April 13, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20548-1090

Re: Modernization of Beneficial Ownership Reporting, File No. S7-06-22

Dear Ms. Countryman:

The Society for Corporate Governance ("the Society") submits this letter in response to the Commission's rulemaking release on the Modernization of Beneficial Ownership Reporting.[1]

Founded in 1946, the Society is a professional membership association of more than 3,500 corporate and assistant secretaries, in-house counsel, outside counsel, and other governance professionals who serve approximately 1,600 entities, including 1,000 public companies of almost every size and industry. Throughout our 75-year history, our members have played an important role in engaging with activist investors and advising corporate directors and management on how to respond to those activists.

Below are our comments for consideration on select questions encompassed in the Proposing Release.

I. The Outmoded Beneficial Ownership Rules Inhibit Engagement and Impose Significant Costs on Companies.

The Society is pleased to support the updates to the Schedule 13D and 13G rules that are part of the Proposing Release. The existing Schedule 13D rules are based on a reporting regime that dates back to the Williams Act of 1968 when stock transactions were tracked on paper and delivered by the postal service or couriers. Back then, investment managers didn't have access to email, instant messaging, fax machines, market data terminals, computer-assisted trading technology, or alternative "dark pool" trading venues that help facilitate the accumulation of significant positions. Daily trading volumes on U.S. exchanges, which averaged 22 million

[1] Modernization of Beneficial Ownership Reporting, File No. S7-06-22, 87 Fed. Reg. 13625 (February 10, 2022) ("Proposing Release").

52 Vanderbilt Avenue, Suite 903 | New York, NY 10017 | 212.681.2000 *phone* | 212.681.2005 *fax* | *societycorpgov.org*

shares in 1968,[2] have grown by more than 1,000 times.[3] Fifty-four years ago, there was no standard period for settling securities trades; today the settlement cycle is two business days and the Commission recently proposed shortening that period further to "T+1" (one business day) by 2024 to reduce risks to investors.[4] As Chair Gary Gensler observed in support of shortening the settlement cycle, "As the old saying goes, time is money." Likewise, the Society believes that the outmoded 13D and 13G disclosure rules (especially the 10-day disclosure period) are costly to public companies and investors generally, and we are pleased that the Commission is proposing to modernize these rules.

The Society has long supported comprehensive reforms to improve stock ownership transparency, submitting comment letters, rulemaking petitions, and testimony in support of modernization of the Schedule 13D, Form 13F, and OBO-NOBO rules to enable companies to determine the identities of their investors and communicate more efficiently with them.[5]

The Society's support for modernization of the Schedule 13D and 13G reporting deadlines is premised on the fundamental concept that a public company must have timely information about its owners in order to engage with them effectively and respond promptly to their concerns. Most public companies rely on the information included in beneficial ownership filings to do just that.

Unfortunately, most companies do not have timely information about their shareholder base. Under the current 13F rules (which the Society believes would also benefit from modernization), an investment manager can buy a 4.9 percent stake in a public company on January 2 and not have to report that position until May 15. Given the potential 135-day time lag in 13F disclosures, most companies don't really know which investors may be approaching the 5% threshold to trigger a potential 13D or 13G filing. While passive indexed funds may not change their positions significantly from quarter to quarter, many hedge funds and other actively managed funds may move in and out of a company's stock throughout the year, making it more challenging to determine who owns their companies' shares.

Having timely data about activist positions and changes in a large investor's ownership is critically important for public companies. Virtually every company will promptly seek to initiate engagement if they learn that an investment manager (whether active or passive) has acquired a

---

[2] *See* SEC, 34th Annual Report (1968), https://www.sec.gov/about/annual_report/1968.pdf.

[3] Markets Media, "US Equity Trading Volume Reaches Record," (January 29, 2021) https://www.marketsmedia.com/us-equity-trading-volume-reaches-record/ (daily trading topped 24 billion shares in January 2021).

[4] Proposed Rule, Shortening the Securities Transaction Settlement Cycle, File S7-05-22 (February 9, 2022). In 1993, the SEC shortened the settlement period from five to three business days; that period was later cut to two days in 2017. (In support of one-day settlement cycle, the Commission noted: "In each past instance, shortening the settlement cycle promoted investor protection, risk reduction, and increases in operational efficiency." Fact Sheet, "Reducing Risk in Clearance and Settlement," February 2022.

[5] *See* Society for Corporate Governance, Comment Letter: Reporting Threshold for Institutional Investment Managers, (September 29, 2020) (hereinafter "Society 13F Letter"), https://www.sec.gov/comments/s7-08-20/s70820-7860050-223909.pdf; Shareholder Communications Coalition, Comment Letter: Recommendations for Interim Improvements to the U.S. Proxy System, SEC File No. 4-725 (April 8, 2019), https://www.sec.gov/comments/4-725/4725-5335206-184008.pdf; and NYSE Euronext, Society for Corporate Governance, and National Investor Relations Institute, Petition for Rulemaking Under Section 13(f) of the Securities Exchange Act of 1934 (February 1, 2013), https://www.sec.gov/rules/petitions/2013/petn4-659.pdf.

5% stake, so the company's senior executives and directors can learn about that investor's intentions and ideas for the company. Whether or not a company welcomes an activist, their management teams and directors typically will listen and respond thoughtfully to their concerns. As hedge fund activists and their allies often argue, many activists have studied their target companies closely and have ideas that may be constructive. There is no reason why these important strategic discussions between activists, management, and directors should be delayed by a 10-day disclosure period, which only serves to provide activists with more leverage by acquiring more shares in secret. More timely disclosure of activist positions would also allow a company a greater opportunity to confer with its long-term passive investors to get their feedback on an activist's demands. In some cases, these long-term investors may conclude that the activist's requests (which may include demands such as increasing share buybacks, reducing R&D spending, cutting employee headcount, or selling off businesses) may increase short-term gains, but are not in the long-term interests of the company.[6]

II. Beneficial Ownership Information Should Be Disclosed Promptly to Investors.

The Society agrees with the Commission's long-standing view that an investor's significant stake in public companies is material non-public information that should be disclosed to the market. Once an activist investor crosses the 5% threshold,[7] Congress has determined that an ownership stake is no longer the activist's proprietary trading secret but is material information that should be disclosed. Given the high likelihood that a 13D filing will trigger in an increase in a company's share price, there should be no dispute about the materiality of this information.[8] The Society is unaware of other situations under where market participants are allowed to retain and trade on material non-public information for an extended period. Accordingly, we support the Commission's efforts to close loopholes in the 13D disclosure rules that allow activist fund managers to conceal their positions and trade ahead of other investors.

The Commission has previously recognized how the 13D rules allow activist managers to delay disclosure of their share accumulations and take advantage of other investors. In 2011, then-SEC Chair Mary Schapiro noted that many believe that the 10-day reporting deadline

---

[6] *See, e.g., The Guardian*, "Long-term investors are taking on the hedge funds over short-term vision" (February 4, 2016), https://www.theguardian.com/money/us-money-blog/2016/feb/04/long-term-investors-are-taking-on-the-hedge-funds-over-short-term-vision

[7] While Section 13(d) sets the disclosure threshold at 5%, we request that the SEC study whether a lower threshold, such as 3%, would be a more appropriate trigger for 13D filings. The United Kingdom, Germany, and the Netherlands all have a 3% threshold for initial ownership disclosures. In its 2011 marketwide proxy access rule, the Commission determined that 3% was a meaningful ownership threshold for investors to meet in order to nominate director candidates to appear on company proxy materials. Many process access bylaws adopted by companies also have 3% ownership requirements.

[8] Elon Musk's recent disclosure of a 9.2% stake in Twitter is another prominent example of how share prices typically respond after a 13D/G filing and how other investors miss out on potential gains when large shareholders fail to disclose their positions on a timely basis. On April 4, 2022, Musk belatedly disclosed his stake in the company; Twitter shares closed 27% higher that day. Musk crossed the 5% ownership threshold on March 14, but he continued to purchase shares in secret, even after March 24 when the 10-day disclosure deadline passed. Musk since has been named in a securities class-action lawsuit by an investor who sold Twitter shares prior to Musk's late disclosure of his significant stake in the company. *See Rasella v. Musk*, U.S. District Court for the Southern District of New York, Case 1:22-cv-03026 (filed April 12, 2022), https://www.documentcloud.org/documents/21583990-marc-bain-rasella-v-musk.

"[r]esults in secret accumulation of securities; [r]esults in material information being reported to the marketplace in an untimely fashion; and [a]llows 13D filers to trade ahead of market-moving information and maximize profit, perhaps at the expense of uninformed security holders and derivative counterparties."

In other regulatory contexts, the SEC has recognized that disclosure rules should be updated to keep pace with market innovations and ensure that investors receive timely information. Over the past two decades, the SEC has accelerated the various disclosure deadlines[9] that apply to public companies and their executives in order to provide more timely information to investors. In most of these cases, the Commission decided to proceed with accelerated disclosure to improve transparency for the benefit of investors, even though some companies argued that they would face greater costs as a result of shortened reporting periods.

In the case of beneficial ownership reporting, hedge fund managers and their allies have raised similar cost concerns in support of a 54-year-old disclosure regime, but we believe that the benefits of market transparency to both public companies and investors generally would far outweigh any additional costs. In our view, maintaining the current 10-day period only serves as a wealth transfer from retail and institutional investors[10] who unwittingly sell their shares to sophisticated activist managers who are secretly assembling a large position to influence control of a company. Notwithstanding the purported benefits of activism, we see no reason why companies and other investors should have to subsidize the activities of a small group of highly compensated activists.

III. The Archaic 13D Rules Discourage Private Companies From Going Public.

The Society believes that modernizing the beneficial ownership rules will help fulfill one of the Commission's core missions to promote capital formation by creating a more hospitable environment for newly public companies. As the Commission is aware, the number of U.S. public companies is substantially lower than it was in 1996, and the threat of activism remains a significant deterrent for private companies that are contemplating going public.

In 2018 testimony[11] to the Senate Banking Committee in support of bipartisan legislation to modernize the 13D rules, Society CEO Darla Stuckey explained how the threat of activism deters private firms from going public:

---

[9] *See, e.g.,* Final Rule: Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 17 CFR 240 (2002) (accelerated the Form 4 deadline to two business days; the disclosure period had been 10 days after the end of each month).

[10] While activists and their allies often argue that most activist campaigns result in governance and operational changes (as well as price appreciation) that benefit the target company's shareholders, those benefits are not received by the unlucky investors who sell their positions during the 10-day 13D preannouncement period. Why should these unwitting investors be expected to subsidize activist campaigns when these selling shareholders don't receive the full benefit from these campaigns?

[11] Statement of Darla C. Stuckey Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Hearing on "Legislative Proposals to Examine Corporate Governance" (June 28, 2018), https://www.banking.senate.gov/imo/media/doc/Stuckey%20Testimony%206-28-18.pdf.

> Another disincentive to public ownership of companies is the burden of being subject to attacks by activist investors, a number of whom have short-term agendas. There is no doubt that some activists create longer-term shareholder value, and the Society is not seeking to stifle activist investing. The Society does not believe, however, that there is a level playing field between activists and companies. Companies are required by securities laws to publicly disclose material information within 4 days. Activist investors, on the other hand, have 10 days to file a Schedule 13D, disclosing the material fact that they have acquired 5% of a particular company's stock.

In her Senate testimony, Stuckey responded to the argument that regulators and lawmakers should leave in place a 50-plus year-old disclosure regime because of the supposed intent of lawmakers[12] to promote shareholder activism. However, that argument ignores how fundamentally activism has changed over the past half century, as activists today have more resources, often win the support of highly influential proxy advisors, can readily share their views on financial news networks, and have access to cash-settled equity swaps and other modern financial instruments that they can use to postpone disclosure. As Stuckey observed:

> Some have argued that the 10 days was a careful balance drawn at the time to give investors an advantage over potentially entrenched management. A lot has changed on that front in 50 years and the argument that the legislative history of the Williams Act requires the 10 days for activists to have an advantage is longer relevant. Shareholder rights and shareholder engagement have come of age. In fact, so much so that we see a decrease in the number of private companies willing to take advantage of the public markets, and we see those who do go public institute stock classes[13] to alleviate the burdens of activism and other shareholder empowerment mechanisms.

As the Society noted in our 2020 letter on Form 13F disclosure, the expenses of responding to activists' campaigns are substantial for public companies and ultimately are passed through to shareholders.[14]

Critics of 13D modernization contend that the Proposing Release would chill shareholder activism by driving up the cost of activist campaigns. To be clear, a shorter 13D reporting cycle won't have any impact on the price of the shares that an activist must purchase to get up to 5%, as any investor who sells shares to an activist holding a 4.9% stake won't be aware of the activist's plans. While activists would have less time to buy additional shares after crossing 5% if the reporting period was reduced to five days, we do not believe there is a shareholder protection rationale that would justify forcing other investors to subsidize activists' efforts to build an 8 or 9

[12] This argument also overlooks the intent of Congress expressed in Section 929R of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which specifically authorized the Commission to adopt a shorter reporting period than 10 days. Had Congress intended for the 10-day period to remain set in stone amid future advances in technology or the evolution of corporate governance, lawmakers would not have acted to permit the SEC to impose a shorter period.

[13] While disfavored by some institutional investors, 40% of the U.S. technology companies that went public in 2020 instituted multiple share classes to protect themselves from activism. *See Fast Company*, "The simple reason tech CEOs have so much power" (April 3, 2021), https://www.fastcompany.com/90620747/dual-class-voting-tech-ceo-power. However, most existing companies do not have these equity class structures and thus would benefit greatly from more timely disclosure of significant activist positions.

[14] *See* Society 13F Letter at 14.

percent positions in companies. If activists believe that obtaining larger (than 5%) stakes would be helpful to their campaigns, they should pay a fair price for those additional shares.[15]

IV. The 13D Disclosure Period Should Be Shortened to Two Business Days.

The Society welcomes the Commission's proposal to shorten the disclosure period for initial 13D and 13G filings from 10 to five days. Such a change is long overdue and would move the United States closer in line with the disclosure practices in other countries. Other major markets, such as the United Kingdom (two days), Australia (two days), Hong Kong (three days), Germany (four days), and France (four days), all have adopted shorter reporting deadlines than the 10-day period now in place in the United States.

While five-day reporting would be a significant improvement, we encourage the SEC to consider a shorter reporting period for 13D filings, such as two business days, to ensure that investors promptly receive material information about activists' accumulations of stock. Two days would be consistent with the SEC's Form 4 disclosure rules for executive stock transactions, which many investors view as valuable information. While the combined value of those daily officer transactions typically is far below 5% of a company's market capitalization, investors follow those Form 4 disclosures closely because of the widely held belief that an executive buying his or her company's stock suggests that the company's share price will soon rise. In the case of 13D filings, there is a much stronger correlation between an activist's disclosure and a resulting increase in the target company's share price. From a materiality standpoint, it would be illogical to permit a longer disclosure period for an activist's 5% stake, which most likely will move the market, than, for example, the two-day reporting period that now applies to an executive's preplanned periodic sale of a hundred shares through a 10b5-1 plan.

The Society believes that a two-day disclosure period would provide sufficient time for activist fund managers and their counsel to document their trades and to prepare 13D filings. Every fund manager with the resources to amass a 5% stake in a company should have sufficient record-keeping technology to determine his or her positions at the close of each trading day. In addition, we know that most activists pay careful attention to whether they are nearing 5% and will not cross that threshold accidentally, so they would have time to ask their counsel to start drafting a 13D filing well before actually crossing the threshold.[16] Most activists carefully research their corporate targets, develop a list of demands, identify potential allies, and plan their

---

[15] Of course, as the Engine No. 1 campaign at ExxonMobil in 2021 illustrated, an activist doesn't need a 5% or larger position to win a proxy contest if it can persuade enough other investors about the merits of its board candidates.

[16] *See, e.g.,* David Katz, Wachtell, Lipton, Rosen & Katz, "13(d) Reporting Inadequacies in an Era of Speed and Innovation," *Harvard Law School Forum on Corporate Governance* (September 24, 2015). ("Moreover, since crossing the 5 percent threshold is rarely a surprise to the beneficial owner of the securities, there is no reason that the Schedule 13D cannot be prepared in advance and filed almost immediately upon acquisition of the reportable interests. Currently, if there is a material change to a Schedule 13D, an update must be filed 'promptly,' which—at least when the material change involves 1 percent or more of the subject securities—is generally understood to mean within one or two business days, and in many circumstances, the SEC staff's view has been that disclosure should be made the same day as the triggering event. There is no reason that the initial report cannot be filed within one or two business days as well.")

campaign well before they cross the 5% threshold. Given this reality, we believe that activist fund managers don't really need a full five days to prepare their 13D filings.

A shorter disclosure period also would be consistent with the approach that the Commission has taken in other recent rulemakings regarding trade disclosure. In its share repurchase rulemaking, the SEC proposed a significantly shorter period (the next business day) for an issuer's share buybacks, which are unlikely to ever exceed 5 percent of a company's outstanding shares in a given day.[17] In support of one-day reporting, the SEC cited concerns about the "informational asymmetry," noting that companies buying shares "will typically have significantly more, and more detailed, information about the issuer and its future prospects" than investors.[18] That may be true, but there is far greater informational asymmetry between an activist fund manager who continues to purchase shares in advance of a planned 13D filing after crossing the 5% threshold, and those investors who sell their shares without knowing that information. The activist manager is buying additional shares with the private knowledge that his or her filing will almost certainly increase the share price (and the manager's potential profits), whereas the potential share price impact from disclosure that a company repurchased shares the previous day is far less certain. If the SEC wants to help investors overcome the more significant information disadvantage they now have versus activist fund managers, the Commission should consider adopting a two-day disclosure for 13D filings.[19]

V. The Society Supports Expanding the Definition of Beneficial Ownership to Include Derivative Securities.

In addition to shortening the reporting period, the Society also supports the Commission's efforts to close loopholes in the current beneficial ownership rules that have long been exploited by sophisticated activists that wish to circumvent the intent of the 13D rules.

One frequently used loophole is the use of cash-settled derivative instruments, which allow a fund manager to enter into an arrangement with a financial institution counterparty that allows the activist fund manager to avoid crossing the 5% threshold until the activist manager is ready to unwind that swap arrangement and obtain shares without going to the public markets. One recent example was the use of derivative instruments to delay public disclosure of the acquisition of a large block of GoDaddy shares by multiple funds controlled by Starboard Value LP last year. The funds' purchases of GoDaddy were converted into forward purchase contracts at regular intervals, which enabled funds to evade disclosure of their accumulated shares until Starboard was ready to cross the 5% threshold. In this case, Starboard funds used the 10-day disclosure period to further increase their stake to 6.5%, and Starboard reaped instant profits on that enlarged position when GoDaddy's price closed up 8.4% after the 13D filing was public.

---

[17] Likewise, the SEC has called for one-day disclosure of large securities-based swap positions in its proposed 10B-1 rule. *See* Fact Sheet, SBS Fraud & Manipulation; CCO Independence; Position Reporting (February 15, 2022).
[18] *See* Proposed Rule, Share Repurchase Disclosure Modernization, File No. S7-21-21 (December 15, 2021), at 10-11.
[19] If the Commission is not ready to adopt a two-day reporting period now, it should consider accelerating the 13D deadline to two days in 2024 when the proposed T+1 settlement cycle is slated to take effect.

To address this loophole, the Commission proposes to "deem" the holder of the instrument the beneficial owner of the referenced equity security if the instrument is held with the "purpose or effect of changing or influencing the control of the issuer."[20] While the Society supports this interpretation, we encourage the SEC to consider the broader definition of beneficial ownership proposed by Wachtell, Lipton, Rosen & Katz. Given the creativity of activists and their advisors, the definition of beneficial ownership should include other instruments (beyond cash-settled derivatives) that enable activists to quickly obtain voting rights and influence control in a public company.[21]

VI. The Society Supports the Commission's Clarification of the Definition of Groups.

Under current rules, when two or more persons "agree to act together" for the purpose of acquiring equity shares, the group formed shall be deemed to have acquired beneficial ownership together for the purpose of disclosures under Sections 13(d) and (g) of the Securities Exchange Act.[22] In the Proposing Release, the SEC observes that a plain reading of these Sections of the Exchange Act does not require an "agreement" among the parties as a necessary element of group formation.[23] The SEC proposes to amend current Rule 13d-5 to track the statutory language and specify that when two or more persons "act as a group," they would be treated as one beneficial owner for purposes of the Section 13 disclosure requirements.[24] Under this clarification, compliance with the group formation rules would not depend on whether there is an express or implied agreement among the parties that are acting together. The Society supports this clarification of Rule 13d-5.

The Society also supports the Commission's interpretation that two parties who are in a tipper-tippee relationship should be deemed to act as a group. As the Commission is aware, activist fund managers often tip off other investment managers about their planned 13D filings, which enables a tippee manager to buy shares from unsuspecting investors and then reap instant profits when the tipper's 13D disclosure becomes public.[25] In return, the tippee manager typically votes with the lead 13D filer, which magnifies the voting power of the activist well beyond 5 percent. Given that information about a planned 13D filing is clearly material to investors, it makes sense to deem tippers and tippees to be acting as a group, even without an explicit agreement. Given their common economic interests and voting intentions, as well as

---

[20] Proposing Release at 13,897.

[21] In its 2011 rulemaking petition and its recent comment letter on the Proposing Release, Wachtell Lipton recommended that "the definition of 'beneficial ownership' should encompass ownership of any derivative instrument that includes the opportunity, directly or indirectly, to profit or share in any profit from any increase in the value of the subject security."

[22] 17 C.F.R. § 240.13d-5(b)(1).

[23] *Proposing Release* at 13,867. Sections 13(d)(3) and 13(g)(3) of the Exchange Act (15 U.S.C. §§ 78m(d)(3) and (g)(3)), state "[w]hen two or more persons act as a … group ….".

[24] Proposing Release at 13,868.

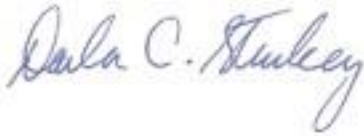
[25] *See, e.g., The Wall Street Journal*, "Activist Investors Often Leak Their Plans to a Favored Few: Strategically Placed Tips Help Build Alliances for Campaigns at Target Companies," (March 26, 2014), https://www.wsj.com/articles/SB10001424052702304888404579381250791474792

their sharing of material non-public information, the holdings of tippee fund managers should be counted in the determination of whether the lead activist has crossed the 5 percent threshold.

Thank you for considering the Society's views on modernizing the beneficial ownership rules.

Respectfully submitted,

Ted Allen
Vice President, Policy & Advocacy
Society for Corporate Governance



Darla Stuckey
President and CEO
Society for Corporate Governance