ES161540

October 30, 2022

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

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

Position Reporting of Large Security-Based Swap
Positions [Release No. 34-93784; File No. S7-32-10]

Dear Chair Gensler,

We write to you today to express support for two rules proposed by the Securities and Exchange Commission ("SEC" or "Commission"): "Modernization of Beneficial Ownership Reporting" and "Position Reporting of Large Security-Based Swap Positions."

If adopted, these rules would improve market transparency, close a number of critical loopholes being exploited by certain investors, and reduce systemic risk. They would achieve this by: 1) reducing the number of days investors have to disclose a 5 percent stake in a public company from 10 days to 5 days; 2) requiring disclosure of derivative positions to ensure that they are not used to hide a stake in public company or a large position that could destabilize financial markets; and 3) clarifying the circumstances under which two or more investors have formed a "group," with a combined ownership stake would need to be disclosed if it exceeds 5 percent.

Additionally, by limiting the ability of market participants (primarily activist hedge funds with short-term investing strategies) to abuse outdated reporting requirements, these rules will also benefit workers and retirement savers—while preserving the ability of shareholders to engage with corporate management regarding environmental, social, and governance (ESG) matters, if they so choose. For these reasons, we support the proposed rules and encourage you to finalize them swiftly.

Ending the Abuse of Beneficial Ownership Disclosure Rules

Upon acquiring 5 percent of a public company's stock, current SEC rules give investors 10 days to disclose their plans to the public in a Schedule 13D filing. During the 10-day period, investors are permitted to continue acquiring additional shares. Also during this period, investors may strategically share information about their impending Schedule 13D filing with allies, who are then able to acquire shares at a discount before other market participants learn about the filing.[1] Derivative instruments, most of which do not count against the 5 percent threshold, may also be used to boost an investor's economic exposure to the company's stock.

The activist hedge fund business model is dependent on the return generated by the short-lived stock price increase that often accompanies a 13D filing. Supporters of hedge fund activism argue that the immediate price increase (before anything at the company has changed) is due to the reputation of the investor and its anticipated changes, making the activist entitled to the increase.[2] This argument becomes muddled when considered against research that shows the stock price increase is temporary and in fact the company is often in a weaker economic position post-activist intervention.[3]

The long disclosure period is an international anomaly, which in part explains why the aggressive short-term investment strategies of activist hedge funds that come at the expense of investments needed for long-term, equitable and sustainable growth are more successful in American financial markets than they are abroad.[4] In fact, the Commission itself acknowledges that this 10-day period is an outdated relic that was premised on paper filings back in 1968 when Section 13(d) was originally passed. The drafters of the Williams Act in fact emphasized the speed of disclosure was of utmost importance and that investors should be providing disclosures of their positions as soon as "reasonably practicable."[5] It is only by taking advantage of outdated regulations and loopholes (10-day reporting delay, exclusion of derivatives, and undisclosed coordination with other investors) that activist hedge funds are able to build stakes large enough to center their strategy around the short-term, temporary price spike of their targets without concern for longer-term value creation and growth.

The voting power that comes with the stock is also crucial to the business model. Securing the votes to credibly threaten the board with removal gives the activist that ability to force through its agenda. By the time the 13D is filed, the activist may have secured enough voting power—

1 Flugum, Ryan and Lee, Choonsik and Souther, Matthew, Shining a Light in a Dark Corner: Does EDGAR Search Activity Reveal the Strategically Leaked Plans of Activist Investors? (May 28, 2020). Journal of Financial and Quantitative Analysis (JFQA), Forthcoming, Available at SRN: https://ssrn.com/abstract=3612507

2 Lucian Bebchuk & Robert J. Jackson, "Law and Economics of Blockholder Disclosure," *Harvard Business Law Review*. July 2011, *available at*: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1884226.

3 Mark DesJardine and Rodolphe Durand, "Disentangling the effects of hedge fund activism on firm financial and social performance," 1054-55, Strategic Management Journal, Feb. 5, 2020, *available at* https://onlinelibrary.wiley.com/doi/full/10.1002/smj.3126.

4 Australia requires disclosure of any position of 5% or more within two business days if any transaction affects or is likely to affect control or potential control of the issuer. See Corporations Act 2001 (Cth) sec. 671B (Austl.). The United Kingdom imposes a two-trading-day deadline for disclosure of acquisitions in excess of 3% of an issuer's securities. See Disclosure Rules and Transparency Rules, Ch. 5 (U.K.). Germany requires a report "immediately," but in no event later than four days after crossing the acquisition threshold. See Securities Trading Act, Sept. 9, 1998, BGBL. I at 2708, as amended, pt. 5 (Ger.). Hong Kong securities laws require a report within three business days of the acquisition of a "notifiable interest" under the law.

5 Doshi, Samir H. Wachtell, Lipton, Rosen & Katz. The Timing of Schedule 13D. Jun 23, 2019. https://corpgov.law.harvard.edu/2019/06/23/the-timing-of-schedule-13d/

without having to engage longer-term shareholders—to threaten the board of directors with a proxy battle if they don't adopt the activist's strategy.

Benefitting Workers and Retirement Savers

By limiting the ability of activist hedge funds to generate financial returns by running their short-sighted investment playbook, these rules will improve outcomes for workers at would-be target companies. A comprehensive study of over 1,300 such campaigns conducted between 2000 and 2016 found that they were associated with:

> "(a) an immediate but short-lived increase in market value and profitability, and an immediate and long-lived decline in operating cash flow;
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> (b) decreases in number of employees, operating expenses, R&D spending, and capital expenditures; and
>
> (c) the suppression of corporate social performance."[6]

The effect on workers was particularly significant, as the study found that after such activist hedge funds acquire ownership, the company's workforce experiences a steady decline—4.57 percent in the first year and 7.66 percent by the fifth year. For an average company, this means a loss of 383 to 642 jobs.[7]

Another detailed study of companies targeted by a specific hedge fund found that target companies performed worse than comparable non-targeted companies over a three-year period, and that this underperformance was tied to a reduction in employment, wages, and overall investment, and an increase in debt and stock buybacks.[8] Therefore, not only is the hedge fund's activism detrimental for workers and their communities, but also for longer- term investors, who lose money if they hold on to their shares for three years after the beginning of a campaign. Notably, the most significant losses occur after 24 months, a few months after the hedge fund sells their shares of the target company.[9]

Preserving Shareholder Engagement and ESG Strategies

Nothing in either proposed rule would limit the ability of investors to engage with company management. Some investors have argued that preventing them from covertly building large stakes in public companies could chill their ability to engage with management. The truth is that

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[6] Mark DesJardine and Rodolphe Durand, "Disentangling the effects of hedge fund activism on firm financial and social performance," 1054-55, Strategic Management Journal, Feb. 5, 2020, *available at* https://onlinelibrary.wiley.com/doi/full/10.1002/smj.3126.

[7] *Id*. at 1070.

[8] "Activist Hedge Fund Risks to Pension Funds: The Case of Elliott Management," 7, SOC Investment Group & Communications Workers of America, Sept. 2021, *available at* https://cwa-union.org/sites/default/files/activist_hedge_fund_risks_to_pension_funds_case_of_elliot_mgt_sept_2020_socig_and_cwa.pdf.

[9] *Id*.

these investors are not looking for fair engagement, but rather they seek to build enough economic and voting power that they are able to dictate terms to management.

Take for example, the cases provided by the very investors calling for the rules to be withdrawn in the name of ESG activism.[10] Even the ESG wins purportedly under threat, modest though they are, were achieved through engagement by investors with less than one percent of the public company's stock. It is clear that changing the disclosure threshold would pose no threat to bona fide ESG activism.

Not only will these rules not chill ESG activism, they may facilitate corporate social responsibility by limiting the ability of activist hedge funds to target socially responsible firms. Recent research found that activist hedge funds were more likely to target firms with high levels of corporate social responsibility—perhaps because hedge funds consider spending associated with benefits to society at large wasteful.[11]

It is further illuminating that some of the most impactful ESG investing to date—campaigns that have led to tangible social benefits like the actual closure of coal plants and reductions in carbon emissions—has been done in Australia, where an acquisition of 5 percent must disclosed within 2 business days, far shorter than the 5 days proposed in this rule.[12] This provides further evidence that a 10 day window is not needed to use shareholder activism to meaningfully change corporate behavior.

In closing, we applaud the Commission for proposing rules that will improve market transparency and reduce systemic risk. Further, by ending the abuse of outdated disclosure requirements, these rules will benefit workers and retirement savers while preserving the ability of shareholders to meaningfully engage with corporate management. For these reasons, we support the proposed rules and encourage you to finalize them swiftly.

Sincerely,

10 Letter from Charlie Penner and Bob Eccles to Vanessa Countryman, Secretary, Securities and Exchange Commission, Re: Modernization of Beneficial Ownership Report. 11 Apr 2022. *Available at*: https://www.sec.gov/comments/s7-06-22/s70622-20123320-279613.pdf

11 Mark DesJardine, Emilio Marti, Rodolphe Durand. "Why Activist Hedge Funds Target Socially Responsible Firms: The Reaction Costs of Signaling Corporate Social Responsibility: Academy of Management. 15 Jun 2021. *Accessible at*: https://journals.aom.org/doi/full/10.5465/amj.2019.0238

12 There, an environmental activist, Cannon-Brookes, acquired over 11 percent of a mining company and pushed for changes in a financial market with far more restrictive disclosure requirements. https://www.ft.com/content/3eb3c42d-d740-460e-a8d8-a9f499f4f1ce?shareType=nongift

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