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

Re: Comments on Proposed Rules Relating to the Reporting Threshold for Institutional Investment Managers
Release No. 34-89290; File No. S7-08-20

Dear Ms. Countryman:

On July 10, 2020, the U.S. Securities and Exchange Commission (the "Commission") proposed an amendment to Form 13F that would increase the reporting threshold from \$100 million to \$3.5 billion (the "Proposed Amendment"). We respectfully submit this letter in response to the solicitation by the Commission for comments on the Proposed Amendment.

As discussed in more detail below, we believe that the Proposed Amendment would decrease market transparency, increase the potential for covert activist behavior and market manipulation, reduce the ability of U.S. public companies to engage with investors in a meaningful and efficient manner, and deprive investors, companies and the Commission itself of valuable, decision-useful information. The justification advanced by the Commission for the Proposed Amendment—purported savings of \$15,000 – \$30,000 annually by the "smaller" institutions that would no longer be subject to filing requirements under Section 13(f) of the Securities Exchange Act of 1934, as amended ("Section 13(f)")—underestimates the market influence of such institutions, likely overestimates the potential savings to those institutions, ignores other costs of the Proposed Amendment and in any event is insufficient to justify the adverse effects of the Proposed Amendment. The Proposed Amendment cuts the information currently available from Form 13Fs by 90%, rendering investors, regulators and the American public blind to important developments affecting the future of major American companies on whom our nation depends for job creation and overall prosperity.

That said, we support the Commission in taking a long overdue look at the Section 13 rule regime. For too long, the Commission's rules have lagged important market developments, leaving the U.S. regulatory scheme out of sync with best practices internationally. And the Commission's current rules fail to serve Section 13's intended purpose and unnecessarily keep investors (including Main Street investors), regulators and the public in the dark about important market developments that have a serious effect on all the stakeholders of American public companies, including their employees and communities of operation. Part of the outdated nature of the Section 13 regulatory scheme, all must admit, involves the failure of the thresholds under Rule 13f to be kept relevant in terms of current market conditions. But the minor effect on the smallest of investment funds is trivial in light of technological improvements that make reporting in a timely and complete way less burdensome than ever, and in any event does not justify exempting much larger funds from filing under Rule 13f.

What is needed given these realities is a comprehensive re-examination of the entire Section 13 rule regime in light of market and technological developments that have rendered the current regulatory landscape badly out of date and incapable of serving its intended purposes. But, rather than undertake a sensible rebalancing of the threshold under Rule 13f in the context of a broader examination of Rule 13, the Commission is proposing to act in a piecemeal fashion that will make the current, suboptimal situation even worse. The primary problem with Rule 13 now is not that it requires too much timely reporting, but that it requires too little. And, fundamentally, the Commission's Rules are antiquated and fail to capture important positions like derivatives that are standard grist for the mill of investment funds, have material implications for the control of public companies, and are covered by the reporting rules of virtually every major capitalist economy except the United States. We understand and regret that the rules implementing Section 13 have been used as a political football by interest groups of all kinds, and the corresponding and natural temptation for the Commission to try to proceed in a discrete way that it may perceive as less controversial. But, it is precisely the failure of the current proposal to situate Rule 13f reform in the context of the overall deficiency of the current Section 13 rule scheme that leads us to oppose the Commission's current approach.

There is a sensible way forward to consider whether to raise the Rule 13f reporting threshold in a meaningful, but measured way, that takes into account the effect of inflation and relieves the burden on holders whose positions are not materially important in the context of current markets. But any increase should occur only simultaneous with reforms to rules implementing Section 13 to require: (1) reporting of all derivative and similar positions under all subsections of Rule 13; (2) that investors filing under Rule 13d cease trading once they hit the 5% threshold until 48 hours after they make their initial filing under the rule; and (3) that Schedule 13D filers make their initial filing within one business day of crossing the ownership threshold, and update their filings within 24 hours of any change in position of more than one percent in any direction. Within the context of this overall reform, an increase of the Rule 13f threshold may well make sense, and the benefit-to-cost ratio of the entire Section 13 regime would improve immeasurably. Under that sensible approach to comprehensive reform, public companies, their stakeholders and regulators would have more timely and complete information about critical market developments, stockholders would be able to assess more accurately the economic motivations of activist investors and small investment funds whose positions are not material to the functioning of our capital markets and for whom the existing Section 13(f) regime might reasonably be considered a meaningful burden can be relieved of the need to file.[1]

In the absence of an overall reform that takes into account the crucial market developments that have rendered the current Rule 13 regime unable to fulfill its intended purpose, we oppose the narrow Proposed Amendment. As a standalone idea, increasing the reporting thresholds of Rule 13f is unwise. Precisely because of the failure to keep all aspects of Rule 13 current, Rule 13f now plays an important role as a stopgap early warning system because it is what issuers and the public must look to in the absence of a modern Rule 13d. Taking action to reduce the number of Form 13F reporting filers by 90% would leave American investors, issuers and the general public even more in the dark about important developments in our economy and make us an even greater laggard in transparency and disclosure internationally. Reducing overall market transparency, when the existing level of transparency is suboptimal, is a step backwards. Any increase to the Rule 13f threshold must be but one part of a comprehensive reform to all the rules implementing Section 13.

<u>Brief History of Section 13(f)</u>

At its core, the purpose of Section 13(f) is to improve transparency in the securities markets.[2] In 1971, the Commission recommended that Congress empower it to require reports and disclosure of securities holdings from "all types of institutional investment managers."[3] In 1975, Congress took this recommendation and enacted Section 13(f), emphasizing three primary needs that it was fulfilling: (1) the need for corporate issuers to be able to identify the holders of their stock in light of the "unnecessary secrecy" caused by the practice of institutional investors using "street names";[4] (2) the need to create a depository of historical and current data about the investment activities of institutional investment managers;[5] and (3) the need to rapidly disseminate institutional disclosure information to the public, thereby stimulating a higher degree of investor confidence in the integrity of the securities markets.[6]

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[1] We have previously submitted a detailed proposal to reform Schedule 13D reporting and believe that those recommendations remain sound and could be the basis of comprehensive reform that could involve measured changes to the Rule 13f filing threshold. *See generally* Wachtell, Lipton, Rosen & Katz, *Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934* (Mar. 7, 2011), https://www.sec.gov/rules/petitions/2011/petn4-624.pdf (the "WLRK Section 13 Petition").

[2] S. Rep. No. 94-75, at 256 (1975) (hereinafter "Senate Report").

[3] *Id.*

[4] *Id.* at 258-59.

[5] *Id.* at 263.

[6] *Id.* at 260-61.

Notably, Section 13(f) was to be a complement to Section 13(d), which was the primary early warning system for issuers and the public, designed to sound when a new investor was seeking to influence company management and policy in a way that could affect other investors, the company's future and the public.[7] Initially, the two provisions were designed to serve distinct, though complementary, functions: Section 13(f) was meant to give investors, issuers, regulators and the public a general understanding of the investment activities of influential investment managers (and, from the perspective of issuers, a better sense of the identity of its shareholder base). Section 13(d) was supposed to alert issuers and the public of potential moves to exert influence or take control of a particular company.[8] But, as the deficiencies of Rule 13d became evident, public companies and investors became increasingly reliant on Rule 13f—originally "an ownership reporting provision of general application"—to fill in the blanks left by the Section 13(d) early warning system. In a practical, real-world sense, Rule 13f became one of the key sources of important market transparency.

<u>Harms of the Proposed Amendment</u>

Since the Commission last updated its rules under Section 13 in a comprehensive way, seismic and well-understood changes have occurred in our capital markets.[9] Through the use of derivatives and other synthetic instruments, it is now possible for an activist or passive investor to accumulate much greater amounts of ownership while escaping the need for immediate disclosure. The Commission's rules under both subsections (f) and (d) fail to capture this important development, and lag international standards among the leading market-based economies.

Unlike when the rules were crafted, it is much easier for investors to accumulate large blocks of stock rapidly and in non-transparent ways, and to accumulate control over much more than 5% of a company's voting stock before the Commission's rules require public disclosure.[10] This has made our markets less transparent.

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[7] See H.R. Rep. No. 90-1711, at 2818 (1968) ("The purpose of section 13(d) is to require disclosure of information by persons who have acquired a substantial interest, or increased their interest in the equity securities of a company by a substantial amount, within a relatively short period of time."); S. Rep. No. 90-550, at 7 (1967) (reciting same language); see also *Hallwood Realty Partners, L.P.* v. *Gotham Partners, L.P.*, 286 F.3d 613, 620 (2d Cir. 2002) ("The aim of § 13(d) is to ensure that investors will be informed about purchases of large blocks of shares."); *GAF Corp.* v. *Milstein*, 453 F.2d 709, 717 (2d Cir. 1971) ("[T]he purpose of section 13(d) is to alert the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control . . . .").

[8] Filing and Disclosure Requirements Relating to Beneficial Ownership, Exchange Act Release No. 15348, 16 SEC Docket 228 (Nov. 22, 1978) (citing S. Rep. No. 550, 90th Cong., 1st sess. 7 (1967); H.R. Rep. No. 1711, 90th Cong., 2nd sess. 3 (1968); and Hearings on S. 510 before the Subcommittee on Securities of the Senate Committee on Banking and Currency, 90th Cong., 1st sess. (1976) ("Section 13(d) is not, however, an ownership reporting provision of general application. Its legislative history reveals that is was intended to provide information to the public and the affected issuer about rapid accumulations of its equity securities in the hands of persons who would then have the potential to change or influence control of the issuer.").

[9] Section 929R of the Dodd-Frank Wall Street Reform and Consumer Protection Act amended Section 13(d) to reduce the administrative burdens associated with filing and gave the Commission the authority to shorten the 10-day filing period for Schedule D filings. *See* the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat 1376 (2010), § 929R. Section 766 of the Dodd Frank explicitly empowered the Commission to expand the definition of beneficial ownership. *See* id. at § 766.

[10] *See infra* notes 54-63 and accompanying text.

Ironically, this development has been facilitated by investors taking advantage of the ten-day reporting deadline under Rule 13(d), which was set at a time when filers had to prepare a filing on a typewriter and arrange for it to be delivered to the nation's capital, in a time-consuming manner. In the 21st century, it has never been easier for filers to compile information in a timely and accurate way, and file it promptly by electronic means.

As things now stand, because the Commission's rules have not kept pace with the speed of markets and technology, American issuers, stockholders and the public are blind to information that is more rapidly available in other nations like the United Kingdom,[11] Germany[12] and Hong Kong.[13] For that reason, the disclosure that is required under Form 13F today plays an even more indispensable role in fostering information flows and market transparency, and thus promoting investor confidence in the securities markets.[14] Form 13F data has not become less useful with market developments; it has become more important because it is needed to cover territory that Section 13(d) was supposed to address but does not. Thus, the Commission itself acknowledges that Form 13F has become more important and that more types of users than ever now rely on this data.[15]

In our view, the Proposed Amendment does not sufficiently weigh the harm that the reduced threshold will cause to the interest of market participants, stakeholders and the public generally. We encourage the Commission to give serious consideration to the damage that the Proposed Amendment would cause to the transparency of the securities markets. To help in the consideration of needed change, we next explain concretely some of the harm that shrinking public disclosure so drastically will have.

Reduced Ability to Verify Investment Assertions

Reducing mandatory reporters by 90% will make it more difficult for investors to screen "smaller" managers and to confirm that such "smaller" managers are investing in accordance with their marketing assertions.[16] Increased market opacity could enable bad-acting managers, newly free from disclosure requirements, to conceal evidence that they are not investing according to fund type. And in the absence of Form 13F data, investors would have little way of knowing. This lack of certainty threatens Congress's "[p]erhaps most important justification" for Section 13(f): "the need to collect and disseminate to individual investors data about institu-

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[11] *See* Chapter 5 of the United Kingdom Financial Services Authority's Disclosure Guidance and Transparency Rules Sourcebook.

[12] *See* Part 6 of the German Securities Trading Act.

[13] *See* Part XV of the Hong Kong Securities Futures Ordinance.

[14] *See* Senate Report at 79-85. As the Commission correctly noted, the "data can also assist individuals in making investment decisions, investment managers in managing assets, and *corporate issuers of 13(f) securities interested in determining the beneficial holders of their publicly traded stock.*" Reporting Threshold for Institutional Investment Managers, Exchange Act Release No. 34-89290 at 22. (emphasis added). ("Proposed Amendment").

[15] *See* Proposed Amendment at 21–22.

[16] *See, e.g.*, Corrie Driebusch and Juliet Chung, *SEC Rule Proposal Would Slash Number of Investment Managers That Need to Report Quarterly Holdings*, Wall St. J. (July 10, 2020), https://www.wsj.com/articles/sec-rule-proposal-would-slash-number-of-investment-managers-that-need-to-report-quarterly-holdings-11594429438.

tional investment managers [and, thus,] stimulate a higher degree of confidence among all investors in the integrity of [the] securities markets."[17] The Proposed Amendment would leave individual investors without much of that data and, as a result, without one of its more valuable due diligence tools. The loss of this verification mechanism may chill investor appetite, hindering market-wide capital formation.

Decreased Availability of Decision-Useful Information

Congress's intent in enacting Section 13(f) was, in part, to ensure "that information about the securities holdings and certain transactions of institutional investment managers [is] available to all investors—both institutional and individual—so that they can have it, whatever its relative usefulness in making their independent judgements."[18] Exempting 90% of Form 13F reporters will deprive institutional managers of useful data points and harm their ability to make informed judgements about the market.

For instance, lack of transparency would harm the already-limited ability of investment managers to detect crowded trades and to invest accordingly. That is, investment managers would have a difficult time deciphering whether a security is experiencing price increases due to fundamental factors or as a result of a short-term play by a collection of hedge funds making similar trades at about the same time. The aggressive accumulation of a security by hedge funds (and the later accumulation by those who wish to take advantage of the volatility arising from these situations) typically results in the inflation of the price of that security. These exaggerated stock prices can plunge to fire-sale prices once the synchronized hedge funds unload the security, leaving the other investors and investment managers holding onto an illiquid security.[19]

Reduced valuation information

Without visibility into the shareholder base of potential investments, it can be difficult to value securities with any precision. As Congress noted, "[a]ccurate valuation of large securities holdings is the touchstone of investor confidence in investment management relationships."[20] Of course, market visibility is a critical component of security valuation, especially if it offers insight into the positioning of short-term investors and market movers. It is, therefore, inadvisable for the Commission to reduce decision-useful information so drastically. In this respect, the impact of the Proposed Amendment is predictable: less institutional disclosure data could harm the ability of managers to gauge the holdings of other institutional investors and, thus, accurately value securities, which in turn could subject investors to increased unpredictability (and likely associated losses) and diminish investor faith in investment managers and the markets generally. Ultimately, this will hurt issuers' ability to raise capital on the markets. Meaningful Form 13F reporting has facilitated the key Commission mandate of promoting capital for-

[17] Senate Report at 260-61.

[18] *Id.* at 261.

[19] *See generally* Gregory Brown, Philip Howard and Christian Lundblad, *Crowded Trades and Tail Risk* (Feb. 2, 2019) (working paper), http://uncipc.org/wp-content/uploads/2019/02/CTTR.pdf (noting "that the crowdedness of an equity position is an important ingredient for characterizing risk" and providing empirical evidence to support this claim).

[20] Senate Report at 261.

mation and accountability. Domestic and international investors also use Form 13F data to understand who their co-investors are in specific companies and industry sectors, assess turnover and trading styles and inform investment decisions.

Negative impact on the M&A market

Additionally, the Commission should note that Form 13F data play an important role in the public M&A market. Specifically, business combination and transaction counterparties rely on Form 13F information as part of the due diligence process. Without this data, it would be more difficult for potential buyers–and sellers–to assess possible partners or strategic counterparties in M&A-related transactions. Many companies, as well as their advisors, find it useful, and even important, to have 13(f) reports in order to assess a counterparty's ownership base, evaluate its stability or level of churn over time, determine shareholder overlap (which can factor into valuation assessments) and identify which investors are aligned or misaligned with a company's strategic direction and value creation strategies or may otherwise seek to intervene in or influence a participant company's future or seek to interfere with or block the successful execution of a proposed transaction. Depriving transaction participants of 13(f) information, as the Proposed Amendment would do, could have the unintended effect of chilling M&A activity and undermine the market for corporate control, increasing costs (and decreasing the efficiency) of public M&A transactions and heightening the risks for potential buyers and sellers by depriving them of decision-useful information.

Increase the Potential for Covert Activist Tactics and Market Manipulation

As we have mentioned, Form 13F filings now act in fact, if not by original intention, as part of the early warning system for issuers, other stockholders and the public, designed to sound upon emergence of an investor that may wish to change the company's strategic direction in material ways. Issuers, other stockholders and the public now rely on Rule 13f as an early warning because of the gaps in Rule 13d's coverage of derivatives and synthetics, and the delays in requiring reporting once an activist investor accumulates 5%.

To gut required disclosure under Form 13F would leave issuers, public investors and regulators even more blind to the reality that an activist investor has taken an influential position in a public company.

The Proposed Amendment would facilitate the covert actions of activist investors, enabling them to accumulate and leverage positions beyond the reach of statutorily contemplated public scrutiny. At the same time, activists will continue to collectivize into so-called "wolf packs" (that is, groups operating with conscious parallelism but no formal "agreement" as would require a 13D filing) further circumventing disclosures and ultimately undermining investor confidence in the integrity of the securities markets.[21] The combination of market opacity and activist "tipping" enables coordinated activist attacks, leaving corporate issuers and other investors

[21] *See* John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 565–66 (2016); *see also* Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1896–97 (2017).

flatfooted.[22] When such an activist's position is finally revealed, the disclosure tends to move the market materially. The activist and the favored few that were tipped enjoy outsized returns, often to the detriment of Main Street investors deprived of the same knowledge.[23]

The Commission is empowered to protect the public interest against such tactics. Accordingly, Congress indicated that it expected the Commission to use Form 13F data "to analyze the characteristics of institutional investment managers, and to analyze the impact of institutional investment managers on the securities markets."[24] Reducing the reporting of Form 13F data by 90% will hinder the Commission's ability to perform its statutorily contemplated role—especially given the outsized impact of many of the sophisticated investors that would be exempted by the Proposed Amendment. Indeed, as a result of the Proposed Amendment, many of those such sophisticated investors could evade the 13F disclosure requirement by apportioning their positions to avoid the $3.5 billion threshold.

Impair Shareholder Identification and Engagement

Corporate issuers rely on Form 13F data. Public companies use 13F data to familiarize themselves with their shareholder base, given that "much of their shareholder list may reflect holdings in 'street name' rather than beneficial ownership."[25] And, Congress intended precisely such use of Form 13F data.[26] Section 13(f)'s legislative history notes that the practice of listing holdings in 'street name' "may impede company management in its attempts to communicate directly with the beneficial owners of its securities" and provides that Section 13(f) was "carefully drawn in response to the problem."[27] Decreased shareholder visibility also hinders the ability of issuers to analyze their current shareholder base, identify gaps and opportunities for improving the composition of their investor base and target new potential investors. As many companies have experienced, some investors (including activist funds) are tight-lipped and vague when companies ask directly how much company stock they hold, and the 13Fs help keep them honest and at least provide a starting point for dialogue. The Proposed Amendment would largely reverse an effective solution to a problem identified by Congress and the Commission itself.

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[22] *See* Adam Emmerich, David Silk, Sabastian Niles and Oluwatomi Williams, *Going Dark: SEC Proposes Amendments to Form 13F* (2020), https://corpgov.law.harvard.edu/2020/07/19/going-dark-sec-proposes-amendments-to-form-13f/ (noting that the increased threshold will make it significantly more difficult to discern whether an activist, or a wolf pack, owns a stake in company and that "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 the activist strike occurs."); Susan Pulliam et al., *Activist Investors Often Leak Their Plans to a Favored Few: Strategically Placed Tips Build Alliances for Campaigns at Target Companies*, Wall Street J. (Mar. 26, 2014), https://www.wsj.com/articles/activist-investors-often-leak-plans-to-peers-ahead-of-time-1395882780.

[23] *See* Theodore N. Mirvis, Andrew R. Brownstein, Adam O. Emmerich, David A. Katz and David C. Karp, *Activist Hedge Fund Abuses Require Immediate SEC Action to Modernize Section 13(d) Reporting Rules and Ensure Fair Reporting of Substantial Share Accumulations* (Mar. 28, 2014), https://www.wlrk.com/webdocs/wlrknew/WLRK-Memos/WLRK/WLRK.23259.14.pdf.

[24] Senate Report at 261.

[25] SEC Form 13F at 7.

[26] Senate Report at 258 (describing "the need for the management of individual companies to be able to identify the holders of their stock.").

[27] *Id.* at 258-59.

The Proposed Amendment also endangers corporate issuers by obscuring the ownership stake of many activist investors. It is likely that if the Proposed Amendment is adopted, some activist investors will build secret stakes in companies and go undetected (except to the "wolf pack" members they have tipped) until right before they decide to launch their attack on an issuer. In response, corporate issuers will have to allocate more resources, time and effort to protect against this heightened threat posed by activists' covert equity accumulation. The time, effort and capital would be better utilized creating real value for shareholders.

Smaller corporate issuers will be especially disadvantaged by the Proposed Amendment, as it will reduce their shareholder visibility most drastically.[28] These companies have fewer resources to pay consultants and market surveillance firms to attempt to identify who their shareholders are and whether any activists are in their stock. And, although the decrease in shareholder visibility for larger issuers will be lower than that suffered by smaller issuers[29], given the size of larger companies' shareholder bases, reducing by 90% the reporters of Form 13F data would in many cases deprive even large cap issuers of the opportunity to proactively identify and engage with potentially disruptive shareholders, who in many cases have an impact beyond their holdings.

Notably, the Proposed Amendment would have economy-wide implications, sparing few industries, with a large majority losing more than 10% of industry-wide shareholder visibility.[30] And the actual impact of the Proposed Amendment will vary across industries, creating additional unpredictability.[31] We respectfully submit that the Proposed Amendment did not fully contend with these concerns and left important interests of corporate issuers largely unaddressed.[32]

Inadequate Alternatives to Form 13F

The "alternative sources of holdings data" that the Commission suggests as viable substitutes for Form 13F (i.e., Schedule 13D and Form N-PORT) are insufficient replacements.[33] For instance, Schedule 13D is applicable only to investors that acquire more than 5% of a company's equity securities. Accordingly, it is typically irrelevant to large-cap companies. And as

[28] *See* Shannon McDermott, *SEC's 13F Proposal – Issuer and Investor Analysis*, IHS Markit (Aug. 7, 2020), https://ipreo.com/blog/secs-13f-proposal-issuer-and-investor-analysis/ (testing the Proposed Amendment on the Russell 3000 to identify its potential impact). The impact of the Proposed Amendment varies widely by market cap. According to the IHS analysis, mega cap and large cap companies would lose 4.4% and 5.5% shareholder visibility, respectively. *Id.* On the other hand, mid-cap would lose 9.4% shareholder visibility, while small and micro-cap companies would lose 14.6% and 17.1% shareholder visibility, respectively. *Id.*

[29] *Id.*

[30] *See id*. (providing that the following industries will each lose more than 10% of its shareholder visibility: Financials (10.4%), Consumer Goods (10.6%), Industrials (10.8%), Technology (12.8%), Consumer Services (13.8%), Healthcare (14.9%) and Energy (16.5%)).

[31] For example, the visibility into investors that focus on industries that experience significant valuation changes, such as the energy sector, may be especially harmed by the Proposed Amendment.

[32] We also acknowledge and support the Commission's recommendations to require managers to provide additional identifying information, including to better reveal interrelationships between managers sharing investment discretion, and eliminate the Form 13F omission threshold and associated share / value limits.

[33] *See* Proposed Amendment at 24–25 n.58.

we have explained, Section 13(d) disclosure is now subject to abuse and circumvention by sophisticated investors and is in serious need of reform itself.[34] Form N-PORT too is an inadequate alternative. It requires information from only registered investment companies. The investors that file on Form N-PORT make up a small percentage of the would-be exempt Form 13F filers. Additionally, Form N-PORT's 60-day disclosure window offers even staler data than the current Section 13(f) regime does.

At one point in its comments on the Proposed Amendment, the Commission implies that market surveillance firms could replicate Form 13F information.[35] This is a generous assumption, at best. For starters, Form 13F filings are themselves the most reliable (if sometimes outdated) information market surveillance firms have available to them. Given the multiple layers of intermediaries in general and the lengths activists will go to in order to remain hidden, market surveillance is more of an exercise in guesswork than a precision science. And not all surveillance firms are created equal; access to the most accurate and timely information costs more. As a result, market participants and stakeholders would effectively be required to pay a premium to market surveillance firms for reduced market transparency. In all likelihood, the cost of Section 13(f) compliance saved by "smaller" managers would be passed on to those willing to pay for (less reliable) information from surveillance firms. Indeed, there will be those—such as smaller issuers—who just cannot afford such a service and will have to navigate blindly the muddier waters of turbulent markets. We respectfully believe that the Commission should give greater consideration to the broad use of Form 13F data and the dearth of suitable alternatives, lest inadequate and unequal access to critical market information reduce the integrity of our securities markets.

Overestimated Burden of Reporting

Generally speaking, improved technology has substantially reduced the cost of aggregating, storing, preparing and filing Form 13F disclosure information. The Commission itself acknowledges that "the direct compliance costs associated with preparing filings on Form 13F have decreased . . . principally due to lower-cost information processing systems."[36] Additionally, the substantive requirements of Form 13F filings are, in most cases, basic.[37] Investment managers already keep track of the required Form 13F data, independent of any disclosure requirement. This process is automated, saving time and reducing associated labor costs. Accordingly, the Commission's estimate of Section 13(f) compliance costs, $15,000 to $30,000 per manager, seems overstated.[38]

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[34] *See, e.g.*, WLRK Section 13 Petition.

[35] *See* Proposed Amendment at 24 n.57.

[36] *Id.* at 13.

[37] Institutional investment managers must report the following on Form 13F: (1) The issuer name of all Section 13(f) securities; (2) a description of the class of security listed; (3) the number of securities owned; and (4) the fair market value of the securities listed, as of the end of the calendar quarter. *See* Frequently Asked Questions About Form 13F, U.S. Securities and Exchange Commission (Feb. 24, 2020), https://www.sec.gov/divisions/investment/13ffaq.htm.

[38] Notably, this estimate is a sharp departure from the SEC's own previous calculation of the same burden, which amounted to approximately $4,000 to $5,000 annually per manager. *See* Allison Herren Lee, Commissioner, U.S. Securities and Exchange Commission, *Statement on the Proposal to Substantially Reduce 13F Reporting* (July 10, 2020), https://www.sec.gov/news/public-statement/lee-13f-reporting-2020-07-10 ("Commissioner Lee Statement").

Notably, most of the costs enumerated by the Commission were not specific to managers filing on Form 13F. Instead, they were general compliance costs, which in most cases would persist even in the absence of the Section 13(f) filing requirement. For instance, managers do not "develop[] and maintain[] hardware and software systems to collect and analyze information" singularly for the purpose of filing on Form 13F.[39] Nor do they undertake "reviews or compliance activities as part of [their] overall compliance program" specifically to file on Form 13F.[40] The main cost associated exclusively with filing on Form 13F is "preparing the information for submission to the EDGAR system."[41] This additional cost is minimal.

Although it is true that there can be, as the Commission notes, costs associated with submitting confidential treatment requests ("CTRs"),[42] these requests are indulgences typically requested by activists or other sophisticated investors from the general rule in favor of market transparency because they perceive an opportunity to profit by acting in secret and shielding their actions from scrutiny by other market participants. Indeed, the existence of Form 13F CTRs has often been criticized for its ambiguity and susceptibility to manipulation[43] and the added costs undertaken by activists or other sophisticated investors to earn outsize profits by covert conduct is no reason to dramatically reduce the transparency needed by all other market participants.

The Proposed Amendment mentions indirect costs to "smaller" managers, namely the potential for front-running and copycatting. In both cases, the Commission acknowledged that the studies upon which it relied neither test nor conclusively establish causal relationships or to what extent investment managers are harmed specifically by front-running and copycatting.[44] In any case, in our view neither contention warrants reducing market transparency. The front-running concerns seem misplaced. Form 13F disclosure occurs after the investor has acquired the security and is often fashioned so that it offers little live information to the market. The "copycatting" argument essentially posits that the market should be kept in the dark while "wolf packs" are able to develop once the activist has accumulated enough in secret and is ready to tip its selected fellow travelers).[45] That proposition is inconsistent with the intended role of Section 13(f). Congress contemplated the use of Form 13F data to better understand "the investment results and investment strategies of different institutional investment managers, including portfolio volatility and portfolio turnover," and "the share acquisition and disposition of different managers."[46] It should not be considered an undue burden that Section 13(f) provides insight into the

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[39] Proposed Amendment at 18.

[40] *Id.*

[41] *Id.*

[42] *See id.*

[43] Richard Teitebaum, *SEC Grants Too Many Confidential Treatment Requests, Critics Say*, Institutional Investor (Oct. 7, 2015), *https://www.institutionalinvestor.com/article/b14z9xzkxzbfqj/sec-grants-too-many-confidential-treatment-requests-critics-say*; *see also* Christian Bonser, *If You Only Knew the Power of the Dark Side: An Analysis of the One-Sided Long Position Hedge Fund Public Disclosure Regime and a Call for Short Position Inclusion*, 22 FORDHAM J. CORP & FIN. L. 327, 365 (2017).

[44] *See* Proposed Amendment at 19–20.

[45] Lucian A. Bebchuk et al., *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy*, 39 J. CORP. L. 1, 4-5, 15 (2013) (showing that before the first filing by the lead activists, abnormal trading patterns emerge consistent with selective knowledge by certain other activists and trading before there is public disclosure for all investors to consider).

[46] Senate Report at 261-62.

trading practices of investment managers. That is the very purpose of the statute. The Commission should not diminish market transparency and eliminate investor access to the investment activities of many of their managers to protect the desire of a small number of investment managers to reap outsize profits through stealthy behavior.[47]

Underestimated Impact of Smaller Managers

So-called "smaller" managers may hold a less substantial percentage of Section 13(f) securities than the largest institutional investors, but they can have the practical ability to materially affect the securities market and the market for most issuers' securities. Tellingly, out of this year's top ten activists (in terms of number of high impact campaigns launched), seven fall below the would-be Section 13(f) threshold.[48] Eighty percent of the "SharkWatch 50 Key Activists" would be exempt from filing on Form 13F.[49] Put plainly, this means a large supermajority of the most influential activists who affect other investors and all the other stakeholders of American companies, including the employees whose hard work is essential to our nation's economic success, would be exempt from disclosing their securities holdings to market participants, the Commission and the public. As a result, high profile investors like David Tepper, Paul Tudor Jones, and George Soros and well known activist firms such as JANA Partners, Corvex Partners, Sachem Head and even Starboard Value, to name a few, would be more easily able, if the Proposed Amendment was passed, to build secret stakes and coordinate attacks on unprepared corporate issuers.[50] We respectfully submit that the risk presented by allowing these "smaller" investors to "go dark," thereby subjecting the market to increased volatility and eroding investor faith in the securities markets, dwarfs any concern that these investors are unduly burdened by relatively minimal compliance costs.

Statutory Intent

Congress did not intend strict adherence to the initial, $100 million, reporting threshold—especially not to the detriment of the transparency that Congress sought by enacting Section 13(f) in the first place. Rather, Congress deliberately set the threshold high, giving the Commission time to phase in any downward refinement it viewed as advisable after the adoption of Section 13(f).[51] Indeed, Congress made clear that its initial reporting threshold was largely meant to facilitate the smooth adoption of the new disclosure regime, explaining that "by limiting *initially* the impact of the reporting provisions to the largest institutional managers," Section

[47] Amy Whyte, *Is Hedge Fund Secrecy a Sign of Skill – Or a Red Flag?*, Institutional Investor (July 20, 2020), https://www.institutionalinvestor.com/article/b1ml48c86hm5z2/Is-Hedge-Fund-Secrecy-a-Sign-of-Skill-Or-a-Red-Flag# ("The more secretive funds, they found, did not outperform the more transparent funds. Instead, the researchers found that secretive hedge funds actually underperformed peers during the financial crisis—suggesting, according to the authors, that the secrecy veiled higher risk-taking.").

[48] SharkWatch 50 (Key Activists), FACTSET, https://my.apps.factset.com/navigator/activism-sharkwatch/sharkwatch-50 (last accessed Aug. 20, 2020).

[49] *Id.*

[50] Notably, if the Proposed Amendment is enacted, 86% of activists currently reporting on Form 13F would no longer be subject to the requirement. McDermott, *supra* note 28.

[51] We note that other commentators have questioned the authority of the Commission to increase the Form 13F threshold above $100 million. *See, e.g.*, National Investor Relations Institute, Comment Letter Template for NIRI Chapters on 13F (2020); *see also* Commissioner Lee Statement. We assume for the purposes of our comments that the Commission has the authority to make the change that it is proposing, and focus our comment on why the Proposed Amendment, as is, is unwise and should not be adopted.

13(f) "could be implemented rapidly with the least amount of unnecessary costs and burdens on the potential respondents."[52] Congress explicitly contemplated and authorized the Commission's reduction of "the securities holdings cut-off figure to [as low as] $10 million."[53] This context is important because it underscores how out of sync the drastic increase contemplated by the Proposed Amendment is with the statutory purposes Section 13(f) was intended to play, and how unwise it would be to proceed with a piecemeal change that materially decreases market transparency without considering the larger context within which Form 13F filings now serve as an important integrity-promoting function.

<u>Comprehensive Section 13 Reform</u>

The Commission has correctly observed that the system for disclosure of beneficial ownership is long overdue for reform. But, the Proposed Amendment does not address the components of Section 13 most in need of modernization. Over the last decade, we have identified the elements of Section 13 most in need of updating and revision, and proposed key reforms to address such needs. In our 2011 rulemaking petition, we recommended changes to modernize Section 13 and better safeguard the beneficial ownership disclosure regime from misuse and circumvention.[54] Others too have recommended comprehensive changes to address the deficiencies of both Sections 13(f) and 13(d).[55] Together, these reforms would bring the United States closer in line with most other sophisticated jurisdictions that have already adopted such disclosure features (including the United Kingdom, Germany, Australia and Hong Kong).

In the age of ubiquitous technology and free-flowing information, there is no reason to blind Americans to even more key market information than is currently the case. The ability to collect, maintain and disseminate information is easier and less costly than ever. Given this reality, any changes to the beneficial ownership reporting regime should come in the context of comprehensive reform that increases—rather than decreases—the amount of meaningful information reported, and decreases the time allotted to do so. For that reason, the piecemeal Proposed Amendment is mistaken and any more measured adjustment to the Rule 13f threshold should come in the context of overall reform of Section 13. Such reform is long overdue, and we briefly sketch the contours of what common sense Section 13 reform should look like.

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[52] Senate Report at 264 (emphasis added).

[53] *Id.* Similarly, the Proposed Amendment's stated goal of adjusting the reporting threshold so that it "reflect(s) proportionally the same market value of U.S. equities that $100 million represented in 1975" is misguided. Proposed Amendment at 12. Congress assigned no "magic" to the percentage of the U.S. equities market that was represented by the $100 million threshold in 1975 (75%). It simply noted that "[i]nitially, the SEC ha[d] estimated that approximately 300 persons—holding about 75% of all institutional equity holdings—would be subject to the reporting provisions of the bill." Senate Report at 264. Again, this percentage was specified only in the context of initial implementation. Upon enactment of Section 13(f), the Commission had authority to decrease the threshold by 90%, "[i]f the SEC should determine that the public interest would be better served by bringing into the program certain smaller institutional investment managers." *Id.*

[54] *See generally* WLRK Section 13 Petition.

[55] *See* National Investor Relations Institute, The Case for 13F Reform at 1 (Sept. 25, 2019), https://www.niri.org/NIRI/media/NIRI/Advocacy/NIRI-Case-for-13F-Reform-2019-final.pdf ("NIRI Letter"); NYSE Euronext, Petition for Rulemaking Under Section 13(f) of the Securities Exchange Act of 1934 (2013), https://www.sec.gov/rules/petitions/2013/petn4-659.pdf ("NYSE Petition").

Reduce 13F and 13D Reporting Windows

The reporting windows under the Rules 13f and 13d are too long, rendering much of the data useless when finally revealed to the public. The same technological advancements that have substantially reduced the cost and burden of filing, have also enabled investment managers to quickly change their positions. Thus, by the time the Commission and the public get their hands on the Form 13F and Schedule 13D data, it is likely stale. "In today's world, ten days [, and certainly forty-five days,] is an eternity."[56] This information lag handicaps the data's users and is incompatible with the underlying transparency goals of the Section 13 disclosure programs.

Importantly, shorter timeframes for reporting beneficial ownership are commonplace in highly successful market economies outside the United States, which demonstrates that a shorter window is indeed workable.[57] Maintaining outdated and slow disclosure timeframes subjects the U.S. markets to disproportionate (as compared to other jurisdictions) risk of ill-informed market decisions, market manipulation and abusive tactics. Accordingly, we recommend that the Commission shorten the Schedule 13D filing window from ten days to one day and the Form 13F filing window from 45 days to two days. In the case of Schedule 13D, acquirers should be prohibited from acquiring beneficial ownership of any additional equity securities of the issuer from the time they cross the 5% threshold until two days after filing on Schedule 13D.[58] This brief "cooling-off" period would allow the investing public to assess and react to the potential market impact of the Schedule 13D disclosures.[59]

Broaden Definition of "Beneficial Ownership" under Section 13

Under the current Sections 13(f) and 13(d) reporting regimes, "beneficial ownership" is comprised of only those securities over which the investor has voting power or investment discretion. Derivatives and other synthetic instruments are not captured by this definition. The prevalence of these instruments has increased since the enactment of Sections 13(f) and

[56] WLRK Section 13 Petition at 3.

[57] *See* Adam Emmerich and William Savitt, *Synthetic Ownership Arrangements for Ambush Equity Accumulation* (Nov. 27, 2010), https://corpgov.law.harvard.edu/2010/11/27/synthetic-ownership-arrangements-for-ambush-equity-accumulation/.

[58] Requiring cease trading at 5% until there is public disclosure and time for the market to absorb that information best fulfills the original purpose of Section 13(d), and would bring the U.S. into the 21st Century with nations like Sweden, Australia and Hong Kong, all of which require public disclosure promptly upon the acquisition of 5%, with some nations like the United Kingdom, Switzerland and Germany even requiring disclosure at a lower 3% level. Notably, however, the use of an even lower 3% early warning level in many EU nations, with a requirement for immediate reporting and regular updating, has not kept activist investing from increasing markedly, thus undermining any suggestion that requiring real time reporting at 5% would inhibit the ability of hedge funds to influence public companies. *See, e.g.*, Svea Herbst-Baylis, *Corporate Activist Investors Eye Europe, Japan More in First Half: Lazard* (July 15, 2020), https://www.reuters.com/article/us-lazard-hedgefunds/corporate-activist-investors-eye-europe-japan-more-in-first-half-lazard-idUSKCN24G1ZK; Andrew Holt, *UK Shareholder Activism Rose Significantly in 2018*, IR Magazine (Jan. 15 2019), https://www.irmagazine.com/activism/uk-shareholder-activism-rose-significantly-2018 (noting the accelerating rise of activism in the UK and predicting "a further fillip in UK shareholder activism."); Elliot Smith, *US Activist Investors' Aggressive Strategies Are Starting to Force Change in Europe*, CNBC News (July 30, 2019), https://www.cnbc.com/2019/07/30/us-activist-investors-aggressive-strategies-europe.html; Lina Saigol, *Activist Investors Are on the March in Europe*, MarketWatch (Dec. 13, 2018), https://www.marketwatch.com/story/activist-investors-on-the-march-in-europe-2018-12-13.

[59] *See* WLRK Section 13 Petition at 5.

13(d). These mechanisms can enable investors to attain and exercise voting power and investment discretion over a company's securities without possessing legal ownership of such securities.

The narrow definition of "beneficial ownership" advantages sophisticated institutional investors to the detriment of other market participants.[60] Specifically, it provides investors with yet another easily manipulable mechanism to circumvent statutorily required disclosures and to improperly exert control over corporations, oftentimes leading to market, management and business disruption. We have long cautioned against the hazards posed by the secret accumulation of derivatives and the resulting harm to the transparency of the securities markets, corporate democracy and the interest of corporate issuers (and their shareholders) in accessing accurate information about their shareholder base and its holdings.[61]

To guard against such dangers, the definition of "beneficial ownership" should be broadened to reflect the realities of the modern securities market and the extent to which power and discretion is no longer exclusively vested in equity securities holders. Specifically, in the context of Section 13, beneficial ownership should include "ownership of any derivative instrument which includes the opportunity, directly or indirectly, to profit or share in any profit derived from any increase in the value of the subject security."[62] This change is appropriate and necessary. Others have similarly called for common-sense changes to the beneficial ownership definition.[63] Moreover, many leading market economies, such as the United Kingdom,[64] Germany,[65] Switzerland,[66] Australia[67] and Hong Kong[68] have broadened their definition of beneficial ownership to include a range of derivative instruments. Indeed, Congress itself has indicated its intent to bolster market transparency by requiring the Commission to establish disclosure rules for short-sale activity.[69]

It is time for the Commission's rules to catch up with longstanding market developments and to make sure that the U.S. does not continue to lag behind its economic competitors by having an outdated approach to a new century's marketplace.[70]

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[60] *See* Theodore N. Mirvis, Adam O. Emmerich, David A. Katz, Sabastian V. Niles and Jenna E. Levine, *Proposed Revisions to 13(d) Beneficial Ownership Reporting Rules* (2010), https://corpgov.law.harvard.edu/2016/03/19/proposed-revisions-to-13d-beneficial-ownership-reporting-rules/.
[61] *See* Theodore N. Mirvis and Adam Emmerich, *De-Coupling of Economic Voting Power in Public Companies – Equity Ownership Derivatives Create Unforeseen Dangers* (2008), https://corpgov.law.harvard.edu/wp-content/uploads/2008/07/de-coupling-of-ownership-economic-and-voting-power-in-public-companies.pdf.
[62] WLRK Section 13 Petition at 8.
[63] NYSE Petition at 5-8.
[64] *See* Chapter 5 of the United Kingdom Financial Services Authority's Disclosure Guidance and Transparency Rules Sourcebook.
[65] *See* Part 6 of the German Securities Trading Act.
[66] *See* Article 20 of the Federal Act on Stock Exchange and Securities Trading in Switzerland.
[67] *See* Australian Takeover Panels Guidance Note 20.
[68] *See* Part XV of the Hong Kong Securities Futures Ordinance..
[69] *See* Section 929X of the Dodd-Frank Act.
[70] If the Commission undertakes a comprehensive review of the Schedule 13D reporting regime, it should consider whether, consistent with its current review of the appropriateness of the current Form 13F filing threshold, the percentage reporting triggers under Schedule 13D should change to take into account the market changes since the percentages were last adjusted. Any such review should consider all relevant empirical evidence bearing on the question, including reporting percentages and other information from other market economies, including those that now use 3% as their baseline reporting threshold.

Consideration of A Measured Increase In the Reporting Threshold

Within the context of a comprehensive modernization of the Section 13 disclosure regimes, the Commission could and likely should consider a responsibly tailored increase to the Section 13(f) reporting threshold. Any increase should be carefully measured to fulfill the purpose of Section 13(f), while avoiding unnecessary burden to any given market participant. By way of example, if the Commission were to adjust the original Section 13(f) threshold by inflation since 1975, then that would have the effect of limiting any burden of Section 13(f) to smaller investors whose investments are not likely to have a material influence on companies or markets, while continuing to have Section 13(f) filings be a meaningful source of important market information.[71] But even within the context of comprehensive reform, increasing the Form 13F threshold by 35 fold, to $3.5 billion, would be excessive and inadvisable.[72]

Conclusion

We commend the Commission for turning its attention to the share ownership reporting regime, and agree that it urgently requires improvement. The Proposed Amendment, however, would not address the deficiencies of the ownership disclosure system but have the opposite effect. By reducing by 90% the number of Form 13F reporting filers, the Proposed Amendment would further diminish transparency in the securities market and increase the risk of manipulative tactics by sophisticated investors, thus seriously threatening investor confidence in the integrity of the securities markets.

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[71] In determining the new threshold under the Proposed Amendment, the Commission applied the growth percentage of the stock market's value from 1975 to 2018, 3,750%, to the current Section 13(f) threshold, $100 million, and rounded down from $3.57 billion. The Commission appeared to take for granted that the percentage of investment managers subject to Section 13(f) after the Proposed Amendment should remain consistent with the corresponding percentage from 1975—75%. A more reasonable approach is the one the Inspector General's Office and others have used in this context: adjust the threshold consistent with the consumer price index inflation, resulting in a $450 million Rule 13f reporting threshold. That type of threshold might make sense in the context of the overall reform of the Section 13 rule regime that we have described.

[72] We also note that, as is the case with filings under Form 13F, filings under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR"), have come to function as part of the early warning system for issuers. There is an element of perversity in that an antitrust filing may be the first notice to an issuer that a party is acquiring a stake in the company. As Commissioner Phillips noted in his concurring statement on a recent proposed Federal Trade Commission rules change , the HSR Act "is not supposed to be an early-warning system for tender offers and corporate takeovers—for that we have a number of laws at the federal and state level. And it is not supposed to be a monitoring system for equity investments generally. To the extent possible, it should not be any of those things. It should effectuate its purpose: helping the Agencies spot transactions likely to violate the antitrust laws, so that we can stop or remedy them prophylactically." Noah Joshua Phillips, Commissioner, U.S. Federal Trade Commission, *Hart-Scott-Rodino Act Premerger Notification Notice of Proposed Rulemaking & Advanced Notice of Proposed Rulemaking* (Sept. 18, 2020), https://www.ftc.gov/system/files/documents/public_statements/1580699/p110014hsrrulesphillipsstatement_0.pdf. But because Rule 13(d) allows filers to continue to acquire above the five percent reporting threshold for many days before reporting, and because it is easier than ever for a sophisticated investor to acquire huge blocks of stock quickly, the HSR filing, at the low $94 million threshold, sometimes acts as the first signal to a public company that an activist is acquiring shares in its stock. 15 U.S.C. § 18a. Given recent proposed rulemaking by the Federal Trade Commission (that we expect to become final before year-end) to exempt most acquisitions of less than 10% of an issuer's outstanding voting securities, however, we do not expect the HSR Act to serve such a significant function going forward. Premerger Notification; Reporting and Waiting Period Requirements, 85 Fed. Reg. 27191 (proposed Sept. 21, 2020) (to be codified at 16 C.F.R pt. 801, 803).

As we, and others, have previously argued, both Sections 13(f) and 13(d) are in need of comprehensive modernization to realign them with their original statutory goals. We urge the Commission to heed these calls and to seize this opportunity to undertake extensive reform of the beneficial ownership disclosure system.

We would be pleased to respond to any inquiries regarding this letter or our view on the Proposed Amendment generally. If you have any questions with respect to this letter or wish to discuss our comments, please feel free to contact Theodore N. Mirvis, Andrew R. Brownstein, Steven A. Rosenblum, Adam O. Emmerich, David M. Silk, David A. Katz, Trevor S. Norwitz, David K. Lam, Sabastian V. Niles or Oluwatomi O. Williams at 212-403-1000.

Very truly yours,

Wachtell, Lipton, Rosen + Katz

Wachtell, Lipton, Rosen & Katz