawrence Glosten and Paul Milgrom, *Bid, Ask, and Transaction Prices in a Specialist Market with Heterogeneously Informed Investors*, 14 J. FIN. ECON. 71-100 (1985)).

[42] The Proposed Rules purport to address this "information asymmetry" by, among other things, shortening the filing deadline from ten to five days. However, as noted above, the economic analysis in the proposed rulemaking provides no empirical evidence to support this change, and only provides data on the distribution of Schedule 13D filings relative to the deadline. Instead, the proposed rulemaking lays out a number of questions for the public, including whether there is "evidence that a Schedule 13D filing . . . impacts shareholders' decisions to sell their shares?" Release, at 26.

[43] Release, at 14 n.19 (citing Coffee & Palia, *The Wolf at the Door*, 41 J. CORP. L. at 597 ("[T]he gains that activists make in trading on asymmetric information—before the Schedule 13D's filing—come at the expense of selling shareholders. . . . Disclosure that is delayed ten days enables activists to profit from trading on asymmetric information over that period.")).

Our analysis focuses on activist campaigns from 2015 to 2021 reported in the FactSet SharkRepellant database. Sophisticated investors are more likely than retail investors to infer with non-zero probability that an activist campaign has begun when a market participant arrives seeking to purchase large blocks in a single name. Accordingly, one can test the hypothesis that retail investors might be systematically harmed by "information asymmetry" by examining retail trading surrounding the filing of a Schedule 13D.

Because retail trading is not directly observable in public datasets, we look to the finance literature for the best-available proxy. Boehmer, Jones, Zhang, and Zhang (2021) (hereafter BJZZ) develop an algorithm for identifying retail order flow using publicly available data.[44] Because virtually all retail orders are executed by large retail wholesalers such as Citadel and Virtu with some price improvement, it is possible to identify trades and determine whether an order was a buy or sell. These trades are reported as off-exchange trades in a Trade Reporting Facility (TRF) and can be estimated using Trade and Quote (TAQ) data. Specifically, retail buys are identified as off-exchange executions where the transaction price is slightly below a round penny quoted price and retail sells are identified as off-exchange executions where the transaction price is slightly above a round penny quoted price. BJZZ validate this approach using a sample of NASDAQ TRF audit trail data.

We construct the percentage of net retail selling using the BJZZ measure of retail sells and retail buys.[45] If retail selling systematically increases prior to Schedule 13D filings, then it could be the case that retail investors were disadvantaged during this window. We examine time series variation in retail trading activity, and regress net retail selling on the event-time date, including campaign and year fixed effects in order to obtain averages within each campaign and remove systematic trends in retail trading.[46] In addition, we compute clustered standard errors, clustering at the campaign and year level to account for potential serial and cross-sectional heterogeneity in our standard errors.[47] The estimates from this regression are plotted below, along with confidence intervals.[48]

The figure below shows that although there are spikes in retail net selling activity around 14 days and 3 days prior to the filing of a Schedule 13D, this selling activity is statistically indistinguishable from zero. Even apart from statistical significance, net selling activity is modest at best—peaking at just below 3% of total retail trading 2 days prior to the filing.

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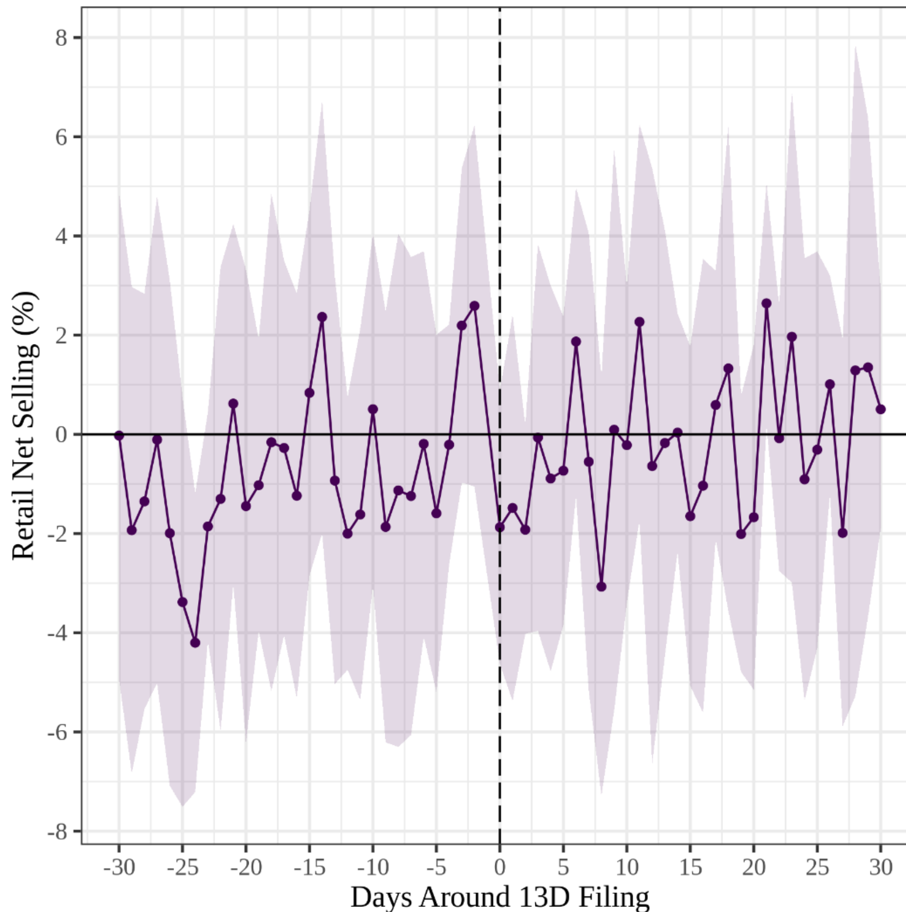
[44] *See* Ekkehart Boehmer, Charles M. Jones, Xiaoyan Zhang, and Xinran Zhang, *Tracking Retail Investor Activity*, 76 J. FIN. 2249 (2021).
[45] Specifically, the measure is (retail sells – retail buys) / (retail sells + retail buys).
[46] Retail trading increased significantly during 2020 and 2021. *See* Caitlin McCabe, *It Isn't Just AMC. Retail Traders Increase Pull on the Stock Market.* WALL ST. J., Jun. 18, 2021, https://www.wsj.com/articles/it-isnt-just-amc-retail-traders-increase-pull-on-the-stock-market-11624008602.
[47] Our results are robust to using date and stock fixed effects and clustering, which would account for stock-specific trends in retail trading, and date-specific (e.g., market-wide) trends in retail trading.
[48] The econometric references in this paragraph might seem daunting to some readers, but are standard analyses for staff in the Commission's Division of Economic and Risk Analysis, including economists who are well-trained and perform similar analyses regularly.



The spikes in net retail selling depicted in the figure above are not uncommon and occur regularly even after the filing of a Schedule 13D—suggesting that retail investors are not concerned about missing out on stock price appreciation following the announcement of activist campaigns. Moreover, there is statistically significant evidence that some retail investors are net *buyers* at points prior to the filing of a Schedule 13D. Overall, it does not appear that retail investors are systematically harmed by "information asymmetry" due to the impending arrival of an activist investor.

The above is just one example of how the Commission could use data it already has to study the questions it asks in the Release. In addition, to the extent the Commission lacks the data it needs, it could request additional data from market participants. Then it could run tests similar to the above test to determine if its assertions about "information asymmetry" are warranted.

We recognize that Commission staff are addressing a very substantial number of proposed rules. The number of questions presented by the various proposals is overwhelming for everyone. It will be impossible for the Commission to move forward with reasoned and well-supported final rules on all of its dozens of proposals. But an artificial need for speed does not justify incomplete work.

The upcoming months necessarily will involve triage, and the Commission will need to shelve some of its proposals. We strongly recommend starting with the Proposed Rules.

We thank the Commission for its consideration of our concerns.

Respectfully,

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