

REMARKS OF RICHARD B. ZABEL  
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SEC Investor Advisory Committee Meeting  
September 21, 2022

Proposed Rule 10B-1 – Position Reporting of Large Security-Based Swap Positions  
(Release No. 34-93784, File No. S7-32-10)

Thank you for this opportunity to address the SEC's proposal to require public position reporting of large security-based swap positions.

Elliott Investment Management submitted a detailed comment letter on this proposal, including an expert report from Professor Craig Lewis, who previously served as the Commission's Chief Economist and Director of the Division of Economic Risk Analysis. In my remarks, I will highlight a few key points from our comment letter. I have also submitted additional materials to the Committee.

I will speak today to activist investing as practiced by Elliott, which we believe is generally comparable to that of peer firms.

Like many other firms, Elliott uses cash-settled security-based swaps in structuring positions and executing activist strategies. Let me take a moment to discuss those concepts because there have been numerous inaccurate descriptions of how such swaps work and the market practices around them.

A security-based swap is a transaction that derives its value from one or more underlying equity securities. A common product in this space is the total return swap. In it, an investor enters into a contract with a derivatives dealer that relates to the common stock of a public company. The dealer will pay the investor the amount of any increase in the value of that stock over the life of the trade. The investor, in turn, will pay the dealer a specified fee, plus the amount of any decline in the value of the stock over the life of the trade. These trades are "cash settled", which means that the only thing that changes hands is cash. The investor has no right to delivery of the referenced stock, nor does the investor enjoy the rights and legal protections afforded to shareholders.

For decades, total return swaps have been used to emulate the economic return of owning the underlying shares. This efficient tool is used by a wide range of investors in a wide range of strategies. Swaps also improve the liquidity of equity markets and thereby enhance price discovery for all investors.

What a total return swap, or any other cash-settled equity derivative, does not do is provide the investor with any ability to influence the underlying company. The investor obtains no voting rights, because it does not own stock. Its interest is purely economic, derived solely from the dealer's performance of the terms of the contract. Accordingly, the SEC has long held that this type of position does not confer beneficial ownership of the underlying stock.

On the other side of a total return swap, the dealer may hedge its exposure by acquiring the referenced shares. Some have alleged that the investor in effect controls the voting or disposition of these shares. This is flat wrong. Under SEC guidance going back to the early

2000's, such an arrangement would confer beneficial ownership on the investor, and also render the investor and the dealer a group under the Exchange Act. Dealers simply don't take that risk, nor do their counterparties. In fact, swap contracts explicitly provide that investors have no ability to control how the dealer might hedge its exposure, unwind its hedge, or vote any shares it holds. Finally, there is no evidence that this practice occurs, and we can't find any SEC enforcement action suggesting otherwise.

One of Elliott's primary activist strategies is to identify a company that is underperforming, develop a thesis that would remedy that underperformance, and then approach the company to share our thoughts. We typically spend many months and significant sums of money in diligencing the merits of our thesis.

When we engage, we disclose that we have a position in the company. We can hold that position in any number of ways, including a long position in the stock, as well as through options and total return swaps. Our position is always a minority one – typically a very small minority position.

Once we approach the company, we are fully transparent with it and the investing public about our thesis, often laying out our views publicly in lengthy documents. The company and other investors are free to agree or disagree with us, and we have experienced both. If our thesis fails, we alone carry the costs of assembling and unwinding our positions. If our thesis is accepted and produces the results we predicted, all shareholders gain. The debate we spark among companies, investors and industry analysts is the foundation of a robust securities market. The Commission should not inhibit this engagement, particularly because activists are among the few investors with the resources and business model to challenge underperforming managements and Boards. A wide body of peer-reviewed academic literature confirms that activists create long-term shareholder value, which accrues to all shareholders.

The ability to assemble positions without public disclosure has been claimed by some to lead to "stealth attacks." That rhetoric makes little sense because, again, we do not have leverage over the company by virtue of our minority position; we only have leverage if the market supports our thesis.

The SEC proposes to require next-day public disclosure of the holding of security-based swaps above very low thresholds. This would pose an existential threat to the activist investor's business model because it would eliminate the ability to assemble an economically viable position at the prices the company's underperformance has caused. The work that Elliott does developing a thesis and building a position is our intellectual property. The proposed rules would deprive us of the economic benefit of this work without demonstrating a countervailing benefit to the markets. The result would be a massive disincentive to undertake the work necessary to engage in activist investing. And the Commission will have chosen the winners and losers in this part of the market, siding with underperforming companies over shareholders.

There is an easy solution here. In November 2021, after much delay, the SEC implemented Regulation SBSR, under which market participants must disclose security-based swap transaction information to the SEC on a confidential basis. The SEC should study this trove of information to evaluate the market before considering whether to implement the seismic changes under Rule 10B-1. I note that Congress required the SEC to publish a report using the data collected under Reg. SBSR no later than November 2023. The Rule 10B-1 proposal does not identify any information necessary to monitor the security-based swap market that cannot be obtained pursuant to Reg. SBSR. And, notably, in the Reg. SBSR adopting

release, the SEC acknowledged that the information it would be collecting is proprietary and confidential and thus should not be publicly disclosed. Now, however, contrary to its own prior view, the SEC has decided that same proprietary information should be stripped of its limited confidentiality.

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My remarks have touched on only a subset of the issues addressed in our comment letter.

I would be happy to address any questions that the Committee may have.

SUPPLEMENTAL MATERIALS TO  
REMARKS OF RICHARD B. ZABEL  
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Below are supplemental written materials to the remarks of Richard B. Zabel. These refer to certain pages of the March 21, 2022 comment letter submitted by Elliott Investment Management L.P. (the “Comment Letter”) and the report from Professor Craig M. Lewis attached as Exhibit B to the Comment Letter, which provide additional detail and support for the statements contained herein.

1. The Proposed Rule would disincentivize activism, diminish market efficiency, and be anti-competitive.<sup>1</sup>

a. Activism plays a critical role in the health of the U.S. capital markets by helping ensure alignment between shareholders and boards of directors. The role of activists has become more important over time as the rise of passive ownership has diminished the few remaining checks and balances on public companies. Activist investors play an essential role in the public markets by providing a check on underperforming, unresponsive or entrenched corporate management and boards in ways that passive investors (such as index funds) cannot and will not. The U.S. capital markets are more vibrant and dynamic than others because companies in the U.S. can be held to account by activists, who are often the only shareholders who have the resources and incentive to make themselves heard by management and cause positive change.

b. We are aware of claims—often expressed by parties representing the interests of management and boards—that activism does not benefit markets and shareholders. We believe the benefits of activism are well established, but our point in noting this divergence of views is that the Commission should not in effect choose a side in this debate, which we believe the Proposed Rule effectively does. Certain companies, and their management and boards, may in fact support that outcome, but that is not an appropriate justification for the Proposed Rule, nor would such an outcome be consistent with the Commission’s obligation to maintain neutrality in exercising its authority under the Exchange Act. Nor do we believe it would be consistent with the Commission’s guiding objective of protecting investors. We want to be clear: this proposed rule is in no way neutral and is in fact exactly what certain issuers and their advisors have for some time been advocating to insulate themselves from criticism and change.

c. The Proposed Rule gives activist investors three potential paths: (1) purchase cash-settled security-based swaps (“SBS”) up to but not beyond the new (and very low) reporting threshold, or purchase beyond the threshold and trigger a very early filing (far earlier than is currently the case) that would significantly limit the prospect of a sufficiently profitable investment (with concomitant loss of confidentiality, and thus of intellectual property), (2) acquire common stock and trigger a notification under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 at what, for most public companies, is a *de minimis* level of ownership, or (3) decide to stop pursuing activist opportunities entirely.

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<sup>1</sup> See pages 4-10 of the Comment Letter and pages 13-22 of the Lewis Report.

d. If an activist with a successful track record of creating sustainable value is forced to make a public disclosure prematurely, then “herding” behavior by new entrants into the stock may make the securities too expensive, preventing an economically worthwhile position from being built and thereby pricing the activist out of the investment. The Proposed Rule would reveal the proprietary business strategies of large traders to the market and to competitors (and in the case of activist investors, to the companies that are the focus of their interest at a far earlier time than would otherwise be the case). Copycat trading would reduce profitability and the incentives to take on such activities. This not only harms efficiency but also would reduce competition as some market participants decide to exit.

e. The Proposed Rule would also spur others to enter the stock at an early stage in the investment and impair the ability of the activist to effect its strategy. On the management side, it would facilitate a variant of front-running, where the company that is the focus of an activist’s campaign learns of the activist’s intent prior to disclosure to the company by the activist. The company then preemptively takes limited steps that, while falling far short of the activist’s recommendations, cosmetically allow the company to claim it is acting proactively to enhance shareholder value. Further, companies will quickly institute anti-shareholder democracy and negative corporate governance steps, like poison pills and restrictive amendments to by-laws, solely for the purpose of fending off shareholder efforts to improve company performance. This dynamic is real. For example, as recently as September 9, 2022, Masimo Corporation attempted to insulate itself from activist proposals by Politan Capital Management, which Masimo became alive to as a possibility because of Politan’s 13D filing. We point to this not to suggest that the current Section 13(d) reporting requirements are inappropriate, but instead to demonstrate how incumbent management often uses information available to it to seek to entrench itself. By enabling entrenchment by boards and management under this new proposal, the Commission will actually encourage investor behavior that is based on assumptions, incomplete information and stunted debate.

f. We disagree with the tropes trotted out in the comment letter submitted on July 18, 2022 by a group of Senators. The letter is predicated on the resonant but false proposition that activists can take a small minority position and wrest control of a company, suggesting that an activist somehow gains control so it has the “ability to force through its agenda” or can “threaten the board of directors with a proxy battle if they don’t adopt the activist’s strategy.” Directors serve as representatives of shareholders and stand for election on a regular basis. We assume that our democratically elected Senators would view it as a feature of the system that shareholders are presented with different ideas and vote for their preferred representatives accordingly. Although the letter argues that under the current rules activists are free to “covertly” “build enough economic and voting power that they are able to dictate terms to management,” even in the largest positions, activist investors have a small minority of stock and economic interests. Activists simply cannot “force” anything. The only traction an activist gets is on the merits of its ideas when others agree with the activist’s good points. If a company fears a proxy fight, which is exceedingly rare, the vulnerability of the company’s position due to poor management and underperformance is more to blame than the minority position of the activist.

g. Contrary to empty allegations of secrecy, in actuality, once activists become public, they are more transparent than any other shareholders in the market because they put all their ideas forward to be appraised. If the activist decides that activism is not appropriate (which happens), it goes away. But if it decides that the company can be improved, and engages with management and the board on a path forward, then the company knows exactly what the activist thinks because the activist will have laid out all of its ideas and thoughts for the company. Where an investor is public in its activism, the entire market knows all of its arguments because they are laid out for everyone to approve, reject or compromise on. Ultimately, other shareholders will accept or reject the substance and

consequences of these engagements and render judgment on them in a fundamental exercise of shareholder democracy.

2. The Proposed Rule would contravene federal and state policy protecting trade secrets and constitute an uncompensated taking under the Fifth Amendment.<sup>2</sup>

- a. The cash-settled SBS data subject to the Proposed Rule's disclosure requirements qualify as trade secrets under the federal Defend Trade Secrets Act of 2016 (the "DTSA") and under state law. Courts have also recognized that the type of information that would be contained in these cash-settled SBS disclosures under the Proposed Rule would expose trade secrets for purposes of the DTSA's definition of "trade secrets."

- b. In addition to being inconsistent with Commission policy and contravening federal and state law protecting trade secrets, the Proposed Rule would violate the Fifth Amendment's Takings Clause. By forcing disclosure of proprietary cash-settled SBS data to the public, the Proposed Rule would destroy the trade secrets embedded in those data, inflicting serious competitive harm on the owner of those secrets. That competitive harm would constitute a taking because investing in cash-settled SBS tied to securities issued by public companies (including in securities of companies that are the subject of an activist campaign) is a common, lawful form of interstate commerce.

3. The Commission fails to identify a market failure or establish a record of recurring fraud—much less of any fraud causing systemic market disruption—that would necessitate the Proposed Rule.<sup>3</sup>

- a. As its sole example to justify this new regime, the Commission refers to the recent Archegos Capital Management incident. This is a unique and inapposite example. Archegos involved the failure of a single highly leveraged family office, whose checkered history made it a high-risk client from the outset. Archegos' conduct was compounded by similarly egregious and serious risk-management failures by certain of the counterparties that Archegos faced.

- b. The Commission does not explain how public disclosure of cash-settled SBS transactions would have prevented these risk management failures. There is no reason to believe that this public disclosure would have prevented that outcome (which was a failure of risk management controls at Archegos and the counterparties facing Archegos). The market has largely corrected for this issue post-Archegos so that most if not all dealers now (i) require dynamic margining with traditional margin add-ons to address particular concentration and other risks in the position, (ii) have strengthened their internal risk management procedures, and (iii) are far more selective as to the extent of financing exposure they allow.

4. The Commission lacks statutory authority to compel the disclosure required by the Proposed Rule.<sup>4</sup>

- a. The Commission relies upon Section 10B(d) of the Exchange Act for the statutory authority to adopt the Proposed Rule. Section 10B does not grant the Commission the authority to compel public disclosure of any information reported to the Commission under that section.

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<sup>2</sup> See pages 10-14 of the Comment Letter.

<sup>3</sup> See pages 14-18 of the Comment Letter and 2 and 12-13 of the Lewis Report.

<sup>4</sup> See pages 19-23 of the Comment Letter.

b. Section 10B(d) authorizes the Commission by rule or regulation to require any person meeting the description of the statutory provision “to *report* such information as the Commission may prescribe regarding any position or positions in any security-based swap . . . .” There is nothing in this statutory provision (or in the legislative history) suggesting that the Commission should make this information publicly available. In fact, the requirement to “report” such information contrasts with the language of Sections 13(d) and 16(a) of the Exchange Act, both of which authorize the Commission to require the *filing* of information as set forth in those statutory provisions.

c. It is a basic principle of statutory interpretation that when Congress uses a particular term in one part of a statute and uses a different term in other parts of the statute, it intends the terms to have different meanings. The word “filing” has precise and well-understood meaning in Commission statutes and regulations—it is material that will become publicly available, subject to the limitations of the Freedom of Information Act (“FOIA”). The plain meaning of “report” in the context of existing Commission statutes and regulations is information provided to the Commission in its regulatory capacity, but *not* made available to the public (subject to compelled disclosure pursuant to FOIA).

d. We also believe that the Commission may be seeking to use its statutory authority under Section 10B(d) to achieve the substantive equivalent of beneficial ownership reporting with respect to cash-settled SBS under Section 13(d). This would be impermissible under the Exchange Act.

The Commission’s recent proposal titled “Modernization of Beneficial Ownership Reporting” (Release No. 34-94211 (Feb. 10, 2022), 87 Fed. Reg. 13846 (March 10, 2022)) (the “13(d) Proposing Release”) explicitly excludes cash-settled SBS from the scope of the expansion of proposed reporting in the 13(d) Proposing Release. The Commission correctly notes that, pursuant to Section 13(o) of the Exchange Act, cash-settled SBS may be deemed to confer beneficial ownership of the underlying security *only* if the requirements of Section 13(o) (including consultation with prudential regulators and the Secretary of the Treasury) are met. Later in the 13(d) Proposing Release, the Commission refers to the Proposed Rule, and notes that “the position disclosures with respect to cash-settled security-based swaps required under our proposed Rule 10B-1, if adopted, would provide sufficient information regarding holdings of security-based swaps such that additional regulation under Regulation 13D-G at this time would be unnecessarily duplicative.” By concluding in the 13(d) Proposing Release that proposed Rule 10B-1 will compel public disclosure of substantially the same information as would be required under Section 13(d), the Commission strongly suggests that it is seeking to do indirectly that which, if it sought to do it directly, would require consultation with prudential regulators and the Secretary of the Treasury and compliance with the other requirements of Section 13(o), as well as extensive empirical and other analysis to justify reversing the longstanding and well-established position that cash-settled SBS do not confer beneficial ownership for purposes of Section 13(d). This is a further confirmation that the Commission lacks the statutory authority to adopt the Proposed Rule.

5. The Commission does not meaningfully consider a reporting structure in which SBS data is submitted on a confidential basis solely to the Commission as opposed to being disclosed publicly, or other alternatives.<sup>5</sup>

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<sup>5</sup> See pages 21-22 of the Comment Letter and pages 22-23 of the Lewis Report.

6. The Proposed Rule is premature considering public reporting of SBS transaction quantities and prices only became effective under Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information (“Regulation SBSR”) in February 2022, which post-dates the Proposed Rule.<sup>6</sup>

a. The Proposed Rule’s restrictive regime is inappropriate in light of the Commission’s recently adopted SBS repository reporting regime, which was implemented to provide less intrusive, nonpublic disclosure of swap holdings in a given issuer that would enable the Commission to effectively monitor the SBS market. The Commission does not identify information that it needs in order to address its concerns in the cash-settled SBS market that is not available under Regulation SBSR. The Commission should evaluate whether the new Regulation SBSR reporting program sufficiently addresses its concerns, and should complete its statutorily mandated data collection report for consideration by Congress, before proposing, much less seeking to implement, additional, highly burdensome public disclosure requirements on cash-settled SBS market participants.

7. The Commission does not provide an adequate cost-benefit analysis as required by law.<sup>7</sup>

a. The Commission does not fully analyze the likely impact on market participation, including the indirect costs from the reduction of incentives to trade and the loss in incentives to engage in corporate governance and operational improvement initiatives. Activist investing strategies would become difficult to execute in the U.S. market, to the detriment of overall market efficiency, including entrenching incumbent management and boards, stifling improved shareholder returns and ESG efforts, as well as making activist-investing returns more difficult to realize. Legitimate investing strategies that do not involve activism but nonetheless utilize cash-settled SBS would similarly become difficult or impossible to execute in the U.S. market. The Proposed Rule also would discourage *bona fide* hedging activities (also unrelated to activist campaigns) by market participants that utilize cash-settled SBS as a part of their hedging structures—strategies that help mitigate risk.

b. Although Professor John Coates recently wrote a letter to the Commission, dated April 11, 2022, suggesting that the Paperwork Reduction Act (“PRA”) prevents the Commission from engaging in the fact-finding necessary to properly evaluate proposed regulations, the PRA does not meaningfully constrain the ability of federal agencies to collect data from third parties. Because the PRA’s requirements apply broadly and cover many of the proposed data collections that agencies seek to undertake, agencies frequently proceed through the PRA review process, which is conducted by the Office of Management and Budget (“OMB”) and Office of Information and Regulatory Affairs. Agencies are well-versed in the review process, and OMB ultimately approves the vast majority of information collection requests that it receives.

c. There is no support for Coates’s statement that any such data collection is “difficult or impossible.” While the Commission would have to proceed through the PRA’s requirements to engage in this type of data collection, the significant volume of PRA-compliant information collections conducted by the Commission, and the apparent absence of any documented OMB challenges to the Commission’s information collections, suggests that the Commission is in fact able to engage in data collection in compliance with the PRA. The same conclusion applies broadly across the U.S. regulatory spectrum; federal agencies routinely comply with the PRA, to the tune of 4,000 to 5,000 requests each year through OMB and OIRA, the vast majority of which are approved. If, for any reason, OMB disapproves a request, multi-member independent agencies, such as the Commission, are

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<sup>6</sup> See page 18 of the Comment Letter and pages 12-13 of the Lewis Report.

<sup>7</sup> See pages 22-23 of the Comment Letter and pages 13-19 of the Lewis Report.



authorized to override OMB's determination and proceed with the data collection. Our research suggests that OMB has approved every single data-collection request from the Commission over the last 30 years.

d. The Commission has a demonstrated ability to comply with the PRA when it needs information from the public or interested parties, and there is no reason it could not do so for the Proposed Rule. The letter from Professor Coates does not paint an accurate overall picture of the PRA's requirements, or the Commission's ability to comply with them. It is not unreasonable – and in fact it is critical -- to require the Commission to marshal data in support of its rulemaking proposals, and the Commission should obtain data to substantiate its conclusions rather than pushing forward with its agenda without such substantiation.

e. Coates also discusses the reasons why, in his view, it is not prudent for the Commission to engage in data collections that are subject to the PRA. He notes that the *ex ante* data collections are less likely to lead to effective regulations than retrospective studies of rule changes, and he argues that the Commission does not have the resources to commit to the long-term retrospective rulemakings that would yield reliable data-based judgments. This is an astounding “close your eyes and hope nothing breaks” approach. Nevertheless, Coates writes, the Commission should engage in regulations that serve the public interest, even though it does not have the resources to gather relevant data and faces other practical challenges.

f. The Commission would likely face significant legal risk if it adopted this portion of Coates's argument as part of its justification for declining to engage in a “collection of information” that is subject to the PRA. An admission by the Commission that it promulgated a new rule notwithstanding the fact that it did not collect data relevant to the rule would need to survive judicial scrutiny that the rule is not arbitrary and capricious under the APA. As we describe in our comment letter, a recent decision of the D.C. Circuit concluded that such an approach exceeded the Commission's statutory authority.<sup>8</sup>

8. The Proposed Rule would reduce price efficiency and therefore result in less capital formation and higher costs of capital.<sup>9</sup>

a. The Commission's discussion does not consider many of the economic consequences the Proposed Rule will have on efficiency, competition, and capital formation. If, as expected, the reporting of large positions reduces incentives to participate in the SBS and underlying capital markets, one would expect markets to become less liquid, which would make it costlier to trade. Reduced incentives have two complementary effects: (1) individual traders will trade less and (2) some traders may choose to exit the market entirely.

b. The Proposed Rule will also reduce incentives to collect information, resulting in a corresponding reduction in liquidity. There is considerable economic value shared amongst activist investors and shareholders from corporate governance and operational improvement initiatives. The public release of SBS position data will prematurely reveal information about the value of a security that activist investors have developed through their own fundamental research.

c. Additionally, if activism declines due to reduced investment incentives, weaker corporate governance would negatively affect competition within individual industries as companies become less accountable to shareholders, as well as the returns that

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<sup>8</sup> See note 44 of the Comment Letter and accompanying text.

<sup>9</sup> See pages 19-22 of the Lewis Report.

investors would have received if the company had in fact improved its governance and performance. This could ultimately lead to less job creation, higher prices and lower quality of goods and services.

9. The Proposed Rule departs from the Commission's longstanding practice of protecting the confidentiality of specific transactions from public disclosure, without acknowledgment of, or reasoned justification for, the change in course.<sup>10</sup>

- a. The Proposed Rule would depart from current, longstanding Commission policy to not require public disclosure of specific transactions in most instances. For example, Regulation SBSR provides for reporting of SBS transaction information to the Commission on a confidential basis, rather than to the public. Any disclosures to the public under Regulation SBSR must be aggregated and anonymized. Other existing reporting requirements, including in connection with Form 13F and Form 13H, also require periodic and (in the case of Form 13H) anonymized position reporting on a confidential basis rather than the detailed next-day *public* transaction reporting called for by the Proposed Rule. In addition, all disclosures to the Commission under any of the foregoing provisions are entitled to protection under FOIA.

- b. Market participants have long relied upon the existing scope of public-disclosure requirements relating to securities positions in developing their models for executing proprietary trading strategies, which are the product of painstaking and expensive research, and the Commission has not provided any basis to justify disrupting this reasonable reliance.

10. The administrative and constitutional law concerns with proposed Rule 10B-1 were made more acute by the Supreme Court's recent decision in *West Virginia v. EPA*<sup>11</sup>

The Supreme Court's recent decision in *West Virginia v. EPA* reaffirms the principle that agencies may not take "unprecedented" action on "major policy decisions" unless a statute grants them "clear authorization" to do so. Much of *West Virginia*'s reasoning applies to the Rule 10B-1 proposal, which breaks with decades of precedent in ways that would radically reshape important elements of the Nation's capital markets.

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<sup>10</sup> See pages 23-26 of the Comment Letter.

<sup>11</sup> See our supplemental comment letter submitted on August 18, 2022.