

SEC Reporting & Compliance Alert

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SEC Proposes New Disclosure Rule for Security-Based Swap Positions

On December 15, 2021, the Securities and Exchange Commission (SEC) voted 3-2 to approve proposed rules that, among other things, would add new Rule 10B-1 to require a prompt disclosure of large security-based swap (SBS) positions, including credit default swaps (CDS) and total return swaps, that exceed a specified threshold.¹ In the same release, as explained in our previous alert, the SEC also re-proposed Rule 9j-1, an antifraud provision for SBS initially proposed in 2010, and Rule 15Fh-4(c), which primarily seeks to prevent undue influence over the chief compliance officer of an SBS dealer or major market participant. The proposed SBS position reporting requirements under Rule 10B-1 are described in greater detail below.

Background

The SEC has previously discussed possibly expanding disclosure obligations to cover SBS positions. Section 10B(d) of the Securities Exchange Act of 1934, added in 2010 by the Dodd-Frank Act, authorizes the SEC to establish reporting requirements for large SBS positions. Proposed Rule 10B-1 would mark the SEC's first use of that authority.

As explained in the proposing release, the impetus behind Rule 10B-1 is the SEC's expressed concern about manufactured credit events triggering credit default swaps and the risks of concentrated SBS positions that are not known to the market or regulators. SEC Chair Gary Gensler referenced the role of SBS in the 2008 financial crisis and the collapse of Archegos Capital Management in March 2021 as reminders of the types of risks posed by SBS and the market's need for greater transparency. The proposing release states that Rule 10B-1 is intended to enhance market transparency and integrity and provide both the SEC and market participants — including financial institutions, issuers and its shareholders — with information about large positions and related securities that could have an impact on the markets, counterparties or other market participants.

Key Requirements of Proposed Rule 10B-1

Who should report. As proposed, Rule 10B-1 would require any person, or group of persons, who, after acquiring or selling (directly or indirectly) any SBS position, is the direct or indirect owner or seller of an SBS position that exceeds a certain threshold

¹ This would be in addition to the existing SBS reporting requirements under Regulation SBSR, which governs regulatory reporting of SBS transactions to security-based swap data repositories and public dissemination of some of that transaction data.

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amount (as described below) to file the required information on a new Schedule 10B. Determinations of who is considered a beneficial owner of SBS positions are similar to the Section 13(d) beneficial ownership rules in that the direct owner and the persons who control such direct owner may be deemed to be beneficial owners and reporting persons.

Timing and amendments. SBS positions on a Schedule 10B must be reported “promptly,” but in no event later than the end of the first business day following the execution of the SBS transaction that results in the SBS position first exceeding the applicable reporting threshold. A Schedule 10B amendment also must be promptly filed upon the occurrence of any “material change,” but in no event later than the end of the first business day following the material change. A change equal to 10% or more of a position previously disclosed in Schedule 10B would be deemed material. According to the release, the SEC believes that by the time the SBS contract is executed, the terms of an SBS contract should be known and able to be reported promptly.

SBS positions subject to Rule 10B-1. Security-based swap positions would include all SBS based on:

- i. a single security or loan, or a narrow-based security index, or any interest therein or based on the value thereof;
- ii. any securities issued by the same issuer (each, an “issuing entity”) of the securities, loans or securities included in the narrow-based index (including any interest therein or based on the value thereof) described in (i); or
- iii. any narrow-based security index that includes any of those issuing entities or their securities (including any interest therein or based on the value thereof), in each case as applicable.

Reporting thresholds. The proposed reporting threshold amounts differ depending on the type of SBS acquired or traded. The threshold calculations are complicated and vary based on the type of SBS. Generally, the threshold amount for SBS positions based on:

- a **CDS** is the lesser of: (i) a long notional amount of \$150 million; (ii) a short notional amount of \$150 million; or (iii) a gross notional amount of \$300 million.
- **debt securities that are not a CDS** is a gross notional amount of \$300 million.
- **equity securities** is the lesser of two thresholds, one based on the notional amount of the SBS position and the other on the percentage of outstanding shares attributable to the applicable position.

- The notional amount threshold means a gross notional amount of \$300 million, provided that if the gross notional amount of the SBS position exceeds \$150 million, then such calculation shall also take into account the number of equity securities of the same issuer held by such person and securities underlying other derivatives based on the same class of equity securities.
- The percentage threshold means an SBS position representing more than 5% of a class of equity securities, provided that if the position represents more than 2.5% of a class of equity securities, the calculation shall also take into account the number of equity securities of the same issuer held by such person and securities underlying other derivatives based on the same class of equity securities.

Disclosure items on Schedule 10B. The Schedule 10B disclosure would require, among other information:

- i. identity of the reporting person(s);
- ii. notional amount of the applicable SBS position(s) and summary information about the composition of the position including the direction (i.e., long or short) and the tenor/expiration of the underlying SBS transactions;
- iii. ownership of all debt or equity securities underlying the SBS and all SBS positions based on debt or equity securities issued by the same reference entity;
- iv. ownership of any other instrument relating to the SBS position and/or any underlying security or loan, of which the price, yield, value or volatility, or any interest therein, is the basis of a material term of an SBS included in the SBS position; and
- v. if the reporting threshold is based on the number of shares corresponding to an SBS position based on equity securities, the number of shares attributable to the SBS position, the closing price used in the calculation and the date of such closing price.

No counterparty information is required.

Takeaways

If adopted, Rule 10B-1 could provide enhanced transparency to the SEC and SBS market participants, including counterparties and issuers of securities and their security holders. But it also may incur significant reporting burdens for certain market participants that hold SBS positions above the applicable reporting thresholds, especially in light of the one business day filing deadline for Schedule 10B and any subsequent amendments.

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It also remains to be seen whether the new reporting obligations, if adopted, would impact investors who used SBS to obtain economic interests while avoiding certain disclosures, particularly activists.

Next Steps

Comments on the proposal will be due 45 days after publication in the Federal Register. The proposal includes specific requests for comment on a number of aspects of the proposed rules, in addition to soliciting comments generally.

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