

Managed Funds Association

The Voice of the Global Alternative Investment Industry

Washington, D.C. | New York



April 11, 2022

Via Electronic Mail: rule-comments@sec.gov

Vanessa A. Countryman
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

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

Dear Ms. Countryman,

Managed Funds Association¹ (“MFA”) appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “**Commission**”) on its “Modernization of Beneficial Ownership Reporting” proposal (the “**Proposal**”).² This letter addresses certain proposed changes to the implementing regulations for Sections 13(d) (“**Section 13(d)**”) and 13(g) (“**Section 13(g)**”) of the Securities Exchange Act of 1934 (the “**Act**”), for which the Securities and Exchange Commission (the “**Commission**”) has solicited public comment.

Sections 13(d) and (g), as well as their implementing regulations, Regulation 13D-G, reflect Congress’ and the Commission’s careful balancing of the interests of various stakeholders in the securities markets, including issuers, engaged shareholders, and the investing public at large. The central policy objective of Section 13(d) is to provide the investing public with timely and adequate disclosure when an investor has obtained sufficiently significant voting power to potentially control or influence an issuer. At the same time, Section 13(d), together with Section 13(g), balances this goal against other equally important objectives, such as incentivizing shareholder engagement, promoting the free exchange of information throughout the market, and avoiding undue and unnecessary burdens on capital formation. The U.S. financial markets are the most liquid and effective in the world in large part because the regulatory structure successfully balances the interests of multiple market participants and creates a level playing field.

Given that context, MFA respectfully urges the Commission to reconsider the Proposal, which we believe will have a significant detrimental impact on the markets, and will undermine, rather than advance, the Commission’s objectives to enhance transparency in a manner that protects investors, maintains fair, orderly, and efficient markets, and facilitates capital

¹ MFA represents the global alternative investment industry and its investors by advocating for regulatory, tax and other public policies that foster efficient, transparent, and fair capital markets. MFA’s more than 150 members collectively manage nearly \$1.6 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has a global presence and is active in Washington, London, Brussels, and Asia.

² “Modernization of Beneficial Ownership Reporting,” 87 Fed. Reg. 13846 (March 10, 2022) (“**SEC Release**”).

formation.³ If adopted in their current form, the Commission’s proposed changes would hobble the free flow of information through the market by impeding ordinary, day-to-day communications between investors, including communications relating to corporate performance and operations. They would also impair investors’ ability to engage with issuers and will ultimately harm companies, along with their shareholders and other stakeholders. The significant additional disclosure burdens that the Commission’s proposed changes would place on investors will impose impracticable costs, raise barriers to entry, and ultimately inhibit capital raising.

Additionally, the careful balance struck by Sections 13(d) and (g) has played a crucial role in allowing engaged investors to launch value-creating shareholder campaigns to address key environmental, social and governance (“ESG”) issues. Shareholder engagement with management is critical for improving corporate governance and preventing management entrenchment. Before engaging with management, an investor often accumulates a position in an issuer in order to justify the financial commitments they make with respect to researching and collaborating with an issuer’s management. Such investors may use a combination of underlying securities and derivative products to build a sizeable position while simultaneously hedging their economic exposure. Many of these campaigns take well over a year to reach fruition and engaged investors will often remain shareholders for years thereafter, particularly if they end up with board seats or other governance rights. Accelerated disclosure timelines would force investors to choose between either publicly disclosing their entire trading strategy with respect to a particular issuer or forgoing pursuing engagement with issuers’ management altogether. This will ultimately impair corporate governance and progress on important issues, including ESG, and deny shareholders and other stakeholders of the positive benefits associated with shareholder and management collaboration. The Commission’s proposed changes threaten to thwart these efforts and undermine decades of work by the engaged investment community on these crucial issues.

The costs of the Commission’s proposed changes—to the investment community and the market at large—come with little discernible benefit. The Commission justifies its proposed expansion of the group and beneficial ownership concepts primarily by positing speculative scenarios involving supposedly clandestine strategies to evade disclosure. Notably absent is any evidence that these scenarios are present in the market, or, even if they did exist, that they would not be adequately addressed by the current regulatory regime. The Commission’s Proposal also lacks any analysis, economic or otherwise, demonstrating that the Commission’s proposed changes are necessary to address its stated concerns, or any showing that the benefits of its proposals outweigh the significant costs. Similarly, the Commission justifies its severe constriction of the Schedule 13D and 13G filing timelines with a generic desire for more timely and frequent disclosure, without meaningful consideration of the costs of its proposals, or any penetrating cost-benefit analysis that would justify these additional burdens on investors and the market.

³ See U.S. Securities and Exchange Commission, *The Role of the SEC*, available at <https://www.investor.gov/introduction-investing/investing-basics/role-sec>.

We encourage the Commission to reevaluate and/or revise its Proposal to more appropriately balance its transparency goals against the significant, unnecessary and unjustified burdens, costs and risks to investors and the market.

I. Executive Summary

MFA respectfully recommends the following revisions to the Proposal:

A. Group Concerns

- 1. Revise Rule 13d-5(b)(1)(i) to clarify that a group will be formed only when investors who have beneficial ownership of an issuer's equity securities take affirmative steps to coordinate their conduct with respect to such issuer.** Given longstanding and well-settled precedent tying group formation to the existence of an agreement, the Commission's proposed expansion of Rule 13d-5 to capture any investors who "act as a group" will sow uncertainty and confusion in the investment community as to the precise circumstances under which investors will form a group. Such broad language threatens to subject investors to Section 13(d) disclosure requirements—or even strict liability for insider trading under Section 16 of the Act ("**Section 16**")—based on nothing more than casual conversations or parallel trading with other investors. Such investors may have no intent to coordinate their actions, no intent to influence or change control of the issuer, and no desire to effect a specific outcome. Such a regime would discourage all manner of ordinary, routine communications between investors that help the markets operate efficiently, including communications on issues related to issuer performance, corporate governance, or ESG objectives. Section 13(d)'s group concept is intended to prevent investors who are truly working together from evading disclosure, not to stifle the free and fair exchange of information through the markets or punish mere parallel, but not coordinated, trading conduct.
- 2. Clarify that investment managers that have full investment discretion over their clients' holdings will not be considered a group with those clients under the Commission's new regulations.** The Commission's broad "act as a group" language threatens to upend well-established precedent that clients who delegate all voting and investment authority to an investment manager are not members of a group with the manager or its other clients. The Commission should clarify that such clients will continue to be protected from the burden of making 13(d) disclosures for investments over which they have no discretion.
- 3. Clarify the circumstances under which a group will be deemed dissolved.** As currently drafted, the Proposal does not provide sufficient clarity as to when a group will be deemed to have ended. The Commission should add language that provides the investment community with certainty as to when the Commission will consider a group dissolved under its proposed rules.

4. **Clarify that the exemption under the Commission’s proposed Rule 13d-6(b) for qualified institutional investors participating in private placements will extend to those investors’ clients as well.** Given the Commission’s expansion of Rule 13d-5 to encompass any investors who “act as a group,” we request that the Commission clarify that its “private placement” exemption, which allows qualified institutional investors to participate in private placement transactions together without fear that a group will inadvertently be formed, will extend to those investors’ clients as well. This will ensure that clients are not inappropriately subjected to Section 13(d) solely because of their manager’s participation in a private placement.

B. Filing Timelines for Schedules 13D and 13G

1. **Retain the current ten-day timeline for filing initial Schedule 13Ds, or at most, restrict the timeline to eight days rather than five.** The current ten-day timeline for filing Schedule 13Ds allows engaged investors time to build a sufficient stake in the issuer before public disclosure and the resulting rise in stock price. Engaged investors need this window to build a stake that justifies the cost of a potential campaign and ensures that their voices are heard in the board room. Compressing this filing timeline will diminish engaged investors’ incentive and ability to wield campaigns that create value for shareholders, promote ESG goals, improve board diversity, and establish a more equitable allocation of shareholder voting rights. Such consequences appear diametrically opposed to Commission’s stated desire to protect both shareholder interests and market integrity.
2. **Modify the Commission’s proposed amendments to Rule 13d-2(a) to set a deadline for filing Schedule 13D amendments of no more than four business days—rather than one—but provide interpretive guidance that specifies different timing expectations in different circumstances.** A strict one-business-day deadline for all Schedule 13D amendments, regardless of circumstances, is unjustified and will lead to a plethora of unintended consequences, including: (1) increased risk of inaccurate or incomplete disclosure; (2) increased barriers to entry; and (3) interference with issuers’ ability to influence messaging about significant developments. We recommend that the Commission revise its proposal to ensure that the most crucial, market-moving events (*i.e.*, those involving a potential change of control of the issuer) are disclosed to the market quickly, while maintaining a more flexible and realistic timeline for amendments requiring less immediate disclosure.
3. **Decline to implement the Commission’s proposed amendments to the timelines for initial Schedule 13G filings, and, if the Commission determines more frequent transparency is necessary, instead rely on Form 13F to disclose positions in excess of 5% beneficial ownership.** Requiring investors to take on the burden of filing Schedule 13Gs on a monthly, rather than annual, basis immensely increases the burden on Schedule 13G filers. This increased burden comes with little benefit to the marketplace, given that Schedule 13G filers have expressly disclaimed any intent to change or influence control of the issuer. To the extent the Commission believes more frequent disclosure of these investors’ filings is necessary, revisions to Form 13F would achieve that goal at a significantly less onerous cost to investors.

4. **Decline to implement the Commission’s proposed regulations regarding Schedule 13G amendments, and instead leave the current filing deadlines in place.** If implemented, the Commission’s proposed changes to its Schedule 13G amendment timelines will cause the costs and burdens on Schedule 13G filers to skyrocket—especially for algorithmic traders with continually fluctuating positions who would need to monitor positions on a daily basis—and would flood the market with near-constant filings about relatively small changes in the holdings of investors with no control intent.

C. Expansion of Beneficial Ownership

1. **Decline to expand the definition of beneficial ownership to include cash-settled derivative securities.** Cash-settled derivatives do not convey voting rights but reflect a solely economic stake in the issuer. They have none of the “incidents of ownership comparable to direct ownership” that Congress intended to include within Section 13(d)’s reach.⁴ Expanding that reach to include cash-settled derivatives will simply create market confusion about which investors actually have the ability to influence or control the issuer, directly undermining Section 13(d)’s key purpose. It would also disincentivize potential derivative counterparties from engaging in derivative transactions with not only investors who actually have an intent to influence or change control of an issuer, but any investors who could possibly acquire such an intent, effectively excluding such investors from the market and impeding capital formation. The Commission’s proposal oversteps the bounds of the Commission’s Congressionally-delegated authority and imposes a significant burden on the market, with no clear economic or policy justification.

II. If Left Unclearified, the Commission’s Proposed Amendments to Rule 13d-5 Will Chill Investor Communications and Undermine Investor Engagement Crucial to the Market

The Commission proposes to amend Rule 13d-5 to significantly broaden the circumstances under which two or more investors may be considered a group for purposes of that rule. Most significantly, the Commission proposes to remove language requiring that two or more persons “agree to act together” for a group to be formed, and replace it with language providing that a group is formed whenever two or more persons merely “act as a group.”⁵ This radical expansion of the group concept threatens to chill the free flow of ordinary, day-to-day communications between investors, undermining decades of work by engaged investors to improve corporate governance and performance and address key policy issues such as ESG goals.

The Commission frames its proposal as a mere clarification to Rule 13d-5 to track the text of Sections 13(d)(3) and (g)(3), and remove an agreement requirement that, in the

⁴ 15 U.S.C.A. § 78m(o) (“[A] person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap, only to the extent that the Commission, by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security.”).

⁵ Compare 17 C.F.R. § 240.13d-5(b)(1)(i), with Proposed 17 C.F.R. § 240.13d-5(b)(1)(i).

Commission’s view, the statutes themselves do not contain.⁶ The reality, however, is that decades of settled case law (both before and since the adoption of Rule 13d-5) tie group formation to the existence of an agreement.⁷ The Commission’s proposed amendment would upend this well-established precedent. Thus, if adopted in its current form, the proposed amendment has the potential to dramatically alter the legal landscape regarding group formation.

A plain reading of the text of Sections 13(d)(3) and (g)(3) further demonstrates that the Commission’s proposed amendment exceeds its authority granted by Congress by impermissibly expanding the term “group” beyond its meaning in statutory context. The Commission’s view that Sections 13(d)(3) and (g)(3) do not require an agreement for a group to be formed does not square with these statutes’ examples of groups, all of which are founded on an agreement between two or more parties.⁸ Congress’s chosen language suggests an intent to limit the group concept to relationships that—like partnerships, limited partnerships, and syndicates—involve some sort of agreement, whether formal or informal, express or implied. Consistent with the statutory language (and contrary to the Commission’s interpretation), the legislative history the Commission points to emphasizes Congress’s intent that the term “group” would refer to situations where investors have either explicitly or implicitly “agreed to act in concert,” such as “contract[s], understanding[s], relationship[s], agreement[s] or other arrangement[s].”⁹

Removing the agreement requirement without replacing it with an alternative limiting principle would create an unmoored, ambiguous standard. The Commission’s current proposed language—“act as a group”—threatens to sweep in all manner of situations involving ordinary communications and mere parallel conduct among investors who have no intent to actively coordinate their behavior. It also threatens to disrupt settled law protecting investors and investment managers in standard, discretionary advisory relationships, in which the investment manager makes all voting and investment decisions on behalf of the clients, from the need to make disclosures as a group under Section 13(d). Section 13(d) was never meant, and should not

⁶ See SEC Release, *supra* note 2, at 13847, 13867-68.

⁷ See, e.g., *CSX Corp. v. Children’s Inv. Fund Management (UK) LLP*, 654 F.3d 276, 283 (2d Cir. 2011) (“[W]hether a group exists under section 13(d)(3) turns on whether there is sufficient direct or circumstantial evidence to support the inference of a formal or informal understanding between [members] for the purpose of acquiring, holding, or disposing of securities.” (citations and internal quotation marks omitted)); *Morales v. Quintel Ent., Inc.*, 249 F.3d 115, 123-24 (2d Cir. 2001) (“[T]he key inquiry in the present case is whether [the defendants] ‘agree[d] to act together for the purpose of acquiring, holding, voting or disposing of’ [the issuer’s] common stock.” (quoting 17 C.F.R. § 240.13d-5(b)(1))); *Wellman v. Dickinson*, 682 F.2d 355, 363 (2d Cir. 1979) (deciding whether a group has been formed requires the court to “determine whether there [was] sufficient direct or circumstantial evidence to support the inference of a formal or informal understanding”); *Corenco Corp. v. Schiavone & Sons, Inc.*, 488 F.2d 207, 217 (2d Cir. 1973) (“[A]bsent an agreement between [the defendants] a ‘group’ would not exist” under § 13(d)(3)).

⁸ See 15 U.S.C. §78m(d)(3) (“When two or more persons act as a *partnership, limited partnership, syndicate, or other group* . . . such syndicate or group shall be deemed a ‘person’ for the purposes of this subsection.”) (emphasis added); 15 U.S.C. §78m(g)(3) (same).

⁹ See, e.g., S. Rep. No. 550, 90th Cong., 1st Sess. 8 (1967); H.R. Rep. No. 1711, 90th Cong. 2d Sess. 8-9 (1968), Reprinted in (1968) U.S. Code Cong. & Admin. News. 2811, 2818 (“The group would be deemed to have become the beneficial owner, directly or indirectly, of more than 10 percent of a class of securities at the time [t]hey *agreed to act in concert*.” . . . [Section 13(d)(3)] “is designed to obtain full disclosure of the identity of any person or group obtaining the benefits of ownership [b]y reason of *any contract, understanding, relationship, agreement or other arrangement*.” (emphasis added)).

be read, to chill these ordinary, routine communications and relationships by burdening them with disclosure requirements meant to prevent separate investors working together from evading transparency.

For the reasons explained further below, we believe the Commission's departure from the statutory text and long-standing, well-established and clearly defined precedent requiring an agreement in order for a group to be formed will do more harm than good. Nonetheless, if the Commission moves forward with this proposal, we ask that it clarify the proposed rule to ensure that it is appropriate in scope and does not unintentionally chill ordinary, market-efficient communications and conduct. Specifically, we ask that the Commission, at a minimum:

- (1) Revise Rule 13d-5(b)(1)(i) to clarify that a group will be formed only when investors who have beneficial ownership of an issuer's equity securities take affirmative steps to coordinate their conduct with respect to such issuer;
- (2) Clarify that investment managers that have full investment discretion over their clients' holdings will not be considered a group with those clients under the Commission's new regulations;
- (3) Clarify the circumstances under which a group will be deemed dissolved; and
- (4) Clarify that the exemption under the Commission's proposed Rule 13d-6(b) for qualified institutional investors participating in private placements will extend to those investors' clients as well.

A. The Commission Should Revise its Proposed Amendments to Rule 13d-5 to Provide that a Group is Formed Only When Investors Who Have Beneficial Ownership of an Issuer's Equity Securities Take Affirmative Steps to Coordinate their Conduct with Respect to Such Issuer

As a practical matter, the Commission's proposed language—"act as a group"—makes it virtually impossible for investors to know what types of conduct or communications will form a group. Any two investors who communicate with each other about, and trade securities in, the same issuer could be viewed as "acting as a group," even in the absence of any intent to work together toward a common purpose. The problem is complicated even further in a context where one investor is separately and independently communicating with multiple other investors about a particular issuer. These other investors are not communicating with each other and may not even be aware of each other's existence. Yet, under the broad "act as a group" standard, they are all at risk of being considered a group with each other and the first investor and subjected to Section 13(d) liability should they happen to purchase, sell or vote securities in the same manner.

Without further clarification and narrowing, such an imprecise and sweeping standard will chill day-to-day, ordinary communications among investors. Investors will fear that mere sharing of information may lead to claims of group behavior and have possible ramifications for members of that group under Section 13(d). This fear will discourage investors from communicating about key issues related to an issuer, including those related to corporate

governance and issuer performance. With a decrease in such communications, information dissemination through the market will shrink or slow and market efficiency will suffer.

As just one example of how the Commission’s proposed rule may lead to unintended and undesirable consequences, consider the “Reddit Revolution” of late 2020 and early 2021. Fueled by enthusiasm generated on social media sites such as Twitter and Reddit, millions of retail investors—including a diverse array of mom-and-pop investors, small brokers, and even high school students—purchased stock in a number of companies that more traditional, institutional investors were short-selling. These issuers included the video game retailer Game Stop, the movie theater chain AMC, and the software company BlackBerry. The trading activity had a meteoric impact on these issuers’ stock prices—in a matter of weeks between December and January, BlackBerry’s shares rose 280%, AMC’s 840%, and GameStop’s 1,700%.¹⁰ The millions of disparate investors who bought these issuers’ stock can hardly be said to have entered into an agreement within the meaning of the Section 13(d) case law. Yet their collective, parallel *action* following merely reading others’ posts on Reddit could be viewed as “acting as a group.” Under the Commission’s proposed standard, this could lead to the absurd result of subjecting all of these individuals to Section 13(d)’s filing requirements, or even Section 16 liability.

The Commission’s broad proposed language also raises ambiguities as to whether investors who do *not* beneficially own securities of a particular issuer but have communicated about that issuer with other investors who do, may be considered part of a group with those investors. Courts have traditionally rejected the notion that investors who beneficially own *no* securities in a particular issuer can be members of a group subject to Section 13(d).¹¹ However, as currently drafted, the Commission’s proposed amendment is not clearly, unambiguously limited to investors who actually beneficially own an issuer’s securities.¹² This raises questions about whether the amendment may be read to abrogate this longstanding precedent as well, exposing investors who have not even transacted in an issuer’s securities to potential Section 13(d) liability based on nothing more than casual conversations.

In addition, to the extent information sharing among investors does continue notwithstanding the foregoing issues, the Commission’s proposal will likely lead to yet another

¹⁰ Matt Phillips and Taylor Lorenz, ‘*Dumb Money*’ is on GameStop, and It’s Beating Wall Street at Its Own Game, N.Y. TIMES (Jan. 28, 2021), <https://www.nytimes.com/2021/01/27/business/gamestop-wall-street-bets.html>; see also Allison Morrow, *Everything you need to know about how a Reddit group blew up GameStop’s stock*, CNN BUSINESS (Jan. 28, 2021), <https://www.cnn.com/2021/01/27/investing/gamestop-reddit-stock/index.html>.

¹¹ See, e.g., *Hemispherx Biopharma, Inc. v. Johannesburg Consol. Inv.*, 553 F.3d 1351, 1366 (11th Cir. 2008) (“[A] beneficial ownership interest in securities is necessary to become a member of a group within the meaning of section 13(d)(3) of the Exchange Act.”); *Rosenberg v. XM Ventures*, 274 F.3d 137, 147 (3d Cir. 2001) (“[B]ased upon the statutory and regulatory text, relevant legislative history, and caselaw from our sister circuits, we conclude that . . . each member of a section 13(d) group must hold beneficial ownership of the shares of the issuing entity prior to becoming a section 13(d) group member.”); *Cartica Management, LLC v. Corpbanca, S.A.*, 50 F. Supp. 3d 477, 494-95 (S.D.N.Y. 2014) (“Although the Second Circuit has not ruled on whether a person can be a member of a ‘group’ without being a ‘beneficial owner,’ a court in this district and two circuits have held that beneficial ownership of the equity securities is necessary in order to be a member of a ‘group’ as defined in section 13(d).” (citations omitted)).

¹² Proposed 17 C.F.R. § 240.13d-5(b)(1)(i) (“When *two or more persons act as a group* under section 13(d)(3) of the Act, the group shall be deemed to have acquired beneficial ownership . . . of all equity securities of an issuer *beneficially owned by any such persons* as of the date of the group’s formation.”) (emphasis added).

problem—that certain investors, concerned that they could be subject to the requirements of Section 13(d) due to other investors’ trading in the same issuer, may feel forced to communicate, share information and coordinate their conduct with those other investors to ensure they do not unwittingly run afoul of Section 13(d) due to other investors’ trading. The risk of strict liability under Section 16 for a potential group exceeding 10% beneficial ownership will further compound these issues.

The Commission’s proposal appears largely based on a concern that limiting Section 13(d)’s reach to circumstances where there is evidence of an agreement may not give the Commission, and the public, sufficient ability to monitor so-called “wolf pack” behavior, *i.e.*, behavior among market actors who appear to be coordinating their trades without a discernible express or implied agreement.¹³ While we do not believe that such behavior is at all prevalent in the market, the limited instances in which such conduct may occur does not justify a dramatic expansion of Rule 13d-5. Simply put, the Commission’s proposed amendment is far too blunt an instrument to address this discrete issue. Indeed, concerns about this behavior are already addressed by the Commission’s proposed Rule 13d-5(b)(1)(ii), which ensures that the group concept will be applied to investors who do not reach an explicit agreement, but who share information about potential Schedule 13D filings “with the purpose” of coordinating their transactions.¹⁴ We believe it is important to distinguish such coordination from mere parallel trading activity that reflects reactions to the same market forces, as may occur across funds with momentum-trading strategies or other strategies that merely react to external developments at the issuer. To the extent the Commission seeks to extend Schedule 13(d)’s reach to coordinated behavior beyond the scope of its proposed Rule 13d-5(b)(1)(ii), this purpose can be achieved through narrower language that avoids sweeping in the types of ordinary investor communications and parallel conduct to which Section 13(d) has no legitimate applicability.

We also recognize and appreciate the Commission’s attempt to somewhat narrow the potential impact of its “act as a group” standard through its proposed addition of Rule 13d-6(c). Rule 13d-6(c) would provide that investors do not form a group “solely because of their concerted actions with respect to [an] issuer’s equity securities” so long as their communications “are not undertaken with the purpose or the effect of changing or influencing control of the issuer” and “are not made in connection with or as a participant in any transaction having such purpose or effect,” and the investors “are not directly or indirectly obligated to take such [concerted] actions.”¹⁵ However, this exemption leaves significant ambiguity and uncertainty as to whether investors who do not themselves have any purpose or effect of changing or

¹³ SEC Release, *supra* note 2, at 13868-70 (explaining the Commission’s concern that investors “may take concerted action informally and without memorializing their intentions in writing” and describing such behavior); *id.* at 13888 (citing the Commission’s view that “recent academic research has underscored concerns that groups of blockholders may work together to gain control of corporate boards without making appropriate disclosure” as a motivation for amending Rule 13b-5).

¹⁴ Proposed 17 C.F.R. § 240.13d-5(b)(1)(ii) (“A person that is or will be required to report beneficial ownership on Schedule 13D who, in advance of making such filing, directly or indirectly discloses to any other market participant the non-public information that such filing will be made, acts as a group with such other person or persons within the meaning of section 13(d)(3) of the Act to the extent such information was shared with the purpose of causing such other person or persons to acquire equity securities of the same class for which the Schedule 13D will be filed . . .”).

¹⁵ Proposed 17 C.F.R. § 240.13d-6(c).

influencing control of the issuer, but casually communicate or engage in parallel (but not affirmatively coordinated) trading or voting decisions with those that do, will be considered members of a group.

As an example, consider a scenario in which Investor A, who intends to change or influence control of an issuer and is actively acquiring securities in the issuer, shares information, viewpoints and analysis about the issuer with a second investor, Investor B, but does not reveal its control intent or its plans to file a Schedule 13D. After considering the information learned from Investor A, as well as conducting its own independent analysis, Investor B begins acquiring securities in the issuer as well, but without any intent to coordinate its trading with Investor A. Later, when Investor A wages a proxy fight to change the composition of the issuer's Board of Directors, Investor B votes in favor of Investor A's candidates. The actions of Investors A and B do not reflect the type of coordinated behavior the Commission hopes to address, nor would it be covered by Rule 13d-5(b)(1)(ii). To the contrary, while Investor B considered information it learned from Investor A, it came to its own independent voting and investment decisions, and made no attempt to coordinate with Investor A. However, the two investors could be viewed as "acting as a group" under the Commission's amorphous proposed standard, and Rule 13d-6(c)'s exemption may not fully protect Investor B, since its parallel trading and voting conduct might be argued by some (wrongly, we submit) to be "in connection with" Investor A's change-of-control transaction.

Thus, even with Rule 13d-6(c)'s exemption, the Commission's broad "act as a group" standard is not limited to the type of coordinated behavior that the Commission seeks to target. It also could be read to sweep in any investors who make similar trading or voting decisions after exchanging information, regardless of any intent to coordinate, where one of those investors has a change-of-control intent. This risk will only discourage investors without control intentions from engaging in beneficial information-sharing about issuers' performance and activity, thus limiting the information that is disseminated to the markets and impeding their fair, efficient operation.

Therefore, while we support retaining Rule 13d-6(c)'s proposed exemption, the investment community and the Commission's enforcement goals would be best served by also clarifying the language of Rule 13d-5 itself to ensure that its reach is limited to the types of affirmatively collusive conduct the Commission intends to police. To the extent the Commission insists on removing Rule 13d-5's agreement requirement, we propose that it adopt the following standard: "a group is formed when investors who have beneficial ownership of an issuer's equity securities take affirmative steps to coordinate their conduct with respect to such issuer."

Such a standard would adequately capture the type of clandestinely coordinated, but not explicitly "agreed-upon," investor behavior the Commission seeks to bring under the umbrella of Section 13(d) (to the extent not already covered by Rule 13d-5(b)(1)(ii)). But unlike the Commission's current proposed "act as a group" standard, our proposed language avoids inappropriately expanding Section 13(d)'s scope to more typical, day-to-day investor communications that benefit the market, and that Section 13(d) was never meant to impede.

B. The Commission Should Clarify that its Proposed Amendments Will Not Disturb Well-Settled Law Establishing that Investment Managers and their Clients Do Not Constitute a Group Under Sections 13(d) and (g)

A related problem with the Commission’s proposed amendments to Rule 13d-5 is that, as currently drafted, they do not clarify whether, or to what extent, the group concept will apply to investment advisory relationships in which clients delegate all discretion over their voting and investment decisions to an investment manager through an Investment Management Agreement (“IMA”). As a matter of precedent, so long as such a client cannot reclaim that discretion within 60 days, the client does not have beneficial ownership of the securities as defined in Section 13(d), and therefore cannot be a member of a group. The Commission’s proposal, if left in its current form, could potentially call this bedrock principle into question.

In *Rubenstein v. Int’l Value Advisers, LLC*,¹⁶ the Second Circuit established that “an investment advisory client does not form a group with its investment advisor by merely entering into an investment advisory relationship. Nor does an investor become a member of a group solely because his or her advisor caused other (or all) of its clients to invest in securities of the same issuer.”¹⁷ Specifically, the Court held that the IMA between the client and his investment manager did not form a group between the client and the manager, or the client and the manager’s other clients, where: (1) the client merely “gave the [investment manager] discretionary authority to trade securities in his account and agreed to pay them a fee for these services”; (2) no specific issuer “was identified as one whose stock [the investment manager] might purchase for [the client’s] account”; and (3) the IMA did not “touch on the subject of whether the [investment manager] might seek to influence or control an issuer whose shares might be in an account they managed.”¹⁸

Shortly thereafter, in *Packer v. Raging Capital Management, LLC*,¹⁹ the Second Circuit affirmed that the *Rubenstein* rule applies with equal force where the investment manager and the client are affiliated, so long as the requirements for valid delegation of beneficial ownership are met. The *Raging Capital* Court evaluated a master-feeder fund structure in which a master fund and its feeder fund investors delegated all their voting and investment authority to an affiliated investment manager pursuant to an IMA, which could not be terminated on less than 60 days’ notice. The Second Circuit held that the mere fact that the manager and its client funds were “intertwined” and “not unaffiliated” did not prevent the funds from validly delegating beneficial ownership of their securities to the manager.²⁰ Rather, whether beneficial ownership was validly delegated turned on “whether, under all the relevant circumstances, [the same individual who was in control of the investment manager was also] in control of Master Fund and the feeder funds with authority to commit these entities to altering or terminating the IMA.”²¹

¹⁶ 959 F.3d 541 (2d Cir. 2020).

¹⁷ *Id.* at 546-47.

¹⁸ *Id.* at 546.

¹⁹ 981 F.3d 148 (2d Cir. 2020).

²⁰ *Id.* at 154-55.

²¹ *Id.* at 155-57.

Under *Rubenstein* and *Raging Capital*, a client who: (1) delegates all voting and investment authority to an investment manager; and (2) cannot recover that authority within 60 days has validly delegated its beneficial ownership, does not retain beneficial ownership over the securities in the account or fund, and thus cannot be a member of a group with the investment manager or the manager's other clients under Section 13(d). The investment advisory industry routinely relies on this principle in structuring investment management relationships, ensuring that investment managers' clients are not subject to Section 13(d) for investment decisions over which they have no discretion. But without further clarification, the Commission's proposed "act as a group" standard will create uncertainty and confusion in the investment community as to whether such standard investment advisory relationships could now give rise to group formation under Section 13(d).

Such a result would be inconsistent with the purpose and intent behind Section 13(d)'s group concept, which was intended to prevent different investors with a common purpose from colluding to evade Section 13(d)'s disclosure requirements. Section 13(d)'s group concept was *not* intended to burden routine investment management relationships by subjecting clients who lack discretion over their investments to potential liability or additional disclosure requirements. Treating investment managers and their clients as a group would be particularly disruptive given the Commission's proposed accelerated Schedule 13G filing timelines (discussed further below), which would require investment managers and their clients to make near-constant filings.²²

Therefore, we ask that the Commission clarify that, consistent with *Rubenstein* and *Raging Capital*, clients who validly delegate all beneficial ownership of their securities to an investment manager will not be considered members of a group, with the manager or its other clients, under Section 13. We also ask that, consistent with *Raging Capital*, the Commission make clear that this principle will not change where an investment manager and its client are affiliated, so long as the requirements for valid delegation of beneficial ownership are met.

C. The Commission Should Clarify When a Group Will Be Considered Dissolved Under its Proposed Amended Version of Rule 13d-5

The Commission's proposed broadening of Rule 13d-5 to encompass any investors who "act as a group" also creates substantial ambiguity and uncertainty among the investment community as to when a group will be deemed to have dissolved. By requiring an agreement for a group to be formed, Rule 13d-5 in its current form places a concrete end point on the group concept; once that agreement ends, the group no longer exists. However, the Commission's proposed amendments both remove the agreement requirement²³ and provide that a group will be deemed to have beneficial ownership over any securities acquired by any member of the group "after the date of the group's formation," with no clearly defined set of circumstances under which investors who "acted as a group" at one time will no longer be considered to be doing

²² Clients of investment advisers that are not themselves on the list of qualified institutional investors listed in Rule 13d-1(b) would be required to file a Schedule 13G using the passive investor timeline if they are a beneficial owner or are deemed a member of a group that beneficially owns more than 5% of a class of equity securities. In addition, if the clients were reporting persons under Regulation 13D-G, the clients would then be subject to Section 16 disgorgement of profits despite not having directed the trades that caused the liability.

²³ Proposed 17 C.F.R. § 240.13d-5(b)(1)(i).

so.²⁴ The Commission should add language that provides the investment community with clarity and certainty as to when the Commission will consider a group to have ended under its new proposed rules.

D. The Commission Should Clarify that Its “Private Placement” Exemption for Qualified Institutional Investors Extends to Their Clients as Well

Under the Commission’s current Rule 13d-5(b)(2), which the Commission proposes to re-designate as Rule 13d-6(b), qualified institutional investors who participate in a private placement offering will not form a group if they act: (1) in the ordinary course of their business with no “purpose or effect” of changing or influencing control of the issuer, nor “in connection with or as a participant in any transaction having such purpose or effect”; (2) with no agreement to act together except for the purpose of facilitating the specific purchase involved; and (3) with respect to which the only actions taken subsequent to the closing date are those which are necessary to conclude ministerial matters.²⁵ This regulation appropriately ensures that investors may participate in private placement transactions together without fear that a group will inadvertently be formed. We appreciate the Commission’s retention of this exemption.

However, consistent with our request for clarification that investment managers and their clients will not form a group under the Commission’s proposed regulations, we would ask that the Commission clarify that Rule 13d-6(b)’s private placement exemption extends to both qualified institutional investors *and* the clients whose investments they control. Otherwise, the Commission’s broadening of Rule 13d-5 to capture any investors who “act as a group” may put such clients at risk of being considered a group with their investment manager and/or each other by virtue of their investment manager’s participation in a private placement, undermining the laudable purpose and intent behind the private placement exemption.

Relatedly, it is unclear why the type or identity of *other* investors participating in a private placement transaction should impact whether qualified institutional investors (and their clients) who participate in financing would be deemed members of a group. Finally, private placements often feature ongoing agreements between the issuer and the investors regarding matters such as registration rights, and we would appreciate the Commission’s clarification that such customary arrangements will not give rise to the existence of a group under the Commission’s proposals.

III. The Commission’s Proposed Revisions to the Deadlines for Filing and Amending Schedule 13Ds and 13Gs Impose Unfair and Unjustified Burdens on Investors, to the Detriment of the Market

The Commission proposes a number of changes that significantly accelerate the filing timelines for Schedule 13Ds and 13Gs, as well as subsequent amendments. The Commission’s

²⁴ See Proposed 17 C.F.R. §§ 240.13d-5(b)(1)(iii), 240.13d-5(b)(2)(ii) (providing an end point as “the earlier of (x) the date of the group’s dissolution or (y) the date of that member’s withdrawal from the group,” but not defining the circumstances under which a group will be considered dissolved or a member will be considered to have withdrawn).

²⁵ Proposed 17 C.F.R. § 240.13d-6(b).

stated justification for these changes is its concern that “the current deadlines for Schedule 13D and Schedule 13G filings are creating information asymmetries in today’s market.”²⁶ The Commission has also expressed its belief that modern technological advances justify shorter filing timelines.²⁷

Respectfully, the Commission’s proposals reflect inadequate consideration of the dramatically increased costs, significant logistical challenges and policy implications of its proposed timelines. Among others things, these accelerated deadlines would: (1) enhance the risk that inaccurate or incomplete information will be disseminated to the market by investors struggling to complete complex disclosures in an extremely abridged time frame; (2) curtail issuers’ ability to control their message to the market regarding significant agreements with their investors and to coordinate their messages with those investors; (3) impose significant additional administrative burdens and expense on 13G filers, who would now have to make tens or even hundreds of issuer-by-issuer filings and amendments on a monthly, or more frequent, basis, with little benefit to the market; and (4) create more substantial barriers to entry, thereby discouraging new potential entrants to the investment management market in general and the engaged investor space in particular.

We propose the following revisions to the Commission’s proposals. As explained further below, we believe these revisions more appropriately balance the competing concerns at issue, achieve the Commission’s goal of greater and faster transparency, and limit unnecessary burdens on investors or the market at large:

- (1) Retain the current timeline for filing initial Schedule 13Ds of ten days after acquiring 5% beneficial ownership, or at most, restrict the timeline to eight days rather than five;
- (2) Modify the Commission’s proposed amendments to Rule 13d-2(a) to set a deadline for filing Schedule 13D amendments of no more than four business days—rather than one—but provide interpretive guidance that specifies different timing expectations in different circumstances, depending on the balance between the need for urgent disclosure and other competing concerns;
- (3) Decline to implement the Commission’s proposed amendments to the timelines for *initial* Schedule 13G filings, and, if the Commission determines more frequent transparency is necessary, instead rely on Form 13F to disclose positions in excess of 5% beneficial ownership; and
- (4) Decline to implement the Commission’s proposed regulations regarding Schedule 13G *amendments*, and instead leave the current filing deadlines in place.²⁸

²⁶ SEC Release, *supra* note 2, at 13847.

²⁷ *Id.* at 13849-50, 13856-57, 13877, 13881.

²⁸ The Commission also proposes to amend the existing requirement to report *any* changes to information reported on a Schedule 13G, so that only *material* changes need be reported, “including, but not limited to, any material increase or decrease in the percentage of the class beneficially owned.” *Compare* 17 C.F.R. § 240.13d-2(b)

A. The Commission Should Leave the Initial Schedule 13D Filing Timeline at Ten Days, Rather Than Shortening it to Five Days

The Commission proposes to accelerate the timeline for filing Schedule 13Ds from ten days to five.²⁹ Compressing the current 10-day filing deadline would disincentivize value-creating shareholder engagement that benefits all stakeholders, thus encouraging entrenchment and diminishing accountability among corporate managers.

Schedule 13Ds are most often filed by engaged investors seeking to improve public companies. Studies demonstrate that, as a matter of course, these engaged investors create value for shareholders and other stakeholders through pursuit of such changes.³⁰ Indeed, stock prices often rise immediately after the filing of a Schedule 13D, and the increased value engaged investors bring is often sustained for years thereafter.³¹ These engaged investor proposals may involve economic changes to create value for shareholders, such as modifying product strategy or selling unproductive assets. More recently, however, such changes have also involved issues that inure to the benefit of all stakeholders, including proposals to pursue ESG issues, improve board diversity, and establish a more equitable allocation of shareholder voting rights.³²

with Proposed 17 C.F.R. § 240.13d-2(b). Regardless of what, if any, changes the Commission makes to the Schedule 13G filing timelines, the Commission should set the “materiality” threshold for purposes of Schedule 13G amendments to be significantly higher than the 1%-change-in-beneficial-ownership standard used in the Schedule 13D context. See 17 C.F.R. § 240.13d-2(a). Given the frequent fluctuations in many Schedule 13G filers’ holdings, a 1% materiality threshold would result in the market becoming inundated with an onslaught of near-constant filings that simply disclose relatively small changes in the holdings of investors who have no intent to change or influence control of the issuer. See Sections III.C-D *infra*. Therefore, the Commission should define a “material change” for Schedule 13G purposes as a change in beneficial ownership in excess of 2.5%, if not higher.

²⁹ Compare 17 C.F.R. § 240.13d-1(a), (e), (f), (g) with Proposed 17 C.F.R. § 240.13d-1(a), (e), (f), (g).

³⁰ See, e.g., Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. of Fin. 4 1729, 1729-75 (2008) (“**Hedge Fund Activism**”); Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1085-1156 (2015) (“**The Long-Term Effects of Hedge Fund Activism**”); Rui Albuquerque et al., *Value creation in shareholder activism*, J. of Fin. Econ., Sept. 17, 2021, <https://doi.org/10.1016/j.jfineco.2021.09.007> (“**Value creation in shareholder activism**”); see also *The Long-Term Effects of Hedge Fund Activism*, at note 17, 74-77 (listing additional studies).

³¹ See, e.g., *Hedge Fund Activism at 1730* (finding that an announcement of an engaged investor’s initiative through the filing of a Schedule 13D results in an average increase in share price of 7 to 8%, and that “the positive returns at announcement are not reversed over time, as there is no evidence of a negative abnormal drift during the 1-year” following announcement); see also *Value Creation in Shareholder Activism at 1* (finding average returns of 6.34% following the filing of a Schedule 13D, compared to 0.59% following the filing of a Schedule 13G, which signals a passive investment); *The Long-Term Effects of Hedge Fund Activism at 1090, 1155* (“performance is higher three, four, and five years after the year of [an engaged shareholder’s] intervention,” and there is “no evidence of [a] reversal of fortune [of the initial stock increases] during the five-year period following the intervention”).

³² See, e.g., Matt Phillips, *Exxon’s Board Defeat Signals the Rise of Social-Good Activists*, N.Y. Times, June 9, 2021, <https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html>; Laurie Havelock, *Investor pressure prompts Apple board diversification*, IR Mag., Jan. 8, 2014, <https://www.irmagazine.com/esg/investor-pressure-prompts-apple-board-diversification>; Royal Dutch Shell ties executive pay to carbon reduction, BBC News, Dec. 3, 2018, <https://www.bbc.com/news/business-46424830>; Press Release, Bus. Wire, *Arjuna Capital: Investors Cast Majority Vote Pressing for Sexual Harassment Accountability at Microsoft Annual Meeting*, Nov. 30, 2021, <https://www.businesswire.com/news/home/20211130006171/en/Arjuna-Capital-Investors-Cast-Majority-Vote-Pressing-for-Sexual-Harassment-Accountability-at-Microsoft-Annual->

In light of the role engaged shareholders play as agents of change, corporate managers and their professional representatives have endeavored to shorten the Schedule 13D filing period for more than a decade.³³ Shortening the filing period hinders engaged shareholders' ability to build a stake in an issuer before the stock price rises upon the filing of a Schedule 13D. This diminishes the economic incentive to commence campaigns that ultimately benefit all investors. The ten-day window appropriately balances providing information to the investing public while allowing engaged shareholders to seek positive changes at companies for the benefit of shareholders and other stakeholders.

In announcing its proposed amendments, the Commission acknowledged "the chilling effect that a shortening of the initial Schedule 13D filing deadline could have on a shareholder's ability and incentive to effect changes at companies that may benefit all shareholders."³⁴ The Commission also recognized "the need to balance the market's demand for timely information against the administrative burden placed upon a filer to adequately and accurately prepare that information."³⁵ We appreciate the Commission's consideration of these concerns, and its efforts to strike an appropriate balance between competing.

Respectfully, however, we believe that five days is too narrow a timeframe to mitigate the impact on engaged shareholders' ability to effectuate positive change. A five-day timeline halves the time engaged shareholders would have to build up their positions before public disclosure would likely result in an increased share price. Building up these positions is necessary to justify the cost of a shareholder campaign, to make overtures to an issuer's management to "test the waters," and to gain sufficient holdings to ensure the investors' voices are heard in the board room. Accelerating the current ten-day timeline would thus encourage entrenchment of corporate management, weaken corporate accountability, and impede engaged investors from waging campaigns that generate value in numerous ways, including, among other things, improving corporate governance, ousting poorly performing directors and officers, and addressing key ESG issues. While we understand and respect the Commission's need to weigh

Meeting; David Benoit, Activist Pressures Ratner Family to Relax Control of Forest City, *The Wall St. J.*, Aug. 10, 2016, <https://www.wsj.com/articles/activist-pressures-ratner-family-to-relax-control-of-forest-city-1470801603>; Jake Mooney, Forest City agrees to eliminate dual-class structure; chairman to retire, *S&P Glob.*, Dec. 6, 2016, <https://www.spglobal.com/marketintelligence/en/newsinsights/trending/Ecb1WBjOww8empIsrpXw2>.

³³ Letter from Wachtell, Lipton, Rosen & Katz to Ms. Elizabeth M. Murphy, Sec'y, Sec. and Exch. Comm'n, at 3-7 (Mar. 7, 2011) (on file with Akin Gump Strauss Hauer & Feld LLP); Adam O. Emmerich, Trevor S. Norwitz, William Savitt, Sabastian V. Niles and Karessa L. Cain, *The SEC Should Address the Risk of Activist "Lightning Strikes"*, Wachtell, Lipton, Rosen & Katz: Memorandum (March 11, 2021), <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27398.21.pdf>; Adam O. Emmerich, Trevor S. Norwitz, William Savitt, Karessa L. Cain and Sabastian V. Niles, *Archegos Debacle Highlights the Continuing Need for Disclosure Reform*, Wachtell, Lipton, Rosen & Katz: Memorandum (March 31, 2021), <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27442.21.pdf>; Adam O. Emmerich, Trevor S. Norwitz, William Savitt, Karessa L. Cain and Sabastian V. Niles, *SEC Considers Improving Market Transparency, Beneficial Ownership Reporting*, Wachtell, Lipton, Rosen & Katz: Memorandum (June 24, 2021), <https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27729.21.pdf>.

³⁴ SEC Release, *supra* note 2, at 13851.

³⁵ *Id.* at 13852.

these concerns against the value of more timely dissemination of material information to the market, we believe the current ten-day timeline strikes the most appropriate balance.

Nonetheless, should the Commission determine that an acceleration of the timeline is necessary, we submit that the Commission should adopt a timeline of eight days rather than five. An eight-day timeline would still meet the Commission's goal of ensuring that information reaches the market more quickly but would do less harm to the equally important goal of ensuring that engaged shareholders have sufficient time and ability to make their voices heard to the benefit of all shareholders.

B. The Commission's Proposed New Deadline for Filing Amendments to Schedule 13Ds—One Business Day Following the Triggering Event—Should Be Amended to Allow for Flexibility in Differing Circumstances

As currently written, Rule 13d-2(a) provides that amendments to Schedule 13D must be filed "promptly" after a triggering event.³⁶ The Commission's proposed amendments would replace this somewhat flexible standard with a strict requirement that Schedule 13D amendments be filed "within one business day after the triggering event."³⁷ Applying a one-business-day deadline to all Schedule 13D amendments, regardless of the circumstances, does not appropriately balance the need for prompt disclosure of important, market-moving events with the need to avoid imposing an undue, impracticable burden on investors making more routine filings.

As an initial matter, one business day is simply not enough time for most investors to prepare complete and accurate disclosures of complex triggering events. Amendments to Schedule 13D are often narrative documents that distill and summarize lengthy, complex agreements and include significant, detailed disclosures. In most circumstances, it is simply not practicable to prepare, finalize and file such complex disclosures within a single business day. Such a tight deadline significantly increases the risk that investors will inadvertently make inaccurate or incomplete disclosures to the market in a rush to meet their one-business-day deadline.³⁸

Moreover, at times, Schedule 13D amendments disclose agreements between engaged investors and the issuer itself. Issuers typically have four business days to publicly disclose such agreements on Forms 8-K after entering into them, and often prefer to be the first to disclose in order to control the initial message to the market.³⁹ Imposing a one-business-day deadline on 13D filers would force them to disclose their agreements with issuers publicly before the issuers are technically required to disclose the information, potentially depriving issuers of this opportunity to have time to shape the narrative. A one-business-day deadline also creates

³⁶ 17 C.F.R. § 240.13d-2(a).

³⁷ Proposed 17 C.F.R. § 240.13d-2(a).

³⁸ The Commission's proposed change in the filing cut-off time from 5:30 PM EST to 10 PM EST, compare 17 C.F.R. § 232.13(a)(2), with Proposed 17 C.F.R. § 232.13(a)(4), does not mitigate this problem. A four-and-a-half-hour extension of the cut-off time does not make up for the loss of several business days and decrease in flexibility caused by replacing the "promptly" standard with an inflexible, one-business-day deadline.

³⁹ See Instruction B.1 to Form 8-K.

practical challenges by making it more difficult for issuers and 13D filers to coordinate their messages to ensure accuracy and consistency. Additionally, a one-business-day deadline may force investors to publicly disclose an agreement in principle through a Schedule 13D amendment before the terms are finalized, creating the risk of prematurely disseminating information to the market that turns out to be inaccurate or incomplete.

Notwithstanding the foregoing concerns, if the information to be disclosed relates to a change of control transaction proposed by an investor, a short amendment timeline of two business days (or, in particularly extreme circumstances, even one) may make sense. Many Schedule 13D amendments, however, are more routine, reflecting changes to the investor's status that are not necessarily market-moving.⁴⁰ A flexible standard would accommodate these less dramatic, but still time-consuming, amendments.

Notably, in the separate but related context of Section 16, Congress has determined that *two* business days following a transaction is a reasonable time period for statutory insiders to file a Form 4 – Statement of Changes in Beneficial Ownership.⁴¹ Unlike Schedule 13D amendments, Form 4s merely report numerical information about a transaction, such as the number of securities acquired or disposed of and the filer's total beneficial ownership level following the transaction. As such, it is only logical that those filing Schedule 13D amendments—which, as discussed above, involve significantly more complex, potentially lengthy narrative disclosures—should have more time to prepare those amendments than Form 4 filers do, except in the context of market-moving events. Indeed, even two business days would not be a reasonable amount of time for Schedule 13D amendments that may require complex and detailed disclosures.

Given the foregoing challenges stemming from the Commission's proposed rigid one-business-day deadline, we ask that the Commission modify its proposed amendments to Rule 13d-2(a) to: (1) retain the requirement that amendments be filed "promptly"; but (2) set an outside deadline for Schedule 13D amendments of no longer than four business days following a triggering event; and (3) add a narrative setting out the Commission's timing expectations in different situations for the filing to satisfy the "prompt" standard, including those where a shorter filing deadline would be required. For example:

- a. For amendments that report extraordinary trading coupled with a potential change of control of the issuer through a material transaction, a two-business day—or, in particularly extreme circumstances, as short as a one-business-day—deadline would likely be appropriate, given the significant, market-moving nature of this information.
- b. For amendments that merely report ordinary changes in an investor's beneficial ownership outside of a change of control situation, investors should have at least three business days—one additional day relative to reporting such changes under Section 16—so that beneficial owners are not burdened with potentially needing to file both a Form 4 and a Schedule 13D amendment at the same time.

⁴⁰ For example, the effect of an initial business combination on a sponsor's holdings may already be disclosed in advance in the issuer's filings, but a 5% holder may still be required to file an amendment upon closing.

⁴¹ See 15 U.S.C. § 78p(a)(2)(C).

- c. For amendments that disclose other types of agreements, investors should have the same four-business-day disclosure timeline that issuers themselves have for reporting on Form 8-K.

This proposal achieves the goals of clarifying the “promptly” standard with more definitive, concrete timelines and ensuring that the most significant, market moving transactions (*i.e.*, those involving potential changes in control of an issuer) are disclosed as early as realistically practicable. At the same time, it maintains a more flexible, realistic timeline for amendments relating to other types of transactions or trading for which there is less need for immediate disclosure. Thus, we believe our proposal strikes a proper balance between the need to ensure crucial information is disclosed to the market quickly and the need to avoid imposing unnecessary, undue burdens on investors that will ultimately be more harmful than helpful to the markets.

C. The Commission Should Decline to Implement its Proposed Amended Timelines for Filing Initial Schedule 13Gs, and, If Any Changes Are Made, Instead Amend Form 13F to Require Disclosure of New Positions in Excess of 5% Beneficial Ownership

The Commission proposes to accelerate the timeline for qualified institutional investors and exempt investors to file initial Schedule 13Gs, from 45 days after the end of the *calendar year*, to five business days after the end of the *month*, in which their beneficial ownership in a class of securities exceeds 5%.⁴² The Commission’s proposal profoundly increases the burden, cost and expense on Schedule 13G filers. Indeed, under the Commission’s proposed regime, Schedule 13G filers will shift from making a single set of filings during one predictable, annual period to making detailed, security-by-security filings every single month. Investment managers’ clients will often bear the additional costs associated with these filings. Moreover, by increasing overhead costs and expanding an already complex regulatory regime, the Commission’s accelerated timeline will render it particularly difficult for smaller managers, who cannot readily bear the costs and administrative burden of monthly filings.

This increased burden on institutional investors and their clients comes with little benefit to the market. Institutional investment managers’ trading activity is already subject to significant scrutiny by the Commission and the public through the filing of Forms 13F. Form 13F includes information about the issuers and securities in which the managers are invested, the number of shares owned, and their fair market value. Moreover, investment managers filing Schedule 13Gs have expressly disclaimed any intent to change or influence the control of the issuer, rendering information about their holdings less urgent and crucial from the market’s perspective than those of a Section 13D filer.⁴³ Given these facts, monthly, security-by-security Schedule 13G filings

⁴² Compare 17 C.F.R. § 240.13d-1(b) and (d) with Proposed 17 C.F.R. § 240.13d-1(b) and (d). For passive investors, the Commission proposes to decrease the timeline for filing initial Schedule 13Gs from ten days to five days after exceeding 5% beneficial ownership. Compare 17 C.F.R. § 240.13d-1(c) with Proposed 17 C.F.R. § 240.13d-1(c).

⁴³ See 17 C.F.R. § 240.13d-1(b)(1)(i).

and amendments would give the market little additional relevant information about these investors' trades.

The Commission's release describing its proposed changes does not contain any economic or market analysis to justify why a monthly filing requirement is necessary or beneficial to meet the Commission's goals of protecting the investing public.⁴⁴ We believe that there is no compelling reason to change the current annual filing requirement for Schedule 13Gs, which allows the market to obtain a clear, accurate picture of every investor's holdings in each issuer at a single point each year. This is especially true in light of the fact that, as discussed above, Form 13F filings provide the market with substantially complete information about investment managers' holdings on a quarterly basis.

To the extent the Commission determines that any additional disclosure is necessary, we submit that a more efficient solution to the Commission's concerns would be to simply add a column to Form 13F requiring filers to explicitly note, for each listed class of securities, whether the filer has acquired over 5% beneficial ownership during the reporting period. Forms 13F can then be filed using the relevant issuers' Central Index Key numbers, so that members of the investing public researching a particular issuer can readily see the Form 13F filers who have disclosed a greater-than-5% position in that issuer. This approach would provide the market and the investing public with the same information that issuer-by-issuer Schedule 13G filings would. However, it would significantly reduce the burden on investment managers relative to the Commission's proposed approach. It would allow investment managers to simply disclose their over-5% positions on filings they already make rather than making separate, issuer-by-issuer filings every month, which would impose a substantial burden without a clearly articulated benefit as compared to requiring the same disclosure on Form 13F filings.

For the foregoing reasons, we believe that leaving the current annual requirement for initial Schedule 13G filings in place and adopting our proposed Form 13F amendment as an alternative is the most efficient way to address the Commission's concerns. Nonetheless, to the extent the Commission determines to move forward with a more frequent Schedule 13G filing schedule, we request that it require Schedule 13Gs to be filed on, at most, a quarterly, rather than monthly, basis. A quarterly filing requirement would still impose significant burdens on investment managers and would require the investing public to hunt through multiple filings, rather than a single Form 13F, for complete information about an investor's holdings. However, a quarterly filing requirement would at least come closer than the Commission's current proposal to the appropriate balance between ensuring market transparency and avoiding undue, inefficient and unnecessary burdens on investors and their clients.⁴⁵

⁴⁴ See, e.g., SEC Release, *supra* note 2, at 13890 (describing, in a single paragraph, the Commission's consideration of a quarterly Schedule 13G filing deadline for qualified institutional investors, and concluding, without any economic or cost-benefit analysis, that a shorter deadline "would provide less timely disclosure compared to the proposed approach, and thus be of less benefit to investors and the market").

⁴⁵ We further note that, to the extent the Commission seeks to provide the investing public with greater transparency regarding the percentage of issuers' securities that are held by their significant investors, an alternative or supplemental option would be for the Commission to require issuers to provide additional disclosure regarding the holders of their outstanding securities.

D. The Commission Should Maintain the Current Timelines for Filing Schedule 13G Amendments

The Commission proposes to accelerate the timeline for Schedule 13G amendments for all filers from 45 days after the end of the *calendar year* in which a triggering event occurred, to five business days after the end of the *month* in which the event occurred.⁴⁶ For passive investors and qualified institutional investors, the Commission has also proposed additional, even more aggressive changes to the deadlines for filing Schedule 13G amendments. For passive investors, the Commission proposes to change the deadline from “promptly” to one business day after exceeding 10% beneficial ownership or a 5% change in beneficial ownership.⁴⁷ For qualified institutional investors, the Commission proposes to change the deadline from ten days after the end of the *month*, to five days after the *day*, in which an investor exceeds 10% beneficial ownership or changes its beneficial ownership by 5%.⁴⁸

The costs of these proposals far outweigh any perceived benefits. For some qualified institutional investors, this proposed monthly amendment regime may mean literally hundreds of filings on a monthly basis, as their investments fluctuate perpetually. Because many institutional investors, and particularly algorithmic traders, may change their holdings on a near-constant basis, the number of Schedule 13G filings could prove overwhelming. Schedule 13G filers have no intent to change or influence control of the issuer and are already subjected to significant disclosure requirements through the filing of Forms 13F. Thus, the information on Schedule 13G is less significant to the marketplace, and the need for disclosure less urgent, than in the Schedule 13D context. Once the market has been made aware that an investor has crossed the initial threshold for filing Schedule 13Gs, there is limited value in monthly information regarding relatively small and potentially perpetually occurring changes in the filer’s beneficial ownership, especially when the beneficial owner would be burdened with making separate filings for each issuer. And any perceived benefit to more frequent disclosure certainly does not justify the potentially extreme burden and expense, and heightened barriers to entry, that a monthly, or even quarterly, filing requirement would pose.⁴⁹

For the same reasons, imposing one-business-day (for passive investors) or five-day (for qualified institutional investors) deadlines for filing a Schedule 13G amendment after surpassing 10% or a 5% change in beneficial ownership poses similarly undue burdens with little value to the market. The Commission’s proposed changes represent a particularly radical change for qualified institutional investors, who will need to shift from monitoring and reporting 13G positions on a *monthly* basis to a *daily* basis. For many institutional investors, but especially for algorithmic traders whose investments are in a perpetual state of flux, this represents a profound (and, for smaller or upstart investment managers, potentially insurmountable) increase in the time, expense and administrative burden necessary to comply with the Commission’s disclosure requirements.

⁴⁶ Compare 17 C.F.R. § 240.13d-2(b), with Proposed 17 C.F.R. § 240.13d-2(b).

⁴⁷ Compare 17 C.F.R. § 240.13d-2(d), with Proposed 17 C.F.R. § 240.13d-2(d).

⁴⁸ Compare 17 C.F.R. § 240.13d-2(c), with Proposed 17 C.F.R. § 240.13d-2(c).

⁴⁹ See Section III.C *supra* (discussing the costs and burdens associated with a monthly filing requirement).

Taken together, the Commission’s proposed new deadlines for Schedule 13G amendments are onerous and unnecessary. The Commission takes the position that “the high thresholds [for filing Schedule 13G amendments] . . . warrant that the amendment be rapidly disseminated to the market.”⁵⁰ However, the Commission presents no economic analyses, academic studies, or other evidence to justify its view that information about mere fluctuations in holdings by institutional investors who do not control the issuer or possess other market-moving intent must be disclosed more quickly than the current disclosure regime allows.

As such, even if the Commission ultimately chooses to accelerate the timeline for filing *initial* Schedule 13Gs, it should leave the timelines for filing *amendments* to Schedule 13G unchanged. There is simply no compelling justification to burden the marketplace with a constant onslaught of Schedule 13G amendments with limited relevance, and investors with the costs of making such constant filings, especially when most institutional investors are already subject to a portfolio-level disclosure in Form 13F.

IV. The Commission Should Not Expand the Definition of Beneficial Ownership to Include Cash-Settled Derivative Securities

The Commission proposes to expand the definition of “beneficial ownership” under Section 13(d) to deem certain holders of certain cash-settled derivative securities, other than security-based swaps, to be the beneficial owners of the referenced covered class.⁵¹ We respectfully believe that this significant proposed expansion of the definition of beneficial ownership is misguided and unjustified.

As an initial matter, cash-settled derivative securities provide none of the “indicia of ownership comparable to direct ownership” that Congress intended to include within the concept of beneficial ownership under Section 13(d).⁵² The purpose of Section 13(d) is to ensure disclosure when an investor acquires voting securities that can provide the holder with influence or control. Unlike ownership of a physical security, cash-settled derivative securities do not result in any potential for control of the issuer. Including them as part of holders’ beneficial ownership will only generate market confusion as to which investors actually have the power to control and influence the issuer through voting. As such, not only is including cash-settled

⁵⁰ SEC Release, *supra* note 2, at 13858.

⁵¹ Proposed 17 C.F.R. § 240.13d-3(e)(1).

⁵² 15 U.S.C.A. § 78m(o). While Section 13(o) of the Act applies specifically to security-based swaps, it reflects Congress’s clear understanding and intent that the definition of “beneficial ownership” include only those securities that the holder either directly owns, or that confer comparable rights upon the holder. We note that, while the Commission has (appropriately) excluded security-based swaps from its proposed Rule 13d-3(e), it has separately proposed to require disclosure of such swaps through its proposed amendments to 17 C.F.R. 240.10B-1 (“**Rule 10B-1**”). We are concerned that the Commission appears to be using its proposed amendments to Rule 10B-1 to require disclosure of security-based swaps without satisfying the requirements of Section 13(o), including that the Commission “consult[] with the prudential regulators and the Secretary of the Treasury” and show that disclosure of such equity securities is “necessary to achieve the purposes of [Section 13].” 15 U.S.C.A. § 78m(o). Our concerns about the Commission’s proposed amendments to Rule 10B-1 are addressed in a separate comment letter.

derivative securities within beneficial ownership not “necessary to achieve the purposes of” Section 13(d), but it also directly undermines those purposes.⁵³

The Commission appears not to have adequately considered the potential consequences of its proposal in tandem with its proposed expansion of Rule 13d-5’s definition of “group.” Consider a party engaging in derivative transactions in an issuer’s securities with multiple counterparties, only one of whom has an intent to change or influence control of the issuer. Under the Commission’s proposed rules, there is a heightened risk that the party and *all* of its counterparties in that issuer will be considered a group, by virtue of the fact that a single counterparty happens to be a control investor. This heightened risk of group formation would discourage parties from engaging in derivative transactions not only with control investors, but with any investors who *could possibly* acquire a control intent in the future, out of fear of inadvertently forming a group. As a result, engaged investors, investors with control intentions, and non-control investors who may acquire a control intent at some point could be effectively foreclosed from the derivative market.

The Commission’s proposed carve-out from Sections 13(d) and (g) for parties who enter into a derivative transaction without the “purpose or effect of changing or influencing control of the issuer, or in connection with or as a participant in any transaction having such purpose or effect,” does not solve this problem.⁵⁴ Investors who do not themselves have a control intent, but are in any way connected to a change-of-control transaction—for example, because they transacted with a counterparty who separately transacted with an investor with a control intent—are not protected by this carve-out. Moreover, given that cash-settled derivative securities do not confer even a control-minded investor with any actual ability to change or influence control of the issuer, the Commission has presented no compelling justification for limiting its carve-out to purely passive investors with no connection whatsoever to a change-of-control transaction.

The Commission’s proposal will also impair engaged investment strategies that are vital to the fair and efficient functioning of our markets. Engaged investors expend considerable resources on independent research to develop sound investment decisions. When their independent research supports a significant investment in a given issuer, they will often invest in derivatives to supplement or substitute their cash investments. Derivatives give these investors no voting rights or ability to impact corporate control. Rather, the investors’ purpose in purchasing the derivatives is to gain additional *economic* exposure to their forecasted increase in value without needing to take on the burdens associated with Section 13(d) or (g) disclosure, including potentially being forced to share their proprietary research with the market. If engaged investors are unable to take advantage of the strictly economic opportunity derivatives provide without risking subjecting themselves to additional disclosure requirements, the investor may not be able to justify the expense of the in-depth research needed to support their investment thesis. This would discourage engaged investment strategies and the associated in-depth research, ultimately harming investors and the markets. Such a result would largely serve the interests of entrenched or indifferent corporate managers to the detriment of their shareholders.

⁵³ *Id.*

⁵⁴ Proposed 17 C.F.R. § 240.13d-6(d).

The Commission’s proposal appears to rest on its unsupported assumption that investors may use cash-settled derivatives to “acquire economic exposure to substantial blocks of securities without public disclosure,” then convert these non-voting, purely economic interests into voting power quickly by acquiring the underlying shares held by their derivative counterparty.⁵⁵ The Commission’s posited scenario is purely speculative and seemingly premised on false assumptions regarding clandestine relationships and agreements between cash-settled derivatives holders and their counterparties. To be sure, in a particular scenario, a seller of a derivative *might* hedge its risks by purchasing the underlying reference shares and *might* later choose to sell those shares to its counterparty, the holder of the derivative. But this scenario is indistinguishable from the derivative holder’s purchase of shares on the open market, absent a preexisting agreement for the seller to keep those shares and sell them to the derivative holder on demand. The Commission has provided no evidence that such agreements are present, much less prevalent, in the market.⁵⁶ Moreover, to the extent such an agreement *did* exist, the derivative holder would be considered to have beneficial ownership of those shares under the current rules, and would therefore be required to disclose.⁵⁷

For this reason, the Commission’s proposed changes are unnecessary to address a scenario in which counterparties to a derivative transaction are actually colluding to facilitate the derivative holder’s attainment of voting power. Outside of that scenario, there is no principled reason why a derivative holder should be considered to have beneficial ownership of the derivative’s underlying shares, based on the mere hypothetical possibility that it could purchase the shares at some point in the future.

Even assuming the Commission’s speculative scenario warranted concern, the Commission has presented no analysis demonstrating that including derivatives in the definition of “beneficial ownership” is an efficient and economically desirable way to address this perceived issue, or that the benefits of its proposed solution outweighs the costs and inefficiencies its proposal would impose on investors and the market.⁵⁸ Indeed, the Commission appears not to have adequately considered many relevant costs, including, among others, the risk of subjecting investors to strict liability under Section 16’s insider trading reporting and matching regime; the risk of flooding the market with information about investors who have mere economic exposure, and thus generating market confusion about who is truly able to

⁵⁵ SEC Release, *supra* note 2, at 13860-61, 13886-87.

⁵⁶ *Id.*; see also *id.* at 13861 note 91 (citing, in support of its proposed amendment, two cases involving “the unreported ‘parking’ of equity securities with another party where such securities are essentially held in reserve for the benefit of the party with the intention to control or ultimately acquire them,” neither of which involved cash-settled derivative securities).

⁵⁷ Specifically, Section 13(d) requires the reporting of equity securities that a person has the right to obtain in the next 60 days or holds for the purpose or effect of changing or influencing control of the issuer. Exchange Act Release 64628, 76 Fed. Reg. 34579 (Jun. 14, 2011). Additionally, to the extent a holder of over 5% of an issuer’s securities has a control or influence intent, Item 6 of Schedule 13D requires them to “[d]escribe any contracts, arrangements, understandings or relationships . . . with respect to any securities of the issuer, including but not limited to . . . division of profits and loss.” 17 CFR § 240.13d-101(e). Therefore, to the extent a derivative holder has the right to obtain underlying securities from its counterparty on demand within 60 days—or at *any* time if the derivative holder as a control or influence intent—that derivative holder would already be subject to Section 13(d) disclosure.

⁵⁸ SEC Release, *supra* note 2, at 13860-61, 13886-87

control an issuer through voting; and the danger of inadvertently triggering poison pills and change of control provisions that tie to Section 13(d)'s definition of "beneficial ownership."⁵⁹

For all the foregoing reasons, expanding the definition of beneficial ownership to include cash-settled derivative securities would lead to market confusion, exclusion of some investors from the derivative market, and a chilling of value-creating investments, all to address speculative concerns that are unsupported by any clear evidence. We therefore respectfully recommend that the Commission leave the definition of beneficial ownership as-is.

* * *

We appreciate the opportunity to provide our comments to the Commission regarding the proposed changes to the implementing regulations for Sections 13(d) and 13(g), and we would be pleased to meet with the Commission or its staff to discuss our comments. If the staff has questions or comments, please do not hesitate to call Joseph Schwartz, Director and Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Jennifer W. Han

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cc: The Hon. Gary Gensler, SEC Chairman
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Allison Herren Lee, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
Ms. Renee Jones, Director, Division of Corporation Finance

⁵⁹ *Id.* at 13887-88 (considering only increased compliance costs and potential lost revenue for derivative counterparties as the potential costs associated with this proposed amendment).