



The Archegos Rules: What the SEC's Security-Based Swap Proposals Mean for your Business

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The Archegos Collapse and Fallout

- Archegos Capital Management was founded as a private family office in 2012 and was managed by Bill Hwang (formerly of Tiger Asia), who had previously been barred from trading in Hong Kong following insider trading charges
- Its investment strategy involved building large, leveraged, concentrated positions in public companies, largely by total return swaps with dealers
- In March 2021, investments in issuers such as ViacomCBS lost value, prompting early terminations and margin calls, ultimately prompting tens of billions of dollar losses for Archegos
- Several dealers reported large losses, prompting internal investigations and scrutiny from Congress and regulators



The SEC's Reaction: Heightened Disclosure

- The fallout from Archegos prompted calls by politicians and regulators to increase the disclosure around security-based swaps.

“Further, to allow the Commission and the public to see aggregate positions, Congress under Exchange Act section 10B gave us authority to mandate disclosure for positions in security-based swaps and related securities. I’ve asked staff to think about potential rules for the Commission’s consideration under this authority.

As the March collapse of the family office Archegos Capital Management showed, this may be an important reform to consider. At the core of that story was Archegos’ use of total return swaps based on underlying stocks and significant exposure that the prime brokers had to the family office.

The limited transparency in this market, combined with potential shortcomings in market participants’ risk management, contributed to firms’ taking overly large positions and to subsequent system-wide tremors when firms started to unwind those positions. I believe additional public disclosure of that fund’s positions, as well as public dissemination of individual transactions in total return swaps, may have helped.”

- SEC Chair Gary Gensler, remarks on July 21, 2021 to the American Bar Association

(APPENDIX 1F. SEC Regulatory Agenda 2021, 7 Exempted Trans. Under Securities Act 1933 Appendix 1F)



The Proposed Rule


- On December 15, 2021, the SEC commissioners voted 3-2 to adopt rules relating to security-based swaps
- What transactions are in scope?
- What would the proposed rule do?
 - **Rule 9j-1** – prohibits fraudulent, deceptive, or manipulative conduct in connection with all transactions in security-based swaps, including misconduct in connection with the exercise of any right or performance of any obligation under a security-based swap (to be discussed further on subsequent slides),
 - **Rule 15Fh-4(c)** – prohibits personnel of an SBS Entity from taking any action to coerce, mislead or otherwise interfere with the SBS Entity’s CCO, and
 - **Rule 10B-1** – requires prompt disclosure of security-based swap positions which exceed a specified threshold (to be discussed further on subsequent slides)



Overview of Amended Proposed Rule 9j-1

- Proposed Rule 9j-1 would:
 - Prohibit a range of misconduct and attempted misconduct in connection with security-based swaps, including misconduct in connection with the exercise of any right or performance of any obligation under a security-based swap;
 - Prohibit manipulation or attempted manipulation of the price or valuation of any security-based swap, or any payment or delivery related thereto;
 - Provide limited safe harbors for certain specified conduct; and
 - Provide that a person cannot escape liability for trading based on possession of material non-public information about a security by purchasing or selling a security-based swap based on that security and cannot escape liability under the proposed rule by purchasing or selling the underlying security (as opposed to purchasing or selling a security-based swap that is based on that security).

¶ 82,967 Prohibition Against Fraud, Manipulation, Or Deception In Connection With Security-based Swaps; Prohibition Against Undue Influence Over Chief Compliance Officers; Position Reporting of Large Security-based Swap Positions. Exchange Act Release No. 93784. December 15, 2021., Fed. Sec. L. Rep. P 82967



How are security-based swaps and other equity derivatives reported now?

- Regulation SBSR (17 C.F.R. § 242.900-909 (2015))
- Section 13 reporting (Schedule 13D and Schedule 13G)
- Proposed 10B-1
- Proposed amendments to Section 13 reporting



Overview: Rule 10B-1 Proposed Amendment

- Proposed Rule 10B-1 would:
 - Require any person, or group of persons, with a security-based swap position that exceeds a specified reporting threshold to promptly file a Schedule 10B disclosing certain information related to its position
 - Provide that any Schedule 10B be filed promptly but in no event later than the end of the first business day following the day of execution of the security-based swap transaction that results in the security-based swap position exceeding threshold
 - Require reporting persons to file amendments promptly in the event of any material change to a previously filed Schedule 10B.
- Schedule 10B would require the following information to be disclosed: the identity of the reporting person and the security-based swap position, as well as the underlying loans or securities and any related loans and securities.

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Reporting thresholds under proposed Rule 10B-1

- Equity SBS threshold is the lesser of:
 - gross notional amount of \$300 million (but if the gross notional amount exceeds \$150 million, then the calculation must also include the number of equity securities of the same issuer held by such person and the delta-adjusted notional amount of any derivatives based on the same class of equity securities), or
 - an SBS position that represents more than 5% of a class of equity securities (but if this position represents more than 2.5% of the class, then the calculation must take into consideration the number of equity securities and securities underlying other derivatives based on the same class of equity securities)



Reporting thresholds under proposed Rule 10B-1 Cont.

- CDS threshold is the lesser of:
 - a long notional amount of \$150 million,
 - (subtracting the notional amount of any long positions in an underlying deliverable debt security)
 - a short notional amount of \$150 million, or
 - a gross notional amount of \$300 million
- Other debt SBS threshold is a gross notional amount of \$300 million



Schedule 10B filing requirements


- A Schedule 10B amendment must be promptly filed on EDGAR when a “material change” occurs
 - A Schedule 10B must be filed no later than at the end of the first business day following the “material change”
 - A “material change” includes a change equal to 10% or more of a position previously disclosed in Schedule 10B
- A Schedule 10B must include: (i) name, address, email address and telephone number of the person authorized to receive notices and communications, (ii) date of the event which gave rise to the filing, (iii) notional amount of the swap position, (iv) other owned instruments related to the SBS, (v) number of shares corresponding to the SBS if the reporting threshold is based on the number of shares, and (vi) other requirements apply depending on whether the SBS is based on debt or equity securities.



Cross-border issues

An SBS is subject to Rule 10B-1 if

1. it would be required to be reported pursuant to “Rule 908” of Regulation SBSR *or*
2. the SBS holder owns any reference securities underlying the SBS (or would be deemed to be the beneficial owner of such reference securities), and the securities are either (i) issued by an entity incorporated in the U.S. or has its principal place of business in the U.S., or (ii) are part of a class of securities registered under Section 12 or 15(d) of the Exchange Act. (See Proposed 10B-1(d))



Implications of Rule 10B-1 proposed amendment

- The proposed amendment to Rule 10B-1 would subject swaps to higher scrutiny and more onerous disclosure requirements, in some cases more onerous than disclosure for direct holdings in the underlying securities (e.g., under quarterly 13F filings for positions over \$300mm but under 5% of shares outstanding)
- Public use of the additional information provided by the proposed amendment:
 - Prime brokers will be able to make more educated decisions when determining whether to engage in a security-based swap
 - The utility gained by regulators from these additional disclosures is less clear, in light of other applicable reporting and disclosure requirements



How does the proposed rule differ from existing disclosure and reporting regimes?

- Schedule 13D/G
 - Filing timeline
 - In-scope transactions and positions
 - Calculation of notional
- Regulation SBSR
 - Content of filing
 - Group reporting



Other Considerations

- The proposed amendment in its current iteration is not narrowly tailored to the stated purpose of the disclosure
- Potentially duplicative information on Schedule 10B under the proposed amendment and under Reg SBSR and Schedules 13D and 13G
- Time intensive endeavor for firms, agencies, and individuals to build systems to effectively utilize the additional information provided in these disclosures, while also maintaining overlapping disclosure and reporting requirements
 - Surprisingly low cost estimates by SEC in proposing release
- Impact on wide range of investors

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10:00 – 11:00 AM ET

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