CLEARY GOTTLIEB

ALERT MEMORANDUM

SEC Proposes a Significant Change in Reporting by Institutional Investors

July 16, 2020

On July 10, 2020, the Securities and Exchange Commission (the "SEC") proposed changes that would substantially reduce the number of investors required to file quarterly reports showing their holdings of U.S.-listed equities on Form 13F.[1] The SEC's proposal would increase the 13F reporting threshold 35 fold — from $100 million to $3.5 billion — and eliminate the ability to exclude *de minimis* positions from reporting on Form 13F.[2] According to the SEC, almost 90% of the investment managers who file a Form 13F today would no longer be required to do so. However, the SEC's data shows that the institutional investment managers that would need to continue reporting are responsible for disclosing over 90% of the aggregate dollar value of securities reported on Form 13F — likely reflecting the increase in the proportion of the market held by the largest mutual fund managers. While the proposed increase in the reporting threshold is significant, the SEC's proposal is also notable for its decision not to consider significant changes to the 13F reporting regime suggested by the various commentators over the past several years.

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[1] SEC Release No. 34-89290.

[2] The SEC also proposed several other changes to Form 13F and the reporting regime, including requirements that the staff review the reporting threshold every 5 years, that institutional investment managers that have a CRD number include that number in Form 13F filings and a change to the instructions regarding confidential treatment requests driven by recent caselaw.

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Section 13(f) of the Exchange Act and Rule 13f-1 currently require an "institutional investment manager" with "investment discretion" over more than $100 million of "13F securities" to file a quarterly report listing its holdings of 13F securities as of the last trading day of the quarter. The report is due 45 days after the end of each quarter and includes the size of each position. The Form 13Fs filed by large-cap activists and other renowned investors attract considerable attention each quarter as they often reveal which new investment positions have been built, and which existing investments have been sold. Only gross long positions are reported — short positions are neither reported nor netted out of reported positions.[3] Under the current regime, a position can be excluded if the reporting person holds fewer than 10,000 shares and the fair market value of those holdings is less than $200,000. Institutional investment managers may also obtain confidential treatment of certain positions for a limited time — in particular for positions held for merger arbitrage and "in certain limited circumstances for an ongoing investment strategy such as an ongoing program of acquisition or disposition."[4]

"Institutional investment manager" is defined broadly and includes all persons and entities (other than natural persons managing their own accounts[5]) that manage 13F securities in excess of the $100 million threshold. Corporations and other entities that manage portfolios for their own account are generally included in the definition of "institutional investment manager."[6] "13F securities" are primarily comprised of U.S.-listed equities (including foreign private issuers, closed-end funds and exchange traded funds), though certain equity options, convertible debt securities and warrants are also included.[7] The SEC publishes a list of all 13F securities each quarter.[8]

Impact of the SEC's proposal

The SEC's proposal to increase the reporting threshold would have disparate effects on different types of market participants. We do not expect the proposal to eliminate the *de minimis* threshold to have a significant impact.

— *Smaller investment managers*. The most direct impact would be on smaller managers that would have the ability to stop reporting on Form 13F. We expect that many of those managers are not investment companies registered with the SEC and required to file Form N-PORT or other public disclosure regarding their positions (other than reports under Sections 13(d), 13(g) and 16 of the Exchange Act), so the change will allow those managers to keep their portfolio and trading from becoming publicly known. According to the SEC, that may be useful in allowing those firms to avoid "front-running" and "copycatting." According to the SEC, there would also be a very modest reduction in compliance costs faced by those investment managers.

However, like larger investment managers, those smaller investment managers would lose insight into the portfolios of their peers. The SEC also did not offer much evidence to support the notion that Form 13F disclosure enables "front-running" and "copycatting." That seems debatable in light of the long lag between when an investment position is built and when it is disclosed in a Form 13F and the ability of sophisticated investors to obtain real-

[3] See "Frequently Asked Questions About Form 13F — Question 41," available at: https://www.sec.gov/divisions/investment/13ffaq.htm.
[4] See "Frequently Asked Questions About Form 13F — Question 57," available at: https://www.sec.gov/divisions/investment/13ffaq.htm.
[5] The staff of the SEC has extended the exclusion for natural persons to certain investment vehicles owned and managed by a single family. See SEC No-Action Letter, Olympia & York Developments (Jan 24, 1983).
[6] See "Frequently Asked Questions About Form 13F — Question 3," available at: https://www.sec.gov/divisions/investment/13ffaq.htm.
[7] See "Frequently Asked Questions About Form 13F — Question 7," available at: https://www.sec.gov/divisions/investment/13ffaq.htm.
[8] See Exchange Act Rule 13f-1(c). The list is available at: https://www.sec.gov/divisions/investment/13flists.htm.

time insights into competitors' investment portfolios through other legitimate means.

The SEC's proposal would also allow most activist funds to completely fly under the radar and not publicly disclose any of their company-specific investment positions unless they beneficially own more than 5%.

— *Larger investment managers*. Investment managers that are required to continue reporting may face a competitive disadvantage relative to managers that are able to cease filing reports on Form 13F and take advantage of the benefits described above.

Larger investment managers would also lose visibility into the portfolios of smaller investment managers. To the extent decisions made by market participants are influenced by actions taken by other significant market participants, a reduction in 13F reporting could reduce an important source of information used in that decision-making process.

— *Issuers.* Issuers often use Form 13F reports to better understand their shareholder base. That information can be important to management in understanding who is building a position in their stock — though even under the current regime the usefulness of 13F reporting in preparing for engagement by activists is substantially undercut by the ability of activists to seek confidential treatment and the long lead time between an investment and when it needs to be reported in a Form 13F. It is also used by investor relations departments in their shareholder engagement efforts, as well as in connection with proxy solicitations and other corporate actions. The impact of this aspect of the proposed amendments will be particularly acute for smaller-cap issuers, whose stocks are more likely to be held by the investment managers who would no longer be required to file Form 13Fs. The services of stock watch surveillance firms will also become an even more valuable tool to help issuers confirm changes in their shareholder base.

Matters not addressed in the SEC's proposal

Several suggestions have been made in recent years to significantly modify the Section 13(f) reporting regime. The SEC acknowledged receipt of these proposals in a footnote to the proposing release but did not otherwise address them.[9] Those proposals have generally been aimed at increasing the timeliness, completeness and accuracy of information included in Form 13F reports. In 2010, the SEC's Office of Inspector General ("OIG") published a comprehensive and highly critical report regarding reporting under Section 13(f) and the SEC's review and management of that regime. Among the substantive suggestions made by the OIG were that consideration be given to increasing the scope of the information required to be reported on Form 13F to include derivative positions and other instruments needed to give a fuller picture of an institutional investment manager's positions and requiring reporting of average positions in 13F securities over a quarter rather than reporting positions as at quarter end.[10] In 2015, the NYSE and the National Investor Relations Institute petitioned the SEC to require reporting of short positions on Form 13F.[11] Those two entities, together with the Society of Corporate Secretaries and Governance Professionals, also petitioned in the SEC in 2013 to shorten the 45-day period for the filing of Form 13F.[12]

Each of those proposals would likely result in an increase in compliance costs and in the commercial sensitivity of information required to be filed on Form

[9] SEC Release No. 34-89290 at n. 28.

[10] See SEC Office of Inspector General, Review of the SEC's Section 13(f) Reporting Requirements (Sept. 27, 2010), available at: https://www.sec.gov/files/480.pdf.

[11] Petition for Rulemaking Pursuant to Sections 10 and 13(f) of the Securities Exchange Act of 1934 (Oct. 7, 2015), available at: https://www.sec.gov/rules/petitions/2015/petn4-689.pdf.

[12] Petition for Rulemaking Under Section 13(f) of the Securities Exchange Act of 1934 (Feb. 1, 2013), available at: https://www.sec.gov/rules/petitions/2013/petn4-659.pdf.

13F. In the proposing release, the SEC stated that "[w]e believe that it is appropriate to propose changes to the scope of managers required to file reports on Form 13F before considering other potential amendments to the Form," which may indicate that the SEC will still consider the above-referenced proposals, but only after limiting Form 13F reporting to larger institutional investment managers. The SEC also did not address long-standing calls to modernize other aspects of its shareholder reporting regime, such as beneficial ownership reporting under Sections 13(d) and 13(g) of the Exchange Act.

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