Consumer Federation of America

September 16, 2020

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

Re: File No. S7-08-20
Reporting Threshold for Institutional Investment Managers

Dear Secretary Countryman:

I am writing on behalf of the Consumer Federation of America (CFA)[1] to express our strong opposition to the Commission's proposal to radically increase the reporting threshold for Form 13F reports by institutional investment managers. Our opposition may come as something of a surprise to the Commission, which appears to have relied heavily on a few sentences in a letter we co-signed 17 years ago as evidence of support for its proposed approach. In the ensuing years, however, much has changed in the markets, including the rapid growth of private funds that operate with far less transparency than their registered counterparts and dramatic advances in information technology, which have simultaneously increased the speed with which such reports can be compiled and decreased the cost of doing so. It is disappointingly consistent with the Commission's recent approach to its regulatory responsibilities that it has failed to seriously consider these developments in issuing its proposal, or indeed to have conducted any meaningful analysis of the proposal's potential impact on users of the 13F data.

Accordingly, we urge the Commission to withdraw its proposal until it can conduct a credible analysis of the issues at play in this decision. That analysis should, at a minimum, seek to determine: whether any increase in the reporting threshold is warranted (and permitted under the statute); if so, at what level the reporting threshold should be set; what the impact of any such increase would be on the various stakeholders who rely on the reports; whether additional categories should be added to the list of securities investment managers are required to report; whether shortcomings in the reports identified by the Commission's Office of Inspector General in its 2010 report, including weaknesses in the agency's oversight of the 13(f) reporting process, have been adequately addressed; and whether the 45-day reporting delay included in the rule continues to be warranted. Until such an analysis is completed, we cannot support any increase in the reporting threshold, let alone the 35-fold increase the Commission has proposed. Should

[1] The Consumer Federation of America (CFA) is a non-profit association of more than 250 national, state and local pro-consumer organizations. It was established in 1968 to advance the consumer interest through research, advocacy, and education.

the Commission determine, based on that analysis, that an increase in the reporting threshold is both warranted and permitted under the statute, it should balance any such increase with other changes needed to update and improve the usefulness of the 13F reports.

1) The proposal is based on a misrepresentation of the legislative record.

As the Commission itself acknowledges, Congress adopted Section 13(f) in order to close "gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors."[2] To justify its proposal to eliminate the reporting requirement for an estimated 90 percent of current filers of Form 13F, the Commission now suggests that Congress intended to accomplish that goal of increased data collection by requiring reporting from only the very largest investment managers. And the Release cherry-picks quotes from the legislative record to support this claim. It states, for example, that the legislative history "indicates that the reporting threshold of section 13(f) was designed so that reporting would cover a large proportion of managed assets, while minimizing the number of reporting persons" and that the $100 million threshold was adopted to limit "the burdens of reporting, particularly on smaller managers."[3]

A more complete reading of the legislative record makes clear, however, that the $100 million reporting threshold was intended as an "initial" threshold designed to allow for rapid implementation of the reporting requirement.[4] Far from intending that this initial focus on only the largest institutional investment managers would be retained in perpetuity, Congress specifically authorized the Commission to lower the threshold to as little as $10 million – a level that would have captured all but the very smallest institutional investment managers – if the Commission "found that a lower test requiring more institutional investment managers to report was in the public interest, for the protection of investors, or necessary or appropriate to maintain fair and orderly markets."[5]

2) The Commission ignores the factors Congress intended for it to consider in adjusting the reporting threshold.

Congress authorized the Commission to lower the reporting threshold, but only after taking certain factors into consideration. On the one hand, Congress sought to ensure that the Commission would "consider the cost and burden of preparing such reports to smaller institutional investment managers." But it also sought to ensure that the Commission would balance those cost considerations against "the public interest that would be served by the expected informational value of the marginal equity securities holdings which would then be subject to the reporting provisions."[6] That balancing of the costs of reporting against the benefits of greater transparency is almost entirely absent from the proposing Release.

[2] Securities and Exchange Commission, File No. S7-08-20, Reporting Threshold for Institutional Investment Managers (Jul. 10, 2020), at 8, https://www.sec.gov/rules/proposed/2020/34-89290.pdf.
[3] *Id.* at 9.
[4] Report to Accompany S.249, Securities Act Amendments of 1975, Sen. Rep. No. 94-75, at 85, 94th Cong. 1975 ("Senate Report"), https://bit.ly/3c2Endd.
[5] *Id.* at 86.
[6] *Id.* The bill also requires the Commission to consult with certain specified federal and state regulatory authorities, national securities exchanges, and national securities organizations in carrying out its regulatory responsibilities. (See Senate Report at 85.) It does not appear that the Commission has engaged in the required consultation.

For example, the Release fails to explore, except in the most superficial way, how the reports are currently used and how its proposal would affect the informational value of the reports to the many different types of current users. It also fails to analyze the effectiveness of the reporting requirement in fulfilling Congress's goal of eliminating "gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors" or what if any changes are needed to improve the informational value of the reports. Instead, the Release's "analysis" of the proposal's impact focuses almost exclusively on the direct and indirect cost of reporting to institutional asset managers, but even there the analysis is superficial, distorted, and incomplete.

Any analysis of whether to raise the reporting threshold should start with a consideration of what Congress was trying to achieve in imposing the reporting requirement. Nothing in the legislative record suggests that Congress's exclusive interest was in collecting data on those funds "whose holdings of section 13(f) securities are large relative to the overall size of the U.S. equities market," as the Commission seeks to suggest.[7] On the contrary, Congress was clearly concerned with the growing role of institutional investment managers and their impact on the securities markets in the aggregate. The Senate Report states, for example: "During the middle and late 1960's, the amount of securities held and traded by institutional investment managers increased materially, both in absolute terms and in relation to other types of investors. Many people became concerned about the effects of such an increase upon the securities markets, upon the issuers of the securities, and upon the interests of individual investors."[8] Pointing to the lack of a centrally located body of data, the Report concluded, as the SEC had before it, that "there was an overriding need to locate basic facts about all types of institutional investment managers, including banks, insurance companies, investment advisers, and investment companies."[9]

Both Congress and the Commission foresaw extensive benefits to a wide array of stakeholders from the data collection. Congress predicted, for example, that "the management of individual companies" would benefit from being able to "identify the holders of their stock" in order to more easily "communicate directly with the beneficial owners of [their] securities."[10] Congress also saw significant benefits to both individual and institutional investors, who would be able to factor the information provided into their investment decisions. As the Senate Report stated: "Many people believe that it is not possible to make informed investment decisions on a security without information related to the likely market activity and the degree of institutional concentration in the security."[11] The Report went on to predict that, "with the dissemination of

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[7] Release at 17. ("We considered raising the threshold to account for consumer price inflation, rather than market growth. However, we preliminarily determined that the group of managers covered by using a market growth standard better reflects the group of managers intended to be subject to reporting under section 13(f) because this approach focuses on managers whose holdings of section 13(f) securities are large relative to the overall size of the U.S. equities market.")
[8] Senate Report at 78.
[9] *Id.*
[10] Senate Report at 80.
[11] Senate Report at 82. ("Institutional concentration may suggest a number of things to a variety of investors. For example, to some it may be a good sign because it may suggest that sophisticated investors believe the security is a good investment. To others, it may be a danger sign indicating a potential depressing 'overhang,' market illiquidity, or high price volatility. That different investors may draw different conclusions from the data is not important; rather, what is important is that information about the securities holdings and certain transactions of institutional

data about institutional investment managers, an institutional disclosure program should stimulate a higher degree of confidence among all investors in the integrity of our securities markets."[12]

In addition to these benefits for various market participants, Congress anticipated that the reports would be used by federal and state regulators to develop standards and protect the public interest.[13] The SEC itself had concluded that "the course of future developments could not be accurately gauged, or reasoned regulatory policies be determined, without a continuing flow" of timely information about "institutional holdings and trading in the equity security markets."[14] Ironically, however, the Commission has not even used data from the reports to provide any in-depth analysis of the likely impact of its current proposal to raise the reporting threshold. It has, for example, failed to provide details that are certainly available to it regarding how different types of institutional investment managers and different types of securities held by those investment managers would be affected by the proposal.

If anything, the 13F data has proved more useful than Congress or the Commission ever anticipated.[15] The Commission itself acknowledges that, "While Form 13F was originally designed to assist regulators and the public in understanding the effects of institutional equity ownership on the markets, the pool of users of the data has expanded to include academics, market researchers, the media, attorneys pursuing private securities class-action matters, and market participants (including institutional investors themselves) who use the data to enhance their ability to compete."[16] The Commission cannot reasonably move forward with a proposal to raise the reporting threshold without carefully considering the impact on these many users of the 13F data, something it has failed to do in this Release.

3) Market changes since the 13F reporting requirement was adopted have made the data more relevant, not less.

Since the adoption of the 13F reporting requirement, the extent to which the market is dominated by institutional investment managers has only grown, rendering the reports even more relevant today than they were in 1975. For example, in 2013, when NYSE Euronext, the Society of Corporate Secretaries and Governance Professionals (SCSGP), and the National Investor Relations Institute (NIRI) jointly filed a rulemaking petition calling on the agency to eliminate reporting delays and adopt other reforms, supporters of the petition cited the "tremendous growth in assets owned by institutional investors in the more than three decades since Form 13F reporting obligations were mandated, and the parallel decrease in direct shareholdings by individuals."[17] While some of those institutional investment managers are subject to detailed

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investment managers be available to all investors – both institutional and individual – so that they can all have it, whatever its relative usefulness in making their independent judgments.")

[12] *Id*.

[13] Senate Report at 85. *See also*, Edward Pekarek, Hogging the Hedge? "Bulldog's" 13F Theory May Not Be So Lucky, Fordham Journal of Corporate & Financial Law, Vol. 12, No. 6 (2007), at 1092-93, https://bit.ly/3mjV5JL.

[14] Senate Report at 79.

[15] Miles Weiss, Benjamin Bain, and Hema Parmar, Tepper, Einhorn, Soros Stock Holdings Would Go Dark in SEC Plan, Bloomberg (Jul. 14, 2020).

[16] Release at 22.

[17] Martin Lipton, Theodore N. Mirvis, Eric S. Robinson, Adam O. Emmerich, William Savitt and Adam M. Gogolak, Wachtell Lipton Discusses Rulemaking Petition for Modernization of Section 13 Beneficial Ownership Reporting Rules, The CLS Blue Sky Blog (Feb. 15, 2013), https://bit.ly/32yqDDV. ("In 1980, 28 percent of

reporting requirements, in addition to the 13F reports, that provide significant transparency into their portfolio holdings, others are not. Indeed, a considerable portion of the growth in assets held by institutional investment managers has occurred among the private funds – hedge funds, private equity funds, and venture capital funds – that are among the least transparent institutional investment managers.[18]

The variety of securities held by these institutional investment managers also has multiplied since the reporting requirement was first adopted. The Commission's Office of Inspector General raised this issue in its 2010 report, voicing concern that, as a result, "the public cannot obtain a complete picture of all significant investment activities of institutional investment managers."[19] As far back as 1998, then House Energy and Commerce Committee Chairman John Dingell complained that, because the list of securities that have to be reported has become obsolete, the information reported "does not reveal much about the trading activities of hedge funds or the ways in which they raise capital or their risk profiles."[20] Other observers have raised concerns about the resulting ability of a "determined investment adviser" to evade the reporting requirement "by employing sophisticated derivative hedging techniques to create or enhance portfolio opacity," because "holdings of other options and derivatives need not be disclosed" in the 13(f) filings.[21]

If the Commission were to increase the reporting threshold to $3.5 billion, as proposed, it would become even easier for investment managers to use such tactics to evade the reporting requirement entirely. Because the threshold is based on a fund's holdings of 13F securities, and not the overall value of its portfolio, elevating the reporting threshold to this level not only "gives funds an incentive to cut their investments at the end of quarters," it also creates an incentive to "enter into derivatives transactions that don't count toward the $3.5 billion reporting level."[22] Funds that couldn't hope to make it under the $100 million reporting threshold using such tactics could do so easily if the threshold were raised to $3.5 billion. Before raising the reporting threshold, the Commission has an obligation to consider the impact of this sort of gamesmanship on market transparency and public confidence in the integrity of the markets.

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outstanding U.S. equities were held by institutional investors, but by 2009 institutional ownership had grown to 51 percent of outstanding U.S. equities." The authors went on to note that, "Institutional investors often have shorter-term investment horizons than individual investors; hedge funds, for example, which manage more than $2 trillion in assets, have an average turnover rate of 35 percent per quarter.")

[18] The growth of these private funds, while already underway when we filed our earlier comment letter addressing this topic, has greatly accelerated since that time. Moreover, the Commission has recently pursued a regulatory agenda designed to make it easier for retail investors to invest in such funds, increasing the need for insight into their activities.

[19] U.S. Securities and Exchange Commission, Office of the Inspector General, Office of Audits, Review of the SEC's Section 13(f) Reporting Requirements, Report No. 480 (Sept. 27, 2010), at 25-26, https://www.sec.gov/about/offices/oig/reports/audits/2010/480.pdf. ("The types of information and categories of investments required to be reported under Section 13(f) have not been updated since the enactment of that Section in 1975. …. More sophisticated investment vehicles, such as derivatives or shares of open-end investment companies and mutual funds that might have been used to hedge equity securities, are not required to be reported on Form 13F. As a consequence, the public cannot obtain a complete picture of all significant investment activities of institutional investment managers.")

[20] Hogging the Hedge at 1094-1095.

[21] *Id.*

[22] Weiss, Bain, and Parmar.

In short, there is a strong case to be made that Section 13(f) reporting requirements are in need of an update to "close substantial gaps in information about the investment activities of institutional investment managers and their impacts on both securities markets and corporate issuers." Numerous concrete suggestions have been put forward to achieve that goal.[23] Instead of acting to improve the informational value of the reports, however, the Commission's proposal would make existing shortcomings in the reports much worse.

4) The Commission has failed to give adequate consideration to the value of the information that would be lost under its proposal to a variety of market participants.

The Commission itself acknowledges that the data provided on Form 13F is "used for a wide variety of purposes," that different uses developed as the data became publicly available, and that users of the data today go well beyond those originally anticipated by Congress when it enacted the reporting requirement.[24] The Commission further acknowledges that: "These uses developed, in part, due to the increased volume of Form 13F data as more and more managers became subject to the filing requirement."[25] It is reasonable to assume then, that if use of the information increased as more managers became subject to the filing requirement, use of the data would likely decline significantly if the reporting threshold were raised to the point that 90 percent of current filers were no longer required to report. The Commission summarily discounts this concern, however, stating without evidence its view that, "the investing public specifically would be less concerned about the availability of portfolio holdings of these smaller managers because the activities of these smaller managers are not likely to cause market effects of the type contemplated by section 13(f)."[26]

Knowledgeable observers strongly disagree. As Eduardo Gallardo, an attorney who specializes in mergers and acquisitions and corporate governance, recently wrote in a post on the Columbia Law School Blue Sky Blog, the Commission's premise that data regarding portfolio holdings of smaller managers is less valuable "ignore[s] the realities of a modern market and media ecosystem that permits small, vocal participants to greatly increase their significance to public companies, including through a heavy reliance on derivative instruments that do not even count toward the Form 13F reporting threshold. Unlike in 1975, activists with minimal 'real' equity exposure can today threaten to launch credible campaigns against multi-billion dollar public companies."[27] That reality strongly argues for retaining the current reporting threshold, Gallardo argues, in order to both "facilitate consideration of the influence of institutional investment managers on the securities markets" and "increase investor confidence in the integrity of the U.S. securities markets," as Congress intended.

Other securities attorneys have echoed, and expanded upon, this concern. As a group of attorneys from Wachtell, Lipton recently wrote in a Harvard Law School blog, "adoption of the SEC's current proposal would impede companies and their shareholders from promptly identifying the company's institutional investors, hinder shareholder/public company engagement, and increase the potential for market abuse by sophisticated investors who wish to

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[23] See, e.g., recommendations in the OIG Report and the NIRA rulemaking petition and legislative proposal.
[24] Release at 21-22.
[25] *Id.*
[26] *Id.* at 24.
[27] Eduardo Gallardo, Why the SEC's Proposal to Amend Rule 13f-1 Should Fail, The CLS Blue Sky Blog (Jul. 27, 2020), https://bit.ly/3kilpSA.

accumulate shares on a stealth basis."[28] Form 13F "is often the primary means by which investors, companies and other market participants first learn or verify that an activist hedge fund is accumulating or has accumulated a significant (but less than 5%) position in a target company's stock," they explained. Because many activists do not own $3.5 billion of 13F securities, adoption of the proposal would "make it significantly more difficult to determine whether an activist, or a 'wolf pack' of activists, owns a stake in a company [and]... activist 'tipping' could well result in only the wolf pack – and not the target company or other shareholders – being aware of the ownership stake until the moment that the activist strike occurs."[29]

Others have raised similar concerns that many activist hedge funds would no longer be required to report under the Commission's proposal, noting that these are "hardly the smaller fund managers that regulators say the overhaul is supposed to benefit."[30] According to Gallardo, for example, increasing the ownership threshold from $100 million to $3.5 billion "would allow some of the most prolific activist hedge funds to cease filing Form 13F reports altogether. … Tellingly, out of FactSet's SharkWatch 50 table of top activists, only 10 would be required to file Form 13F reports under the new 13F reporting threshold."[31] Meanwhile, Goldman Sachs, which has tracked equity hedge fund positioning on a quarterly basis since 2007, said the proposed change "would cut the number of funds in its analysis to 59 from 822, and shrink equity assets covered to $815 billion from $1.2 trillion."[32]

This loss of transparency into important and influential institutional asset managers raises serious concerns. It is particularly troubling that the Commission is proposing to decrease the data available about hedge funds at the same time that it is taking steps to expand retail investor access to such investments. In an environment in which moderately well off, but financially unsophisticated, retail investors are being actively marketed investments in hedge funds and other private funds, transparency around holdings of these funds is made more important, not less. The Commission has an obligation to factor that into its regulatory decision-making.

Among those most likely to suffer significant harm under the Commission's proposal, according to knowledgeable observers, are small and mid-sized companies. For example, NIRI spokesman Ted Allen predicted that, "If this rule goes through, you will see more small and mid-sized companies getting ambushed by hedge funds. This will increase activism in all of the mid-cap companies because there will be less transparency."[33] In addition, the proposal would make it more difficult for these smaller companies to "identify and engage with many of their shareholders," according to Gallardo.[34] Gallardo noted that the 13F reports "are particularly useful for smaller issuers that may not be able to afford more costly stock-surveillance

[28] Adam O. Emmerich, David M. Silk, and Sabastian V. Niles, Wachtell, Lipton, Rosen & Katz, Going Dark: SEC Proposes Amendments to Form 13F, Harvard Law School Forum on Corporate Governance (Jul. 19, 2020), https://bit.ly/2FIqMeF.
[29] *Id.*
[30] Weiss, Bain and Parmar.
[31] Gallardo, Why the SEC's Proposal … Should Fail.
[32] OnWallStreet, Goldman warns SEC proposal could shroud hedge-fund crowding, (Jul. 23, 2020), https://bit.ly/33Makmn. ("'The primary drawback of fewer hedge fund filings is lack of clarity around crowding risk,' strategists led by David Kostin said in a note July 17. 'Reported hedge fund holdings allow investors to understand crowding risk, and to appropriately hedge portfolios.'")
[33] Weiss, Bain, and Parmar.
[34] Gallardo, Why the SEC's Proposal … Should Fail.

programs," and he warned that raising the reporting threshold "would limit issuers' ability to track ownership changes or to verify how much of their stock is owned by investors who refuse to disclose their stakes – even after reaching out to issuers, requesting meetings with issuer management, or launching activist campaigns against issuers."[35]

The Commission also fails to consider the impact of its proposal on market analysts who use the data to provide valuable insights to their clients. As one example, Alphacution Research Conservatory has identified 13F data as "a very important dataset."[36] In a recent posting on the firm's website, Alphacution's Director of Research Paul Rowady explains how Alphacution "has leveraged the entire 13F report as a signal for a manager's underlying strategy" and the evolution of that strategy over time. Using that analysis as its starting point, Alphacution has "been able to leverage a library of 13F-supported models to compare notable managers and illuminate an expanding spectrum of their impacts on the trading and asset management ecosystem."[37] Much of the value of that data would be lost under the Commission's proposal, which threatens to filter out data from smaller, but highly "impactful" investment managers, according to Rowady.[38]

The Commission cannot reasonably move forward with this proposal without carefully assessing its impact on issuers, market analysts, and others who benefit from the transparency the current reporting regime provides.

5) The Commission has failed to use the 13F data to analyze the impact of its proposal on different types of stakeholders.

A key goal of Congress in adopting the 13F reporting requirement was that the Commission would use the data to support more informed policymaking. Ironically, the Commission has failed to conduct even a superficial analysis of that data to weigh the impact of its current proposal to raise the reporting threshold on different types of issuers and different types of asset managers. Others, who appear to have made better use of the 13F reports than the Commission has done, confirm that the proposal would have both a significant impact on market transparency overall and sharply different impacts on different segments of the market.

For example, IHS Markit analyzed the impact of the Commission proposal and found that it would cause 55 percent, on average, of an issuer's shareholders to stop filing Form 13Fs.[39] The impact on smaller companies would be particularly significant, with small cap companies losing insight into 14.6 percent of total shares outstanding, on average, and micro-cap companies losing insight into 17.1 percent of total shares outstanding. Companies in the Energy (16.5 percent), Healthcare (14.9 percent), and Technology (12.8 percent) sectors would experience particularly

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[35] *Id.*
[36] Paul Rowady, "The Evolving Value of 13F Reporting: Building a Macro-Structure Cockpit," Alphacution Research Conservatory website, last accessed Sept. 15, 2020, https://bit.ly/3hyUkZM.
[37] *Id.*
[38] Rowady suggests an alternative approach designed to "capture a comprehensive roster of institutional investment managers that **are impactful to the market ecosystem.** In others words, given the growing body of evidence that the industrialized use of technology leads to 'winner-take-all' dynamics in all types of markets, we need to make sure that new value-only thresholds are not set such that smaller, yet highly impactful, investment managers are filtered out with new 13F disclosure rules."
[39] *SEC's 13F Proposal – Issuer and Investor Analysis*, IHS Markit-Ipreo (Aug. 7, 2020), https://bit.ly/2Ru0aAP.

sharp declines in insight into holders of their securities, according to the IHS Market analysis.[40] The loss of transparency for smaller companies is particularly troubling, in light of the Commission's often voiced concern over the struggles these companies can face in attracting investor interest and interacting with shareholders.

IHS Markit also found significant differences in how the proposal would affect different types of institutional asset managers. Specifically, it found that index investors, where the Form 13F reports arguably offer the least added value, would be least affected by the proposal "as they would still have to file for 99% of the dollar value which they currently file for."[41] At the other end of the spectrum, the proposal would result in a decline of 20.4 percent in "total filing dollars" for specialty investors and 32.9 percent for alternative investors.[42] By focusing exclusively on the overall percentage of the dollar value of Form 13F holding data that would be retained under the Commission's proposal, the Release obscures these disparate impacts on different types of issuers and different types of funds.

The Commission cannot reasonably move forward with this proposal without taking these potentially significant harmful impacts on certain sectors of the market into account.

6) The Commission's estimated cost savings appear to be greatly exaggerated.

The Commission estimates compliance cost savings of \$15,000 to \$30,000 annually per manager for a total savings in compliance costs across the industry of \$68.1 million to \$136 million.[43] The Commission has failed to provide any evidence to support those figures, which are nearly four times the Commission's past estimates of the overall cost, except to state that it is based on "staff analysis and outreach to managers."[44] A number of parties, including Commissioner Allison Herren Lee, have expressed skepticism with regard to the accuracy of these estimated compliance cost savings.[45] As Commissioner Herren Lee stated, "This new estimate, in addition to being impossible to reconcile with past Commission estimates, is difficult to square with the substantive requirements of Form 13F." Gallardo similarly stated that the estimate "seems inflated given the limited information required and the fact that Form 13F filings are typically managed in-house by existing compliance departments."[46]

The Release also barely acknowledges how technological advances have lowered the cost of reporting since 13F was adopted. It states, albeit grudgingly, that "some of the direct compliance costs associated with preparing filings on Form 13F have decreased since 1975,

[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] Release at 17-18.
[44] Release at 18.
[45] Statement of Commissioner Allison Herren Lee on the Proposal to Substantially Reduce 13F Reporting (Jul. 10, 2020), https://www.sec.gov/news/public-statement/lee-13f-reporting-2020-07-10. (Citing the Commission's 2018 estimate of the total compliance costs of approximately \$31.2 million for the entire industry, Commissioner Herren Lee stated: "The proposal abruptly takes a new approach to the PRA estimate, increasing it to roughly \$113.6 million. The nearly fourfold increase in estimated burden is driven in large part by new assumptions about the types of professionals involved in the preparation of Form 13F filings. Specifically, the Commission now assumes that each filing requires *equal time* from a compliance attorney, a senior programmer, and a compliance clerk, resulting in a hefty increase in the hourly cost estimate.")
[46] Gallardo.

principally due to lower-cost information processing systems."[47] However, it quickly dismisses those cost reductions by adding that "direct compliance costs are likely to be proportionately higher for smaller managers than they are for larger managers."[48] There are numerous problems with this statement, starting with the fact that many of these "smaller" managers actually manage multi-billion-dollar portfolios. They are hardly the mom and pop operations the Commission implies. But beyond that, the reporting cost decrease attributable to technological advances since 1975 unquestionably dwarfs the proportional differences in cost between larger and "smaller" managers, and the Commission has an obligation to factor that cost reduction into its analysis.

For all these reasons, we share Commissioner Herren Lee's concern that "the approach to revising the burden estimate for Form 13F relies on assumptions that vastly overstate the complexity and resulting burden of the reporting requirement." And we further agree that more detail is needed "in order to ascertain whether the analysis is sufficiently rigorous and methodologically sound, especially in light of the heavy reliance on the analysis in justifying the proposal."[49]

7) The estimated cost savings, even if accurate, are not sufficient to justify the proposal.

Even if you accept the Commission's estimated compliance cost savings as accurate, and we do not, the projected savings are still paltry on both an individual fund basis and for the industry as a whole, particularly when weighed against the $2.3 trillion in assets held by funds that would no longer be required to file the reports. According to the Goldman Sachs strategists quoted by OnWallStreet, for example, hedge funds view the 13F reporting costs as "inconsequential."[50] Even for funds at the smaller end of the range, the compliance cost savings predicted by the Commission are unlikely to have any measurable impact on their "cost to participate in the market," as the Commission suggests, let alone on the level of management fees paid by or "enhanced services" offered to investors. Meanwhile, an added $15,000 to $30,000 a year won't buy much additional market research, another potential benefit cited by the Commission. As such, it wouldn't do anywhere near as much to "promote price discovery" as raising the reporting threshold will do to undermine transparency. In fact, the evidence suggests that the Commission's proposal will seriously undermine price discovery by reducing available data. As Goldman Sachs strategists explained, "Clients believe transparency aids in price discovery. More information is better than less."[51]

For the Commission to suggest that projected compliance cost savings would have the beneficial effects it attributes to this proposal is patently absurd. Perhaps recognizing that its proposal cannot be justified based on these paltry compliance cost savings, the Commission speculates that institutional investment managers also may face significant "indirect costs such as the potential for front-running and copycatting" as a result of the reporting requirement.[52] The SEC itself acknowledges that the academic literature it cites as supporting its views provides, at best, "partial" evidence, and generally did not demonstrate harm to the reporting entities related

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[47] Release at 13.
[48] Statement of Commissioner Herren Lee.
[49] *Id.*
[50] OnWallStreet article.
[51] *Id.*
[52] Release at 19.

to the front running and copycatting issues that the SEC suggested might be problematic.[53] Other market participants appear to find this argument regarding indirect costs even less credible than the Commission's estimated compliance costs. The Goldman Sachs strategists, for example, argue that the front-running concern is "backwards because the filing takes place after the purchase occurs and with a 45-day lag after quarter-end."[54] Moreover, as the Bloomberg article explains, the 13F filings "are more a snapshot than a true depiction of what fund managers' have in their portfolios," both because of the reporting delay and because they do not cover the full range of a fund's investments.[55]

The Commission itself has questioned the validity of this concern in the past. For example, it stated in a 2004 final rule release that, "Fund portfolio holdings have been required to be disclosed on Form 13F, aggregated by investment manager, since 1979. By contrast, concerns about predatory trading practices arising from Form 13F have surfaced recently in the context of the current proposal. Commenters have not presented concrete evidence that quarterly disclosure of aggregate holdings by institutional investment managers on Form 13F has resulted in such trading practices."[56] The Release provides no new concrete evidence to support this concern.

But even if it were to fully validate its estimated cost savings with concrete evidence, those savings do not justify its proposal to eliminate the 13F filing requirement for roughly 4,500 investment managers and $2.3 billion in assets. Moreover, this analysis, in addition to being unsupported by evidence, fails to take into consideration the economic impact of the Commission's proposal on issuers, market analysts, and other users of the 13F reports. As discussed above, those negative impacts are likely to be considerable for important sectors of the market – far more consequential than the paltry cost savings the Commission projects for institutional investment managers. To be credible, the Commission's analysis would need to examine these impacts on different sectors of the market under the proposed approach and compare the results to projected impacts under various reasonably available alternatives.

In short, the Commission cannot reasonably move forward with this proposal without first providing a more thorough and credible economic analysis, more clearly detailing the assumptions behind and findings of that analysis, and demonstrating that the benefits to institutional investment managers outweigh the harm to other market participants and to market transparency more generally.

8) The Commission's authority to increase the reporting threshold is unclear.

All of this assumes that the Commission has the authority to raise the reporting threshold. That is far from clear. As Commissioner Herren Lee said in her public statement, "The text [of Section 13(f)] is clear: Congress set a statutory reporting threshold at $100 million, and the Commission has the authority to lower it."[57] The Release fails to adequately discuss the legal

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[53] Going Dark.
[54] OnWallStreet article. *See also,* Gallardo and Going Dark.
[55] Weiss, Bain, Parmar ("The filings don't include non-U.S. traded securities or wagers against stocks, nor do they show the price at which a fund bought or sold a security.")
[56] Securities and Exchange Commission, Final Rule: Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, File No. S7-51-02 (Aug. 9, 2004), https://www.sec.gov/rules/final/33-8393.htm#83.
[57] Statement of Commissioner Herren Lee.

basis for the Commission's action, in light of this limitation in the statute, but it appears that the Commission is relying on its exemptive authority in Section 13(f)(3). As Commissioner Herren Lee stated, "using exemptive authority in this way would vitiate the limit that Congress placed on our authority in the plain language of Section 13(f)(1). We would, in effect, use our exemptive authority to rewrite the statute to reflect the opposite meaning from its plain language."[58]

We agree. The Commission's recent proclivity for using its general exemptive authority to circumvent clear statutory language is a highly questionable tactic that threatens to contravene the will of Congress, as we have discussed in greater detail elsewhere.[59] At the very least, the question of the Commission's legal authority deserves more careful consideration than it receives here. The Commission cannot reasonably move forward with this proposal without providing a much clearer explanation of the legal basis for its action.

9) The Commission should scrap the current proposal and develop a balanced approach to 13F reporting reform that includes steps to enhance the informational value of the reports.

Over the years, a number of market participants have urged the Commission to update the 13F reporting system to improve the information value of the reports. These include recommendations from the Commission's own Office of Inspector General to: update the list of securities that have to be reported to better reflect the full range of assets held by institutional investment managers; require reporting of average positions held during the quarter rather than simply those held at the end of the quarter; require disclosure of aggregate purchases and aggregate sales of 13F securities during the quarter; and require managers to separately report holdings in proprietary accounts and holdings in customer accounts.[60] They also include suggestions in the rulemaking petition from NYSE Euronext, the SCSGP, and NIRI to shorten the reporting deadline from 45 days to 15 days.[61] These groups separately advocated increasing the frequency of the reports from quarterly to monthly, and urged the Commission to work with Congress to achieve this goal.[62]

Some of these steps, like the proposal to increase the frequency of the reports, would require new legislation from Congress, while others appear to fall within the Commission's existing authority. Unaccountably, the Commission has chosen to completely ignore those suggestions. The result is a one-sided proposal that prioritizes reducing the already minimal costs of reporting to institutional investment managers over increasing the informational value of the reports for other market participants.

We believe many of the proposals that have been put forward to reform 13F reporting have merit. In particular, we believe significant benefits could be obtained by updating the list of

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[58] *Id.*
[59] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, regarding File Number S7-05-20, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets (Jun. 4, 2020), at 28, https://bit.ly/2H1kNlX.
[60] OIG Report.
[61] NYSE Euronext, Society of Corporate Secretaries and Governance Professionals, National Investor Relations Institute, Petition for Rulemaking Under Section 13(f) of the Securities Exchange Act of 1934 (Feb. 1, 2013), https://www.sec.gov/rules/petitions/2013/petn4-659.pdf.
[62] *Id.* at 3.

securities that have to be reported. Specifically, the list should be updated to include *all* equity securities – including derivatives thereof, synthetic equity securities, options on equity securities, and securities-based swaps – regardless of whether the securities are registered with the Commission or traded on an exchange. For those securities, such as private securities, which are valued by the fund itself, holdings of the security should count toward the reporting threshold based on whatever valuation the fund places on the security. A comprehensive approach to expanding the categories of 13F securities along these lines would be critical to bringing the reporting requirements up-to-date in a way that fulfills the underlying purpose of the 13F reports – closing "gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors." It also has the potential to greatly benefit the Commission by providing far better information on which to base its regulatory actions.

Without specifically endorsing each and every one of the suggestions that have been put forward by interested stakeholders, we urge the Commission to adopt a more balanced and thoughtful appraisal of the 13F reporting requirements than it has presented here. That appraisal should take into account the needs and concerns of all stakeholders who benefit from the 13F reports, not just investment managers. We believe the best way for the Commission to proceed would be through publication of a Concept Release seeking comment on various reform proposals that have been put forward. Based on the input it receives, the Commission should then work with Congress on legislation to bring the 13F reporting requirements into line with modern market realities and maximize their informational value.

We would welcome the opportunity to work with the Commission in advancing such an approach. In the absence of a more careful analysis and more balanced approach, however, we cannot support any increase in the reporting threshold, particularly not the 35-fold increase proposed without evidentiary support by the Commission in this Release.

Respectfully submitted,

Barbara Roper

Barbara Roper
Director of Investor Protection

cc: Chairman Jay Clayton
Commissioner Caroline A. Crenshaw
Commissioner Allison Herren Lee
Commissioner Hester M. Peirce
Commissioner Elad L. Roisman