

WE THE INVESTORS

June 27, 2023

By Email

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 205499-1090
rule-comments@sec.gov

Re: Reopening of Comment Period for Modernization of Beneficial Ownership Reporting (File No. S7-06-22)

Dear Ms. Countryman:

We The Investors¹ appreciates the opportunity to comment on the new economic data and analysis developed by the staff of the Securities and Exchange Commission (“SEC” or “Commission”), regarding its Proposed Rule to modernize beneficial ownership reporting.²

This Proposed Rule was released in March 2022 and the Commission’s rulemaking seeks to: (1) update antiquated reporting requirements regarding large investment positions; and (2) improve market transparency and efficiency.³

We The Investors is organized around five key principles, as described in our Investors’ Bill of Rights.⁴ These include (1) Transparency; (2) Simplicity and Fairness; (3) Choice and Control; (4) Best Execution; and (5) Better Settlement and Clearing. This comment letter will focus on two of these principles: (1) Transparency; and (2) Simplicity and Fairness.

Background

¹ We The Investors is a grass roots advocacy campaign launched in March 2022 built by, and for, retail investors. Our mission is to educate retail investors in order to empower them to represent themselves on market structure issues. We are supported by industry firms and over a hundred thousand retail investors.

² Reopening of Comment Period for Modernization of Beneficial Ownership Reporting, 88 Fed. Reg. 28,440 (May 4, 2023).

³ Modernization of Beneficial Ownership Reporting, 87 Fed. Reg. 13,846 (Mar. 10, 2022) (hereinafter “Proposed Rule”).

⁴ The Investors’ Bill of Rights can be accessed at: <https://www.urvin.finance/advocacy>

Under current SEC rules, institutional investors purchasing shares through brokers and banks (called “beneficial owners”) are required to disclose any ownership interest they may have in a public company once such ownership interest exceeds 5% of outstanding shares.⁵ This disclosure is accomplished by filing a beneficial ownership interest report with the SEC on Schedule 13D. This report is required to be filed within 10 calendar days after a beneficial owner crosses the 5% threshold. This 10-day deadline has been in effect and unchanged since 1968.⁶

Much has changed in the financial markets over the past 50 years and the 10-day window has been the subject of mounting criticism for allowing too much time for hedge funds and other activist investors to accumulate large stock positions before being required to disclose anything publicly. Acquiring large blocks of shares secretly for such a long period of time allows these investors to trade on asymmetric price information and continue accumulating shares from unwitting investors for almost two weeks after the 5% threshold is reached.

This extra time before public disclosure allows activist investors to accumulate a much higher ownership position than 5% before an SEC filing is required. And this lengthy reporting window disadvantages investors who are selling their shares after the 5% threshold is reached. These investors are unaware of a pending Schedule 13D filing and won’t receive the increase in share price that typically occurs once this SEC filing is made.

The SEC now proposes to shorten the reporting window from 10 calendar days to 5 calendar days. This change would reduce information asymmetry in the price discovery process and provide the marketplace with more timely notice of the acquisition of a 5% share ownership position.

The SEC Staff Memorandum on Beneficial Ownership Reporting

On April 28, 2023, the SEC released a staff memorandum providing statistical data and analysis regarding the economic effects of its 2022 proposals to modernize the reporting regime for institutional investors that accumulate more than 5% of the outstanding shares of a public company.⁷

The SEC analyzed Schedule 13D filings from 2011-2021 and reached the following conclusions:

1. After the 5th day following the trigger date of reaching a 5% ownership position, abnormal pricing of shares remains, indicating that information about a new large position in the company has not been reflected in market prices and that a shortened deadline for filing would reduce information asymmetry.⁸

⁵ See 17 C.F.R. § 240.13d-1(a).

⁶ See *Proposed Rule* at 13,849.

⁷ SEC Division of Economic and Risk Analysis, Staff Memorandum: Supplemental data and analysis on certain economic effects of proposed amendments regarding the reporting of beneficial ownership, April 28, 2023, available at <https://www.sec.gov/comments/s7-06-22/s70622-20165251-334474.pdf>.

⁸ *Id.* at 7-8.

2. During the time period studied, the SEC staff found that approximately 1/3 of Schedule 13D filers continued to accumulate shares after 5 days and before the 10-day filing deadline.⁹
3. Based on the data studied, the SEC staff estimates that there is a significant wealth transfer between selling investors unaware of a pending Schedule 13D filing and other market participants possessing superior market information during the lengthy 10-day filing window.¹⁰

The data and analysis in this SEC Staff Memorandum demonstrate conclusively that reducing the filing window from 10 calendar days to 5 calendar days would reduce information asymmetry and mitigate the unfair insider advantages that activist investors have during the lengthy Schedule 13D reporting deadline. As stated by the SEC staff in this Memorandum:

The harms to selling shareholders from trading opposite potentially informed, opportunistic traders, and the associated information asymmetry, may have broader implications for trust in markets and liquidity. In particular, lessening an informational advantage that some market participants may perceive to be unfair could enhance trust in the securities markets, thereby promoting capital formation. In addition, under current rules, the risk of facing these opportunistic traders and bearing these harms may lead market makers to charge wider bid-ask spreads and thus reduce liquidity.¹¹

The SEC's proposal to shorten the reporting window would be a significant improvement for the securities markets. However, We The Investors urge the Commission to consider a two (2) business day reporting deadline.

The two business day threshold would mirror the SEC's Form 4 disclosure requirements for executive stock transactions. These preplanned sales or purchases by executives under Rule 10b5-1 plans should not be treated as information that is more valuable to the marketplace than disclosures about an investor that has accumulated a 5% position in a company. An ownership stake this large by a single investor is likely to move a company's stock price and is a far more important disclosure to investors than many of the Form 4 disclosures, which are often for small share amounts.

There is another perspective to consider as well. As the SEC demonstrates, the disclosure of a Schedule 13D filing is an event that will move the price of a stock. This is akin to inside information—the filer knows that the filing is coming, while nobody else does. They are in possession of material non-public information and have many days to trade on that information. The Commission should reduce that time period as much as possible.

⁹ *Id.* at 15.

¹⁰ *Id.* at 26.

¹¹ *Id.* at 27.

From a policy perspective, both relative to Form 4 disclosure requirements and considering the possession of material non-public information, it makes more sense for the SEC to require a two (2) business day reporting window.

Expanding the Definition of Beneficial Ownership

Under current SEC rules, investors are considered to be beneficial owners of a security if they have voting and/or investment power over such security.¹² The definition of beneficial ownership does not include anyone with a purely economic interest in a security.

Certain derivatives, such as cash-settled equity swaps (also called total return swaps), provide institutional investors with economic exposure to an equity security, but without any formal voting or investment powers. Certain activist investors use these instruments to acquire significant equity positions in public companies without any disclosure requirements.

Under a typical cash-settled equity swap, two parties enter into an agreement that seeks to replicate the position of a long equity investor in a particular public company.¹³ A swap investor does not receive any voting rights or investment powers but does receive: (1) all the benefits of an increase in the stock price; and (2) the cash flows that replicate any dividends paid by the company. Any differences are settled in cash, and the financial institution that is a counterparty to the swap often holds the underlying securities as a hedge against its position.

If the swap is unwound, the swap investor is usually able to immediately purchase the underlying securities, thereby rapidly increasing its ownership position and securing beneficial ownership voting rights and investment powers, without having to accumulate shares directly in the equity markets.

The SEC's Proposed Rule recommends that the holder of this type of swap include the underlying reference shares in calculating whether the institutional investor has exceeded the 5% ownership threshold. This treatment of a cash-settled equity swap in the 5% calculation would only occur if the instrument is held with the "purpose or effect of changing or influencing the control of the issuer."¹⁴

We The Investors strongly support this aspect of the Proposed Rule. If adopted, it would provide additional transparency in the securities markets for large, concentrated cash-settled derivative instruments and accelerate public disclosure of equity positions that exceed a 5% ownership threshold.

There has been some confusion among individual investors about whether the SEC's rule on cash-settled equity swaps would result in institutional investors obtaining voting rights and/or investment powers in a security through the use of such a swap instrument. The SEC does not

¹² 17 C.F.R. § 240.13d-3(a). The term "investment power" means the right to dispose of or direct the disposition of a security.

¹³ The typical counterparties to an equity swap of this type are: (1) an institutional investor; and (2) a large financial institution.

¹⁴ *Proposed Rule* at 13,897.

have the authority to transfer voting rights or investment powers to a swap instrument, and a cash-settled equity swap only involves economic exposure to an equity security. The SEC's Proposed Rule does not alter in any manner the voting rights and investment powers of a beneficial owner. The only mechanism for obtaining these rights and powers in a security is for an investor to purchase the security directly.

In its Final Rule, the SEC should clarify that any disclosure requirements for cash-settled equity swaps would not result in any change to the voting rights or investment powers of the underlying reference securities that are the basis for these types of swaps.

Short Position Reporting

While the SEC's Proposed Rule is focused on Schedules 13D and 13G long position disclosures, we would be remiss if we did not take this opportunity to reiterate the position in our previous comment letter on the SEC's Proposed Rule 13f-2.¹⁵ For too long, short positions have gone undisclosed, and individual and institutional investors lack the same level of transparency into short positions as they have for long positions. As the SEC works to modernize its position reporting disclosure regime, we urge the Commission to adopt the changes to 13f-2 outlined in our previous comment letter.

Conclusion

We The Investors appreciates the opportunity to provide comments on this rulemaking and the Staff Memorandum analyzing beneficial ownership disclosures. Thank you for considering our comments and we would be happy to answer any questions or further explain any of the points contained in this letter.

Sincerely,

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¹⁵ See Letter from We The Investors to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, File No. S7-08-22, available at <https://www.sec.gov/comments/s7-08-22/s70822-typea.pdf>.