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:

Alan Schwartz is the Sterling Professor of Law at Yale Law School and Professor of Management at the Yale School of Management. He writes extensively about transactions, many of which involve asymmetric information. See, e.g., *Unenforceable Securitization Contracts (with tracy Lewis),* 37 *Yale J. Regulation* 164 (2020) and *Pay to Play: A Theory of Hybrid Relationships* (with Tracy Lewis), 17 American L. and Econ. Rev. 462 (2016).

Steven Shavell is the Samuel R. Rosenthal Professor of Law and Economics at Harvard Law School, holds a PhD in economics, and is the director of the John M. Olin Center for Law, Economics & Business at Harvard University. He is the author of an article directly related to Release Nos. 33-11030; 34-94211 (the "Proposed Rules" or the "Release"), concerning the modernization of beneficial ownership reporting. The article is entitled "Acquisition and Disclosure of Information Prior to Sale," *RAND Journal of Economics*, Vol. 25, 1994, pp. 20-36. Another article of clear relevance to the Release is A. T. Kronman, "Mistake, Disclosure, Information, and the Law of Contracts," *Journal of Legal Studies*, Vol. 7, 1978, pp. 1-34.

We are writing specifically in response to the SEC's proposal to modify certain disclosure requirements in connection with a Schedule 13d filing. We thank the Commission for the opportunity to comment on the Proposed Rules.

An investor must file a Schedule13d filing when the investor has accumulated a stake of 5% or more in a company. Today, the investor has ten days after accumulating its stake in which to file. During this interval, the investor can purchase more shares. The proposed rule would shorten the post-5% accumulation period to five days. The SEC offers two related justifications for this change.[1] Regarding the first, the filing informs the public that the investor has taken a material stake in a company. The market will then incorporate this information into the company's share price. Shortening the accumulation period would accelerate disclosure of the investor's stake. As the SEC puts it, early public disclosure would incorporate potential "market moving information" into prices more rapidly, thereby improving the informational efficiency of the securities markets. Regarding the second justification, during the accumulation period the "activist" investor knows its plan for the target but the market does not. Thus, "asymmetric information" exists between the activist and any seller: that is, the seller would not trade at market but rather raise its price if the seller knew the activist's plan. The more shares the activist can purchase at the uninformed market price, the greater the unfairness to the selling side.

[1] The Appendix to this Letter quotes the relevant sections of the SEC's report.

The SEC recognizes that shortening the accumulation period would reduce the gains to activist investing and so reduce activism itself. This, the SEC agrees, is a cost because the data show that activists produce beneficial change. However, the SEC believes that the gain in better market pricing and fairness to sellers outweighs this cost. Put another way, there may be less activism but more efficient markets.

This Comment rests on three basic principles: (i) the market cannot impound a datum of information into a price if the datum does not exist; (ii) it is costly to acquire, or discover, information; (iii) in a securities market, an agent recovers its cost of acquiring information by trading on the information. These three principles have a clear implication: an agent who must disclose its information *before the agent trades* will not acquire the information initially. The basic flaw in the SEC's reasoning thus is that the SEC requires an activist buyer to disclose information that the buyer *has acquired*, but the SEC fails to ask whether the buyer would acquire the information if it had to disclose pre-purchase. The answer is clear: the buyer would not.

Consider a simple example. Suppose potential buyer B contemplates spending $5 million to determine whether target company T is worth acquiring because T might be inefficiently managed. B would lay out the $5 million to investigate T only if B can be reasonably confident he could make a decent profit from acquiring T's securities if T is in fact mismanaged. After all, B would not only be spending $5 million on research about T, B might be disappointed to learn that T is *not* inefficiently managed—which means that B's $5 million would be lost. So B's $5 million investigation cost would represent a risky investment and B would want a real payoff coming his way if the investigation pointed to mismanagement of T.

But if the SEC now imposes a 5 day requirement that has the effect of faster disclosure by B to the market of its plans, B's profits will be reduced because other buyers will learn what is going on and buy T's stock before B has a chance to acquire much more of it at its present price.

Hence, if the world changes as the SEC hopes it will under the 5 day requirement, then companies like B aren't going to be nearly as willing to shell out $5 million in the hope of profiting from acquiring T stock. The result will be that B might be reluctant to investigate T in the first place. That would mean that if T isn't well managed, B will not correct this bad situation for desirable economic functioning. Moreover, if B doesn't investigate T, then present shareholders of T are not going to profit from a run up in the price of T.

We turn briefly to the SEC's second justification for shortening the accumulation period, that it is unfair to sellers to permit activist buyers to purchase shares during the accumulation period because the sellers are trading with less information than the buyers. This justification misconceives the nature of security markets. Prices in securities markets move in consequence of shifts in demand and supply curves. These shifts occur not because buyers tell sellers (or sellers tell buyers) but because agents acquire information about companies and events and trade on that information. Requiring an agent to tell *before* he trades prevents the market from reflecting information in prices because it prevents agents from acquiring information initially. Using a current phrase asymmetric information is a feature, not a bug, of informationally efficient markets.

We thank the Commission for considering our comments regarding the use of the term "information asymmetry" in the Proposed Rules.

Respectfully,

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Appendix: The SEC's Justifications in the Release for Shortening the Accumulation Period

"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." Release at 109

"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." Release at 118.

"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." Release at 119.

"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." Release at 121

"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." Release at 122.

"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." Release at 123 (citing Lawrence Glosten and Paul Milgrom, *Bid, Ask, and Transaction Prices in a Specialist Market with Heterogeneously Informed Investors*, 14 The Journal of Financial Economics 71-100 (1985)).

"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." Release at 123.

"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." Release at 125

"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". Release at 142

"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." Release at 150.