Securities Regulation Daily Wrap Up, TOP STORY—SEC sees flurry of comments opposed to 35-fold increase in Form 13F reporting threshold, (Oct. 20, 2020)

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Even investment advisory groups think the SEC's plan to raise the threshold for investment manager reporting from $100 million in holdings to $3.5 billion goes too far in sacrificing transparency for questionable benefit.

Comments on the SEC's plan to modernize the Form 13F reporting regime are overwhelmingly opposed to the proposal, with even those in favor of some kind of threshold adjustment arguing for a considerably more modest increase. In July the Commission proposed to raise the reporting threshold for institutional investment managers, which has stood at $100 million since 1978, to $3.5 billion. Noting that the market relies on the information in the reports, the Investment Adviser Association suggested a $500 million threshold instead, with voluntary filings permitted below that amount.

Proposal. According to the SEC's release, the proposed $3.5 billion threshold would retain disclosure of 90 percent of currently reported holdings data by dollar value, but eliminate the filing requirement for the nearly 90 percent of filers that are smaller managers. The SEC observed that since 1975, the number of Form 13F filers has increased by a factor of 17, even as the overall size of the U.S. equities market has declined. Currently, over 5000 investment managers are required to file a Form 13F. Raising the threshold to $3.5 billion would reduce that figure to 550. The proposal acknowledges that the information reported on the form is used for a variety of purposes, but posits that some of this data is now available elsewhere, notably on Form N-PORT.

The SEC said that legislative history indicates that the statutory reporting threshold was meant to capture large institutional managers. By raising the reporting threshold, smaller managers would save a collective $68 to $136 million in compliance costs. Meanwhile, the rulemaking would remove the omission threshold for Form 13F filers, requiring managers that meet the $3.5 billion threshold to report even small positions. The proposal would also direct SEC staff to review the reporting threshold every five years and recommend any adjustment to the Commission.

Commissioner Allison Herren Lee dissented, saying that the proposal downplays the ways that Form 13F data is used and the costs of raising the reporting thresholds. Lee also questioned whether the SEC even has the authority to raise the reporting threshold. She added that the proposal does not address the concern, raised last year by the National Investor Relations Institute (NIRI), that greater transparency is critical to smaller issuers that cannot afford to pay for trading data analysis by stock surveillance firms.

Comments. NIRI, joined by publicly traded companies and IR counseling firms, wrote to oppose the idea, as did a number of NIRI chapters. NIRI said that the proposals threaten the robust environment of engagement that has developed since the adoption of the Form 13F rules. The 4500 investment managers that would be allowed to "go dark" under the proposal include "a number of well-known hedge fund executives and billionaire investors who fall under the proposed $3.5 billion threshold because they do not hold a significant volume of 13(f) securities on a long-term basis," NIRI wrote. On the other hand, many of the largest investors that would continue to report on Form 13F are passive, indexed investors whose holdings do not change appreciably from quarter to quarter. NIRI suggested that rather than raising the threshold, the SEC reduce the "archaic 45-day reporting period," require disclosure of short positions, and support legislation requiring monthly disclosure. The group also suggested that the SEC convene a public roundtable on Form 13F and other market transparency issues.

On the manager side, the Investment Adviser Association supported raising the threshold only to $500 million and asked that voluntary filings be permitted below the threshold. IAA said that it believes that most of its members file Form 13F reports and that raising the threshold would provide welcome relief to smaller advisers who handle reporting in-house. Even for some smaller advisers, though—and more so for larger ones—the ability to access the data from Form 13F reports outweighs the burden of filing their own reports. IAA gave examples of how asset managers use this information to manage active strategies; monitor activist shareholder activity; divine diversity-of-ownership data; help satisfy regulatory obligations; and provide outreach to shareholders. Furthermore, institutional investors that allocate their capital to investment managers use the reports as part of their due diligence.

Other commenters from the advisory, investment, and academic spaces had their own perspectives on why the proposal goes too far. Saying that N-PORT data is not a substitute for Form 13F data, the Investment Company Institute recommended leaving the reporting threshold where it is and only increasing, rather than entirely eliminating, the omission threshold. ICI also shared the feedback from its smaller members that the Form 13F reporting requirements are not burdensome on their own but are part of an overall compliance regime that is burdensome in the aggregate; the group encouraged the SEC to look for ways to eliminate burdens that may have more of an impact on small advisers.

CFA Institute voiced concerns about harm to market transparency and integrity, along with echoing Commissioner Lee's point about whether the SEC is authorized to raise the reporting threshold. The Closed-End Fund Association supports eliminating the omission threshold and the proposed amendments to the instructions regarding confidential treatment requests, but otherwise said that the proposal would make it more difficult to identify and communicate with shareholders because shares of closed-end funds are typically held in street name. OTC Markets Group said that rather than restrict the Form 13F reporting requirements, the SEC should expand the reporting obligations to apply to all publicly traded equity, including securities traded on the OTC markets.

The Society for Corporate Governance said that public companies have such limited visibility into their shareholders' identities that they primarily rely on Form 13F filings to compile their shareholder lists. While reiterating many of the comments about the effect a $3.5 billion threshold would have on transparency, the Society said that an increase to $450 million would appropriately account for consumer price inflation since the implementation of the Form 13F rules. The group said that this adjustment should only be done as part of a "comprehensive modernization of shareholder reporting." Business Roundtable also stressed the importance of identifying shareholders from Form 13F data and suggested the SEC postpone its amendments until there is an alternative source of this information. Alternatively, the Commission should make incremental adjustments to the reporting threshold rather than a 35-fold increase at once.

Wachtell Lipton submitted a comment opposing the amendments, saying that the SEC overestimates the savings to smaller advisers and ignores other costs, while supporting the idea of a "sensible rebalancing." The SEC is doing the opposite, the firm argues, by acting piecemeal in a way that will make the problem worse rather than better. Wachtell's letter proposes a suite of reforms to encourage timely and complete information while providing relief to those for whom the current reporting requirements truly are burdensome. Georgetown University Professor James J. Angel said that, along with harming transparency and market integrity, the decrease in Form 13F data would harm academic studies. Professor Angel quoted another commenter, Daniel Ferrao, whose comment letter states in its entirety, "When Congress first adopted Section 13(f) it did so to stimulate a higher degree of confidence among all investors in the integrity of securities markets. Taking this data away will have the opposite effect. Transparency is what gives investors confidence in US markets. If only they had the same confidence in US regulators."

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