HMA | HEALTHY MARKETS ASSOCIATION
A MEMBER ORGANIZATION

April 29, 2022

Via Electronic Mail

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Modernization of Beneficial Ownership Reporting, File No. S7-06-22[1] and Position Reporting of Large Security-Based Swap Positions, File No. S7-32-10[2]

Dear Ms. Countryman:

The Healthy Markets Association[3] writes to supplement our comments on the Commission's above-referenced proposals to promote transparency and market efficiencies by modernizing the reporting of beneficial ownership information.[4] In particular, we wish to respond to assertions made by some commenters and recent market events.

As described more fully below, the final rule should:

- Decouple the reporting obligation from the position-holder's subjective intent;
- Reduce the artificial delay in reporting of large positions, which tacitly permits trading while in possession of material, non-public information to the detriment of other market participants and market integrity; and
- Acknowledge that transparency will reduce ill-gotten profits for some market participants, but will not severely restrict investor engagement or advocacy.

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[1] *Modernization of Beneficial Ownership Reporting*, SEC, Feb. 10, 2022, *available at* https://www.sec.gov/rules/proposed/2022/33-11030.pdf ("Proposal").

[2] *Prohibition Against Fraud, Manipulation, or Deception in Connection With Security-Based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions*, SEC, 87 Fed. Reg. 6652 (Feb. 4, 2022), *available at* .https://www.govinfo.gov/content/pkg/FR-2022-02-04/pdf/2021-27531.pdf ("Security-Based Swap Position Reporting Proposal").

[3] Healthy Markets Association ("HMA") is a not-for-profit member organization of public pension funds, investment advisers, broker-dealers, exchanges, and market data firms focused on reducing conflicts of interest and improving the transparency, efficiency, and fairness of the capital markets. As a result, HMA members would be directly impacted by the Proposal. To learn more about HMA or our members, please see our website at http://healthymarkets.org/about.

[4] Letter from Tyler Gellasch, HMA, to Vanessa Countryman, SEC, Mar. 22, 2022, *available at* https://healthymarkets.org/wp-content/uploads/2022/03/Letter-to-SEC-re-13D-and-13G.pdf ("Initial Comment Letter").

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The Intent of Position-Holders Should Be Irrelevant to Reporting Obligations

Large position holders in a company's equity securities and certain related derivatives are required to disclose those positions.

While issuers and some investors may focus on whether a position holder is an "activist," there are significant risks and impacts of large holdings on investors irrespective of the stated intentions of a large position holder. If a "passive" holder sells a large, concentrated position, it could lead to a precipitous decline in the stock's trading price – to the detriment of other investors.

For example, just last year, when a handful of banks began to liquidate their large holdings of certain equity securities that had been intended as hedges for a particular customer's trades, the stock prices of several large companies with generally liquid equity securities, including ViacomCBS, Discovery, and Tencent Music, all plummeted.[5]

Those concentrated positions negatively impacted investors and other market participants, even though the actual holders of those positions didn't intend to uproot the companies' management teams or engage in other "activist" activities.

In fact, the Division of Trading and Markets' recent Staff Statement recognized that large position concentrations pose risks for brokers and (appropriately) did not differentiate these risks based upon the position holder's subjective intent.[6] Importantly, while a broker may suffer a loss selling collateral or a hedge at a depressed price based upon the position's size, the action is also impacting all other investors in those securities.

Further, as Elon Musk's filings regarding his position in Twitter make clear, distinctions in filings based on the subjective intentions of the filer at a specific period in time are extremely difficult to enforce.[7] Allowing investors to avoid making timely disclosures of

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[5] Jill Goldsmith, *ViacomCBS, Discovery Shares' Mysterious Rise And Fall Driven By Obscure Hedge Fund That Just Went Bust*, The Deadline, March 29, 2021, *available at* https://deadline.com/2021/03/viacomcbs-discovery-stock-archegos-hedge-fund-wall-street-1234723778/.

[6] TM Staff Statement, SEC, Mar. 14, 2022, *available at* https://www.sec.gov/news/statement/tm-staff-statement-20220314 ("2. Concentrated positions of prime brokerage counterparties pose particular concerns. Staff urges broker-dealers to seek sufficient information to determine counterparties' aggregate positions in any markets that may experience liquidity concerns and work with the counterparties to mitigate risk. 3. Staff urges broker-dealers to stress test positions with the proper severity in light of current events and potential market movements, and act to manage the risk of the positions, particularly those that are concentrated, appropriately.").

[7] Alan Kapan, *Passive Aggressive: Unpacking Elon Musk's Beneficial Ownership Filings Regarding Twitter, Inc.*, JDSupra, Apr. 11, 2022, *available at*

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large positions because they may arguably not – at that precise moment in time – have a specific "activist" intention leaves all other investors at greater risk, undermines market transparency, and encourages gaming.

Artificial Reporting Delays Enable Insider Trading to the Detriment of Other Investors and Market Integrity

As we said in our Initial Comment Letter:

> At a time when stock transactions are reported to the markets in fractions of seconds, and the Commission has proposed requiring investors to disclose their stock lending within fifteen minutes of effecting a loan,[8] we do not understand why the vast majority of market participants (including investors and issuers) are to be deliberately kept in the dark for several days regarding material, non-public information impacting their holdings and exposures.[9]

Nevertheless, Commission rules currently allow for a lengthy delay between when an investor or group hits the threshold triggering disclosure of a large position and when the position must be disclosed. The Proposal would generally cut that extremely lengthy delay period in half, on the purported basis that "[m]ore timely and enhanced disclosure would reduce information asymmetry and mispricing in the market."[10]

The Proposal has met stiff opposition from some commenters. Some have argued that the current ten day reporting delay was established as a deliberate "reward" for activist investors. For example, Elliott Investment Management L.P. has argued that the Proposal would "truncate the filing deadlines for amendments to Schedule 13D, all in disruption of the carefully calibrated balance struck by the Williams Act and without a proper empirical basis or analysis of costs and benefits."[11] The letter continued:

> Activism increases the stock price for all investors in a company, but is time-consuming, research intensive, and costly to effect. If activists have no economic incentive to

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https://www.jdsupra.com/legalnews/passive-aggressive-unpacking-elon-musk-4583366/#:~:text=On%20April%204%2C%202022%2C%20Elon,filing%20used%20by%20passive%20investors.

[8] *Reporting of Securities Loans*, SEC, 86 Fed. Reg. 69802 (Dec. 8, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf.

[9] Initial Comment Letter.

[10] Proposal, at 13889.

[11] Letter from Richard Zabel, Elliott Investment Management, to Vanessa Countryman, SEC, Apr. 11, 2022, at 29, *available at* https://www.sec.gov/comments/s7-06-22/s70622-279518.pdf ("Elliott Investment Mgmt Letter")

> pursue activism, other shareholders will not experience the increase in value that would have otherwise resulted from the activist's conduct—which they enjoy for free. Most investors are simply not in a position to do what activists do and are therefore unable to pursue credible activism at scale. For them, activists can be their voice and their catalyst for value in their investment. The markets rightfully reward participants such as activists who acquire securities based on fundamental research or in anticipation of advocating transactions that would enhance shareholder value, ***and the economic incentives to engage in such activities depend on the presence of these asymmetries***.[12]

Essentially, the Elliott Investment Management Letter is arguing that "activism" is a universal good that wouldn't occur *but for* the ability of activists to trade while in possession of material, non-public information for a period of time after establishing a position sufficiently large so as to trigger the disclosure requirements.

Further, the Elliott Investment Management Letter suggests that Congress was (1) aware of those facts, (2) contemplated them, and (3) expressly determined to promote activism by allowing some investors to profit by trading while in possession of material non-public information for exactly ten days (despite that the profits come at the direct expense of other investors and market integrity).

If this were true, then we might expect a discussion of that in the legislative record surrounding the creation of the reporting obligation. We might expect a lengthy consideration of different reporting delay periods, and why Congress was purportedly expressly granting this unique exception to insider trading law.

The legislative history of the Williams Act doesn't seem to reflect that. Rather, any "balance" to be considered was between activist investors seeking to change companies and those companies' management – not between an activist investor on the one hand, and other investors on the other.

Further, contrary to the assertions of some commenters, the Proposal included an extensive analysis of the economics of shareholder engagement and activism.

We are aware of no evidence or legitimate policy rationale to support a connection between the purported benefits of activist strategies generally on the one hand, and the purported need to preserve the ability of the small subset of investors engaged in them to be able to trade while in possession of material, non-public information to the detriment of other investors – for precisely ten days.

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[12] Elliott Investment Mgmt Letter, at 29 (emphasis added).

When confronted with the pragmatic reality that the current reporting delay tacitly establishes a safe harbor period for "permissible" insider trading, it is natural to consider what an appropriate delay should be. Perhaps, ten days is inadequate. Would a longer delay, and thus a potentially greater opportunity for activists to trade at distorted prices, promote more or less activism? What would be the impacts on other investors or market integrity? Why is five days materially different? What about one day? What about fifteen minutes?[13]

When Congress first established the position disclosure obligation more than fifty years ago, it recognized that the presence of a large position holder (or group) is, by itself, material, non-public information. Congress determined that the mere existence of a large position is – by itself – information that companies and the public deserve to know. Accordingly, Congress expressly created a "duty" with regards to that material, non-public information. And, as we have seen repeatedly over the years, this analysis that investors and companies believe this information is important was correct. Disclosures of large positions frequently move the prices of the held stocks.[14]

So why did Congress and the Commission set the disclosure to occur ten days following the accumulation of a sufficiently large position? The answer is simple: ten days made sense at the time. The physical trading and settlement processes took much longer than they do today. Paper stock certificates were physically transferred between parties – and were beginning to create trade processing and reconciliation delays. Reconciliation of accounts and positions took several days. It should not be surprising that parties were not expected to report their holdings prior to confirmation that their holdings actually existed.

In the decades since, technology has dramatically improved the trade, settlement, and reconciliation processes. Trades are often originated, executed, and confirmed within fractions of a second, and while the Commission is in the process of moving to a standard settlement cycle of T+1, many trades are already settled on the trade date.[15]

Despite these technological, market, and regulatory advancements, the Commission has not shortened the delay in reporting of material positions.

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[13] The Commission has separately proposed requiring lenders to disclose securities loans within fifteen minutes of when effected. *Reporting of Securities Loans*, SEC, 86 Fed. Reg. 69802 (Dec. 8, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-12-08/pdf/2021-25739.pdf.

[14] *See, e.g.*, Nivedita Balu, *Musk takes 9% stake in Twitter to become top shareholder, starts poll on edit button*, Reuters, Apr. 5, 2022, *available at* https://www.reuters.com/technology/musk-discloses-92-stake-twitter-2022-04-04/ (reflecting Twitter share price increasing 27% on the date of the announcement).

[15] See, DTCC, *Ask the Expert: Same Day, Every Day – How Same Day Settlement Works at DTCC*, Apr. 11, 2021, *available at* https://www.dtcc.com/dtcc-connection/articles/2021/april/19/ask-the-expert-same-day-every-day-how-same-day-settlement-works-at-dtcc.

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The Commission's inexplicable failure shorten the delay in reporting of material positions over the past five decades has allowed position holders (or those in their group and any other tippees) to continue to trade while in possession of material, non-public information – despite the obligation to disclose it – during the period between when they triggered the obligation to report their positions and when they are obligated to finally make the disclosures.

The Proposal has detailed how those in possession of this information are often able to exploit it to their benefit in the group context:

> For example, any near-term gains made by these other investors attributable to this asymmetric information may come at the expense of uninformed shareholders who sell at prices reflective of the status quo. Even though the demand to acquire shares in the covered class may increase as a direct result of the blockholder's communications, and in turn increase the prices at which such selling shareholders exit, such prices may be discounted in comparison to the price selling shareholders would have achieved had the information about the impending Schedule 13D filing been public. Consequently, this informational imbalance may result in opportunistic purchases benefitting a favored few.[16]

This analysis has already proven to be well-founded, as demonstrated by Elon Musk's recent trading in Twitter stock.

Musk began acquiring shares earlier this year, and reportedly hit the 5 percent threshold requiring him to disclose his position in Twitter on March 14th. Under the current rules, Musk was required to disclose his position on March 24th. But he didn't. Instead, he did not make the mandatory filing until April 4th. We understand that Musk continued to expand his position between March 14th and April 4th.

For all of the purchases after March 14th, Musk was able to buy at artificially low prices – as were all other investors who purchased during the period between the triggering event and his eventual disclosures. In fact, according to one analysis, during just the period between when he was legally required to make the filing (March 24th) and when he did (April 4th), Musk personally saved over $140 million.[17] Obviously, the impacts on all investors, for the entire period between March 14th and April 4th was much greater.

Thus, the delayed reporting essentially enabled a wealth transfer of hundreds of millions of dollars from investors who were not aware of the material, non-public information to

[16] Proposal, at 13869.
[17] Complaint, *Rasella v. Musk*, 1:22-cv-03026 (S.D.N.Y. 2022), *available at* https://www.documentcloud.org/documents/21583990-marc-bain-rasella-v-musk.

Musk and other acquirers during the period from March 14 to April 4th. If the Commission were to accept the assertions in the Elliott Investment Management Letter, the Commission would be essentially blessing much – if not all – of this wealth transfer.[18]

Again, assertions that Congress or the Commission deliberately "calibrated" a grace period for insider trading particularly are curious, as we are not aware of any such declaration by Congress or the Commission. Rather, it seems markedly more plausible that Congress and the Commission tailored the reporting delay to the trading and settlement practices (and technology) that were commonplace over fifty years ago – when the reporting obligation was established.

The Commission should revise the Proposal to make it clear that a position holder (or group) that has triggered the reporting threshold is prohibited from trading while in possession of that material, non-public information. Accordingly, such persons may continue to trade only after the disclosure of such a position. Further, to avoid any gaming, the Proposal should further shorten the backstop on position reporting to the day after settlement of the trade giving rise to the reporting obligation. Currently, that would be T+3 for most securities trades. However, if a position is placed for accelerated settlement, then the reporting obligation should follow with it.

A Strong Rule Should Reduce Some Investors' Ill-Gotten Profits, But Won't Materially Impact Investor Engagement or Advocacy

Some commenters have asserted that simply requiring disclosures of coalitions formed for engagement will somehow stifle or kill activist investing strategies and shareholder engagement. We question any empirical basis for this analysis. If investors wish to engage companies over so-called environmental, social, or governance issues, and they wish to engage other investors in those efforts, they can freely do so. We have seen no rational connection between the disclosure of the effort and some mechanism to inhibit their abilities to engage in those activities. Further, in most cases, the primary investors engaged in these efforts are likely to be already filing public disclosures of their positions.

We appreciate that some "raiders" may prefer to "sneak up" on target companies, but what is the policy justification of them being able to do so after they have accumulated a five percent holding, versus the policy rationale to insure other investors also possess

[18] Elliott Investment Mgmt Letter, at 2. We take no position as to whether this activity violated federal securities laws.

that holdings information? Congress and the Commission have determined that once a person (or group) has a significant position, that position must be disclosed.

Notably, we share concerns raised by some other commenters that the Commission should be careful with its interpretation of what constitutes a "group" for the purposes of the rule, so as to not inaccurately suggest that limited shareholder discussions regarding potential proxy efforts, such as use of Rule 14a-8, would cause otherwise unrelated investors to be compelled to disclose participation in a "group," when that is not what is actually happening.

Ultimately, the Proposal may change the tactics currently used by some activist investors, and it may reduce the profitability for some from that engagement (by shortening the time period during which position holders or other insiders are able profit from trading while in possession of material, non-public information at the expense of other investors), but that's the point. Promoting investor protection and promoting fair, orderly, and efficient markets are the Commission's mission – not preserving the profit margins for a small subset of investors at the expense of others.

Conclusion

We urge the Commission to revise the Proposal to revise and adopt the Proposal without delay.

Thank you for your consideration. Please feel free to contact me by email at ty@healthymarkets.org or telephone at (202) 909-6138 for any follow up.

Sincerely,

Tyler Gellasch
Executive Director