



400 NORTH CAPITOL STREET, NW • SUITE 585 • WASHINGTON, DC 20001
TELEPHONE: (202) 624-1460 • FACSIMILE: (202) 393-5218
WWW.SHAREHOLDERCOALITION.COM

February 18, 2021

The Honorable Maxine Waters
Chairwoman
U.S. House Committee on
Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
U.S. House Committee on
Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Subject: Virtual Hearing – Game Stopped? Who Wins and Loses When Short Sellers,
Social Media, and Retail Investors Collide

Dear Chairwoman Waters and Ranking Member McHenry:

The Shareholder Communications Coalition (“Coalition”)¹ submits this statement for the record in today’s House Financial Services Committee hearing regarding recent trading activities in the shares of GameStop Corporation (ticker: GME).

The Coalition does not have answers to all the questions raised by the very volatile GameStop trading sessions over the past several weeks. However, this series of events has highlighted the need for Congress and the Securities and Exchange Commission (“SEC”) to: (1) modernize the public company disclosure regime; and (2) improve the financial infrastructure underpinning our capital markets.

Specifically, the Coalition recommends the following:

1. Improve Disclosure of Short Sale Positions. The practice of short selling, *i.e.*, the sale of a security the seller does not own and has typically borrowed, has long been a controversial practice. While advocates for short selling argue that it promotes market price efficiency, many public companies have found that certain forms of short selling—particularly “naked” shorting—can facilitate illegal market manipulation to the detriment of other investors.

¹ The Shareholder Communications Coalition (“Coalition”) comprises the Society for Corporate Governance (www.societycorp.gov.org) and the National Investor Relations Institute (www.niri.org). Together, these associations represent senior executives at more than 1,600 public companies.

Small-cap companies with thinly traded shares and companies in industry sectors with lengthy product development cycles before becoming profitable are particularly vulnerable to short selling abuses. For instance, the lack of transparency in this area has allowed certain hedge funds and other institutional investors to accumulate secret short positions and launch a specious challenge to a company's technology, patent, or business model. These funds then profit when the dispute becomes public and the company's shares fall. In some cases, investors with short positions have deliberately published misleading information, or tried to interfere with a company's operations, to drive down its share price.²

Congress has already attempted to address this problem. Section 929X(a) of the Dodd-Frank Act of 2010 requires the SEC to promulgate rules obligating large investment managers to publicly report short sale activity at a minimum of once every month.³ In enacting this provision, Congress clearly intended the SEC to adopt rules to require investment managers, who now report their "long" positions each quarter as required by Section 13(f), to start reporting their short positions. Unfortunately, the SEC has failed to implement this Congressional mandate to promulgate an effective disclosure regime for short selling activities.

After the enactment of Section 929X, one of the Coalition's members, the National Investor Relations Institute ("NIRI"), joined with several other organizations in 2015 to submit a rulemaking petition with the SEC, urging the agency to adopt rules requiring the disclosure of short sale activities by institutional investment managers.⁴ The SEC has not acted on this rulemaking request, even though Members of Congress and individual companies submitted letters of support for this petition.⁵

Support has been growing among capital market participants for many years now to increase the transparency of institutional short positions. The SEC should be urged to initiate a rulemaking pursuant to Section 929X of the Dodd-Frank Act.

2. Modernize the Schedule 13D Reporting Rules. The Brokaw Act, legislation

² For more details on these abusive practices, please see Petition for Rulemaking on Short and Distort, Petition No. 4-758 (February 12, 2020), available at <https://www.sec.gov/rules/petitions/2020/petn4-758.pdf>. This petition was filed with the SEC by a group of securities law professors led by Professors John C. Coffee, Jr. and Joshua Mitts of Columbia Law School.

³ See 15 U.S.C. § 78m(f)(2).

⁴ Letter from Elizabeth King, Corporate Secretary, NYSE Group, Inc. and James M. Cudahy, CAE, President and CEO, National Investor Relations Institute, to Brett J. Fields, Secretary, U.S. Securities and Exchange Commission, Petition No. 4-689 (October 7, 2015), available at <https://www.sec.gov/rules/petitions/2015/petn4-689.pdf>. See also Letter from Edward S. Knight, Executive Vice President, General Counsel and Chief Regulatory Officer, Nasdaq, to Brett J. Fields, Secretary, U.S. Securities and Exchange Commission, Petition No. 4-691 (December 7, 2015), available at <https://www.sec.gov/rules/petitions/2015/petn4-691.pdf>.

⁵ See Comments on Rulemaking Petition: Request to require the periodic disclosure of short-sale activities by institutional investment managers, available at <https://www.sec.gov/comments/4-689/4-689.shtml>.

February 18, 2021

sponsored by Senator Tammy Baldwin (D-WI), seeks to modernize the SEC's outdated Schedule 13D reporting rules, which are a relic of the Williams Act of 1968.⁶ Brokaw is the name of a village in Wisconsin that was harmed by a group of hedge funds after they seized control of the Wausau Paper Company in 2011.

Under current 13D rules, an activist investor does not have to report a 5% share position in a public company until *ten (10) days* after first reaching the 5% threshold. As a result, hedge funds and other institutional investors can secretly accumulate large positions (often significantly more than 5%) at the expense of other investors and then ambush their target companies. These funds often pressure companies to agree to plant closings, job cuts, reduced R&D spending, and other concessions that may not be in the best long-term interests of shareholders.

The Brokaw Act would shorten the reporting period to *four (4) days* and would close loopholes that permit these funds to use derivatives and other financial instruments to accumulate and mask their equity positions. These new rules would significantly improve transparency for the benefit of retail investors, pension fund and mutual fund beneficiaries, and other investors who typically hold shares for the long-term.

Meaningful reform to the Schedule 13D reporting rules will require legislation. Financial Services Committee members should consider introducing and passing a House companion bill to the Brokaw Act, as proposed by Senator Baldwin.

3. Modernize the Section 13(f) Reporting Rules. In 1975, Congress passed Section 13(f) of the Securities Exchange Act to increase the public availability of information regarding securities held by large investment managers. Lawmakers believed that these institutional disclosures would increase investor confidence in the integrity of U.S. capital markets.

Current SEC rules require investment managers with at least \$100 million in assets to disclose their share ownership positions within 45 days after the end of each calendar quarter, through a Form 13F filing. An exception is permitted for those managers that petition the SEC to delay these disclosures on the basis of confidentiality.

Unlike companies in the United Kingdom and other international markets, U.S. companies do not have access to a share registry that lists all their investors. For this reason, companies in this country rely on the data contained in institutional 13F filings to learn which investment managers own their shares and the size of their positions. Similarly, both institutional and retail investors rely on these filings to monitor developments in the capital markets and to make investment decisions.

⁶ See S. 1744, introduced on August 3, 2017.

The 13(f) disclosure rules have not been updated since the 1970's. In their current form, they have become outdated and serve as a barrier to the receipt of timely information by investors and public companies.

In 2013, NIRI, the Society for Corporate Governance, and the NYSE petitioned the SEC to shorten the 13F reporting deadline from 45 days to *two business days* after the end of each quarter.⁷ The SEC has not acted on this petition.

In July of last year, the SEC issued a hastily prepared proposal to increase the threshold for filing 13F reports by *35 times*, from \$100 million in assets to \$3.5 billion in assets.⁸ This proposal would eliminate 89% of the current 13F filings and significantly reduce transparency of share ownership within the capital markets. Thousands of comments in opposition to this proposal were submitted and media reports indicate that this rulemaking has been shelved.

Meaningful reform to the 13(f) reporting rules will require legislation. Financial Services Committee members should consider introducing and passing a bill to, among other things: (1) shorten the filing deadline from 45 days to two business days; (2) provide for monthly disclosure instead of quarterly reporting; (3) require that 13F filers disclose their short positions; and (4) require derivative positions that are substantially equivalent economically to direct ownership of a 13F security to be disclosed.

4. Modernize the SEC's Proxy Voting and Shareholder Communication Rules. As noted earlier, U.S. companies do not have a share registry that lists all their investors, unlike companies in the United Kingdom and other international markets. More than 75% of U.S. investors hold their shares with brokers and banks in "street name," where they are not considered the shareholders of record.

Public companies are not permitted to know who many of their street name shareholders are and can only communicate with them through intermediaries. This cumbersome system was developed in the 1980's through SEC regulation and the SEC's rules have not been updated to reflect modern communication tools, the growth of the Internet, and the need for more engagement between companies and their shareholders.

Companies would like to be able to have an ongoing dialogue with their long-term investors, in part because they have annual shareholder meetings and report earnings on a quarterly basis. Regulators and other capital market participants are also encouraging more

⁷ Letter from Janet McGinness, Executive Vice President & Corporate Secretary, NYSE Euronext, Kenneth A. Bertsch, President & CEO, Society of Corporate Secretaries and Governance Professionals and Jeffrey D. Morgan, President & CEO, National Investor Relations Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, Petition No. 4-659 (February 1, 2013), *available at* <https://www.sec.gov/rules/petitions/2013/petn4-659.pdf>.

⁸ Proposed Rule, Reporting Threshold for Institutional Investment Managers, 85 Fed. Reg. 46,016 (July 31, 2020).

frequent contact between companies and their shareholders for transparency and corporate governance purposes.

Individual investors do not understand this system and are surprised to learn that, as shareholders, they do not appear on the company's stock ledger.

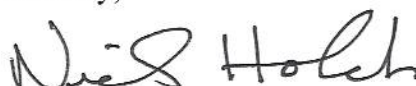
There is no policy reason why public companies hosting annual shareholder meetings and director elections should not be able to obtain a list of all their shareholders and be able to communicate with them directly for proxy voting and communications purposes.⁹

The SEC is well aware of these issues and the agency has taken steps to understand more about how the proxy voting and shareholder communications system works. Financial Services Committee members should encourage the SEC to undertake a rulemaking to modernize this system so that all investors—and especially retail shareholders—can communicate and interact directly with the companies in which they have chosen to invest.

* * *

Thank you for the opportunity to present the views of the Shareholder Communications Coalition regarding improvements that can be made to the regulatory framework underpinning the U.S. capital markets. If any Committee members or staff want to discuss these issues in greater detail with the Coalition and its members, please contact me at (202) 624-1461 or via email at nholch@holcherickson.com.

Sincerely,

A handwritten signature in black ink that reads "Niels Holch". The signature is written in a cursive, slightly stylized font.

Niels Holch
Executive Director

⁹ In the Coalition's view, this would be no different than a Member of Congress requesting and obtaining from the Secretary of State a list of eligible voters in his or her Congressional District for the purpose of constituent communications.