

**ONPOINT** / A legal update from Dechert's Financial Services Group

# SEC Proposes to Require Reporting of Large Security-Based Swap Positions

Authored by Philip Hinkle, Audrey Wagner, Jonathan Gaines and Katherine Sachs

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The Securities and Exchange Commission on February 4, 2022 published in the Federal Register its proposed new Rule 10B-1 under the Securities Exchange Act of 1934, together with a related form, Schedule 10B.<sup>1</sup> The SEC had voted on December 15, 2021 along party lines three-to-two to propose Rule 10B-1 and Schedule 10B.

Proposed Rule 10B-1 would require any person, or group of persons, that owns a security-based swap position (SBS position)<sup>2</sup> exceeding a reporting threshold amount to promptly file on the SEC's EDGAR system a statement containing the information required by Schedule 10B. All filings received pursuant to Rule 10B-1 would be made available to the public. The proposed rule is intended to increase transparency in SBS positions.<sup>3</sup>

The calculations and related reporting required to comply with Rule 10B-1 and Schedule 10B are complex and may necessitate systems build-outs if adopted as proposed. Traders in security-based swaps are advised to review the proposal carefully, and to consider submitting comments in advance of the March 22, 2022 deadline for comment submissions.

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<sup>1</sup> [Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions](#), SEC Release No. 34-93784, 87 Fed. Reg. 6652 (Feb. 4, 2022) (proposing release). Section 10B of the Exchange Act provides the SEC with the authority to establish limits on the size of positions in security-based swaps, to the extent such limits are "reasonably designed to prevent fraud and manipulation."

At times, this OnPoint tracks the proposing release without quotation marks.

<sup>2</sup> The proposal would define the term security-based swap position to mean all security-based swaps 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.

To the extent an SBS position is based on a single security or loan that is included in a narrow-based security index, the calculation of the SBS position with respect to a particular component of that index would be based on the weighting of the reference entity or securities as a component of the index. With respect to security-based swaps based on equity securities, an SBS position includes all security-based swaps based on a single class of equity securities.

In the proposing release, the SEC provides a helpful illustration of this concept: if a person is a counterparty to a security-based swap on a narrow-based security index composed of equity securities with a notional amount of \$100 million, the security-based swap position on the index itself also would be \$100 million. In addition, if one security makes up 40% of that index by weight, that person would be considered to have a security-based swap position of \$40,000,000 attributable to such security for purposes of that transaction (which would need to be added to any other security-based swaps based on the same security in calculating the entire security-based swap position with respect such security).

<sup>3</sup> Unless otherwise indicated, all statements in this *OnPoint* as to the SEC's expressions or intent are based on the proposing release.

## Who Would be Required to File under Rule 10B-1?

Any person (and any entity controlling, controlled by or under common control with such person), or group of persons, that through any contract, arrangement, understanding or relationship, after acquiring or selling directly or indirectly, any security-based swap, is directly or indirectly the owner or seller of an SBS position that exceeds the reporting threshold amount.<sup>4</sup>

## What Information and Format of Data Would Need to be Filed?

A statement containing the information required by Schedule 10B should be filed on EDGAR.

Schedule 10B would require reporting persons to disclose: the identity of the reporting person and other information regarding the reporting person; the notional amount of the applicable SBS position(s) along with summary information about the composition of the position; and detailed information regarding certain other related holdings in underlying and related securities and instruments. A copy of Schedule 10B as proposed is included as an **Appendix** to this *OnPoint*.

Filers would be required to submit Schedule 10B with structured, machine-readable data language using Financial Information eXchange Markup Language (FIXML).

Importantly, Schedule 10B would not require reporting of information about SBS counterparties, but would instead require disclosure of a reporting person's aggregated positions. However, the proposing release notes that the SEC could obtain such information directly from the reporting person or from a registered SBS data repository under applicable requirements.<sup>5</sup>

## When Would Schedule 10B Filings be Due?

An initial Schedule 10B with respect to a reportable SBS position would need to be filed promptly, and no later than the end of the first business day following the day of execution of the SBS transaction that resulted in the SBS position first exceeding the reporting threshold amount.

## When Would Amendments to Schedule 10B Filings be Due?

Amendments to Schedule 10B would be due: upon the occurrence of a material change in the facts previously reported on Schedule 10B (including, but not limited to, any material increase in the SBS position(s)); or when an SBS position falls back below the applicable reporting threshold amount.

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<sup>4</sup> A group's filing obligation could be satisfied either by a single joint Schedule 10B-1 filing or by each of the group's members making an individual Schedule 10B-1 filing. If the group's members elect to make their own filings, each such filing should identify all members of the group, but the information provided concerning the other persons making the filing need only reflect information which the filing person knows or has reason to know. Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device as part of a plan or scheme to evade the reporting requirements with respect to an SBS position would be deemed to be the owner of such SBS position.

<sup>5</sup> Pursuant to 17 CFR 242.900 - 242.909 (Regulation SBSR) and Section 13(m) of the Exchange Act.

For this purpose, a change equal to 10% or more of an SBS position previously disclosed in a Schedule 10B would be deemed “material.”

All amendments would need to be filed promptly, and no later than the end of the first business day following the material change.

## What Size of a Security-Based Swap Position Would Trigger Schedule 10B Reporting?

The reporting threshold amount would vary depending on the type of SBS position being reported as follows:

| Type of SBS Position   | Corresponding Reporting Threshold Amount  |
|--|---|
| <b>SBS positions that are credit default swaps:</b>                        | <p>The least of:</p> <p>A long notional amount of \$150 million (subtracting the notional amount of long positions in underlying deliverable debt securities),<sup>6</sup></p> <p>A short notional amount of \$150 million, or</p> <p>A gross notional amount of \$300 million</p>  |
| <b>SBS positions on debt securities that are not credit default swaps:</b> | A gross notional amount of \$300 million  |
| <b>SBS positions based on equity securities:</b>                           | <p>The lesser of:</p> <p>A gross notional amount of \$300 million (including the value of underlying equity securities and adjusted notional amount of certain other derivatives owned, if the SBS gross notional amount exceeds \$150 million),<sup>7</sup> or</p> <p>An SBS equivalent position<sup>8</sup> that represents more than 5% of a class of equity securities (including underlying equity securities owned by the holder of the SBS position, as well as the number of shares attributable to certain other related derivatives owned, if the SBS equivalent position exceeds 2.5%)<sup>9</sup></p> |

<sup>6</sup> The long notional amount would be calculated by subtracting (i) the notional amount of any long positions in a deliverable debt security underlying an SBS included in the SBS Position from (ii) the long notional amount of the SBS Position.

<sup>7</sup> If the gross notional amount of the SBS position exceeds \$150 million, the calculation of the SBS position also would be required to include the value of all of the underlying equity securities owned by the holder of the SBS position (based on the most recent closing price of shares), as well as the delta-adjusted notional amount of any options, security futures or other derivative instruments based on the same class of equity securities.

<sup>8</sup> The term security-based swap equivalent position would mean the number of shares attributable to all of the security-based swaps comprising an SBS position.

<sup>9</sup> If the SBS equivalent position represents more than 2.5% of a class of equity securities, the calculation of the SBS equivalent position also would include in the numerator all of the underlying equity securities owned by the holder of the SBS position, as well as the number of shares attributable to any options, security futures or any other derivative instruments based on the same class of equity securities.

## What Cross-Border Security-Based Swap Positions Would be Reportable?

The proposal specifically defines the cross-border application of the reporting requirements based on: the U.S. person status of a party to the security-based swap or U.S. location of the clearinghouse for the security-based swap; or, if reference securities are held by the reporting person, the place of the issuer's organization or the place of trading of the reference securities on a U.S. exchange.

Under this cross-border framework, the reporting requirements would apply to all SBS positions, so long as:

1. Any of the transactions that comprise the SBS position would be required to be reported pursuant to Rule 908 of Regulation SBSR;<sup>10</sup> or
2. The reporting person holds any amount of reference securities underlying the SBS position (or would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Exchange Act and the rules thereunder<sup>11</sup>), and:
  - a. The issuer of the reference security is a partnership, corporation, trust, investment vehicle or other legal person organized, incorporated or established under the laws of the United States or having its principal place of business in the United States; or
  - b. The reference security is part a class of securities registered under Section 12 or subject to Section 15(d) of the Exchange Act.

This means that security-based swap traders that have relied on their security-based swap dealers to handle reporting under Rule 908 will need to conduct additional analysis as to whether they nevertheless must report under this proposal, if finalized.

## What is the Deadline for Submission of Comments on the Proposal?

The proposing release sets forth a number of requests for comment regarding each element of the proposal. Industry participants that trade in security-based swaps should carefully consider the implications of the proposal. The proposal was published in the Federal Register on February 4, 2022 and the public comment period will end on March 21, 2022.

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<sup>10</sup> Rule 908(a) provides that a security-based swap is subject to regulatory reporting and public dissemination if: there is a direct or indirect counterparty that is a U.S. person on either or both sides of the transaction; or the security-based swap is accepted for clearing by a clearing agency having its principal place of business in the United States. A security-based swap that is not included in the above provisions still is subject to regulatory reporting (but not public dissemination) of the reported information, if there is a direct or indirect counterparty that is a registered security-based swap dealer or a registered major security-based swap participant on either or both sides of the transaction.

<sup>11</sup> A person generally will have beneficial ownership pursuant to Exchange Act Section 13(d) and the rules thereunder if the person has the right to vote or dispose of the applicable securities, or the ability to acquire either of the foregoing rights within 60 days, including through a derivatives contract.

## What are the Purposes Underlying the Proposal?

The SEC expressed concern related to: the possibility of manufactured credit events that could trigger payments under credit default swaps, where the counterparty to the credit default swap received payment by encouraging activity related to the security or loan; and the risks posed by concentrated SBS positions that are not disclosed to the public. The SEC stated that requiring the reporting of such large SBS positions and the related transparency could provide a number of benefits, including:

- Providing market participants (e.g., counterparties, issuers and issuers' stakeholders) and regulators with access to information that might indicate that a person (or a group of persons) is building up a large SBS position, which in some cases could be indicative of potentially fraudulent or manipulative purposes;
- Alerting market participants and regulators to the existence of concentrated exposures to a limited number of counterparties, which should: inform those market participants and regulators of the attendant risks; allow counterparties to manage those risks; and lead to better pricing of the security-based swap with respect to transactions with persons holding large positions therein; and
- In the case of manufactured credit defaults or other opportunistic strategies in the credit default swap market, reporting could provide market participants and regulators with advance notice that a person (or a group of persons) is building up a large credit default swap position, which in turn could create an incentive to vote against the interests of such market participants as debt holders in the underlying debt that the credit default swap references, even if such conduct is not inherently fraudulent. In other words, a credit default swap counterparty might have more to gain from its credit default swap positions if there is a default with regard to the underlying debt than the counterparty would suffer from a default with regard to the underlying debt that it holds.

## What Related SBS Proposals are on the Horizon?

On February 10, 2022, the SEC proposed further rules and rule amendments under Sections 13(d) and 13(g) of the Exchange Act and Regulation 13D-G thereunder, to enhance market transparency, including disclosure related to beneficial ownership of interests in security-based swaps and options. Among these proposals is a new rule that would deem the holder of a cash-settled derivative, other than a security-based swap, to be a beneficial owner of the referenced equity securities in certain circumstances. In addition, the SEC has included a proposed amendment to Schedule 13D that would clarify that persons are required to disclose interests in all derivative securities that use an issuer's equity security as a reference security. As of the date of publication of this *OnPoint*, the proposal had not yet been published in the Federal Register.<sup>12</sup>

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<sup>12</sup> [Modernization of Beneficial Ownership Reporting](#), SEC Release No. 33-11030; 34-94211.

## Appendix

### Securities and Exchange Commission, Washington, DC 20549

#### Schedule 10B

#### Under the Securities Exchange Act of 1934

(Amendment No. \_\_)\*

#### (Name, Address, Email Address and Telephone Number of Person Authorized to Receive Notices and Communications)

#### (Date of Event Which Requires Filing of This Statement or Any Amendment Thereto As Required by Rule 10B-1(c))

1. State the name of the reporting person (or names of reporting persons if making a joint filing as a group). State if the reporting person is a member of a group. If the reporting person is a member of a group and the members of the group are satisfying the group's Rule 10B-1(a)(1) (§ 240.10B-1(a)(1)) filing obligation by making individual filings, identify all members of the group.
2. State the residency or place of organization of the reporting person(s).
3. State the type of reporting person(s) (see instructions).
4. For reporting persons that are legal entities, state the Legal Entity Identifier (LEI) of the reporting person(s), if such person(s) has an LEI.
5. State the notional amount of the applicable security-based swap position(s), as defined in Rule 10B-1(b)(3) (§ 240.10B-1(b)(3)), of the reporting person(s), along with summary information about the composition of the position as it relates to the direction (i.e., long or short) and the tenor/expiration of the underlying security-based swap transactions and the product ID (§ 17 CFR 242.900(bb)) of the security-based swap(s) included in the security-based swap position, if applicable.
6. In the case of a security-based swap position based on debt securities (including credit default swaps), state the ownership of: (i) all debt securities underlying a security-based swap included in the security-based swap position, including the Financial Instrument Global Identifier (FIGI) of each underlying debt security, if applicable, and the LEI of the issuer of each underlying debt security, if the issuer has an LEI; and (ii) all security-based swaps based on equity securities issued by the same reference entity, including the FIGI of each underlying equity security, if applicable. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.
7. In the case of a security-based swap position based on equity securities, state the ownership of: (i) all equity securities underlying a security-based swap included in the security-based swap position, including the FIGI of each underlying equity security, if applicable, and the LEI of the issuer of each underlying equity security, if the issuer has an LEI; and (ii) all security-based swaps based on debt securities issued by the same

reference entity (including credit default swaps), including the FIGI of each underlying debt security, if applicable. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.

8. State the ownership of any other instrument relating to the security-based swap position and/or any underlying security or loan or group or index of securities or loans, or any security or group or index of securities, the price, yield, value, or volatility of which, or of which any interest therein, is the basis for a material term of a security-based swap included in the security-based swap position, if not otherwise disclosed pursuant to Items 6 or 7 of this statement. For any underlying security disclosed pursuant to this Item, disclose the FIGI of the security, if applicable, and the LEI of the issuer of the security, if the issuer has an LEI. In addition to the FIGI, other unique security identifier(s) may be included at the filer's option.
9. To the extent that the reporting threshold amount, as defined in Rule 10B-1(b)(1) (§ 240.10B-1(b)(1)), is based on the number of shares corresponding to a security-based swap position based on equity securities, state the number of shares attributable to the security-based swap position, along with the closing price used in the calculation and the date of such closing price.

### ***Instructions to Schedule 10B***

*Type of Reporting Person* - Please classify each "reporting person" according to the following breakdown and place the appropriate symbol (or symbols, i.e., if more than one is applicable, insert all applicable symbols) on the form:

| <b>Category</b>  | <b>Symbol</b> |
|--|---------------|
| <b>Broker Dealer</b>   | BD            |
| <b>Security-Based Swap Dealer or Major Security-Based Swap Participant</b> | SBSE          |
| <b>Bank</b>  | BK            |
| <b>Insurance Company</b>   | IC            |
| <b>Investment Company</b>  | IV            |
| <b>Investment Adviser</b>  | IA            |
| <b>Employee Benefit Plan or Endowment Fund</b>                             | EP            |
| <b>Parent Holding Company/Control Person</b>                               | HC            |
| <b>Savings Association</b>   | SA            |
| <b>Church Plan</b>   | CP            |
| <b>Corporation</b>   | CO            |
| <b>Partnership</b>   | PN            |
| <b>Individual</b>  | IN            |
| <b>Other</b>   | OO            |



*Incorporation by Reference* – Rule 10B-1(e) (§ 240.10B-1(e)) provides that if some or all of the information required to be disclosed on Schedule 10B is publicly available on EDGAR at the time the Schedule 10B is required to be filed, such information may be incorporated by reference in answer, or partial answer, to any item of Schedule 10B. Include an express statement clearly describing the specific location of the information you are incorporating by reference. You must include an active hyperlink to information incorporated into Schedule 10B to the applicable link to EDGAR). The information must not be incorporated by reference in any case where such incorporation would render the disclosure incomplete, unclear, or confusing. For example, disclosure must not be incorporated by reference from a second document if that second document incorporates information pertinent to such disclosure by reference to a third document.

*Signature.* After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

Date

Signature

Name/Title

The original statement shall be signed by each person on whose behalf the statement is filed or their authorized representative. If the statement is signed on behalf of a person by their authorized representative (other than an executive officer or general partner of the reporting person), evidence of the representative's authority to sign on behalf of such person shall be filed with the statement, provided however, that a power of attorney for this purpose which is already on file with the Commission may be incorporated by reference.

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