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Frequently Asked Questions on the SEC's Form 13F Proposal

Why Does NIRI Oppose the SEC's Proposal to Increase the Form 13F Filing Threshold?

NIRI has many concerns about the SEC's proposed rule amendments to raise the Form 13F disclosure threshold from $100 million to $3.5 billion. Here is a summary of key points about this proposal:

- The SEC is seeking to increase in 13F threshold by 35 times, which far exceeds the rate of inflation since 1975.
- This rulemaking would exempt 4,500 (89 percent of current 13F filers) from disclosure, including many hedge funds and active money managers who would fall under the proposed $3.5 billion threshold.
- 13F data is critical to IR teams when deciding how to allocate scarce C-suite time among buy-side investment managers who request a call (or a meeting) with the CEO, CFO, or other senior executives.
- This proposed rule would significantly inhibit issuer-investor engagement, especially by small and mid-cap companies that have a greater percentage of investors who would evade disclosure.
- This 13F change would expose more U.S. public companies to hedge fund activism, which is expected to surge after the pandemic subsides in 2021 or 2022.
- The SEC's proposal does not include any reforms suggested by NIRI and other corporate groups (such as reduce the 45-day reporting period, include short positions in 13F filings, and move to monthly disclosure) to improve transparency.
- The SEC did not hold a public meeting or a roundtable or otherwise seek the views of issuers or investors before proposing this rule.
- NIRI agrees with SEC Commissioner Allison Herren Lee that the agency <u>does not</u> have the authority under Section 13(f) of the Securities Exchange Act of 1934 to increase the threshold for Form 13F disclosure.
- This proposal also ignores the clear intent of Congress, as expressed in the Dodd-Frank Act, to require more disclosure from 13F filers.
- Hundreds of retail shareholders have submitted comments against the SEC's proposal; many of them use 13F data to inform their investing decisions.
- This 13F rule change would deter private companies from going public or prompt them to list overseas. The U.K., Germany, and Australia all provide far greater transparency to issuers that wish to learn the identity of their investors.

- The SEC's estimate of cost savings ($15,000 to 30,000 a year) for investment managers would be minimal for hedge funds and other asset managers who oversee more than $450 million in equities. Commissioner Lee has questioned this estimate and noted that past SEC studies have found that the annual cost of 13F compliance is less than $5,000 per filer. In any case, these cost savings do not justify the substantial loss of transparency for companies and other investors.

In addition to NIRI, who else opposes the SEC's proposal?

Commissioner Lee expressed strenuous opposition to this proposal and cited NIRI's arguments for reform. Both NYSE and Nasdaq oppose this proposal. Well-regarded corporate lawyers from Wachtell, Lipton, Rosen & Katz and Gibson Dunn & Crutcher have authored blog posts that question the SEC's rationale for this rulemaking. The U.S. Chamber of Commerce, which has asset management firms as members, and the National Association of Manufacturers, also plan to oppose this rulemaking. According to news reports, the New York City Comptroller, who is influential on corporate governance matters, opposes the SEC's proposal. The SEC already has received hundreds of comments from retail investors who object to the proposed increase in the 13F threshold.

With the SEC's 13F proposal coming of the blue, and clearly generating so much pushback, why do we think it was even proposed like this? What is the general consensus as to WHY that the SEC proposed this rule and the way in which the SEC diverged with normal process? Is it just lobbying by the hedge funds and the political influence they wield through donations?[1]

The origins of this proposal are unclear, as this rulemaking did not emerge through the normal regulatory channels at the SEC. There were no roundtables held on this topic, although NIRI has repeatedly asked the Commission to hold a roundtable so investors and issuers could share their views on equity ownership disclosure, 13D, and 13F. Neither the SEC's Investor Advisory Committee nor the Asset Management Advisory Committee discussed this proposal during an open meeting before it was proposed. It seems logical that hedge fund executives lobbied behind the scenes for this proposed rule, as hedge funds under the $3.5 billion threshold would be the primary beneficiaries from reducing transparency. About 60 percent of activist investors would evade disclosure under the SEC's proposal, according to Edelman.[2]

Many hedge funds are prolific political donors to both major parties, spending as much as $240 million on campaign donations and other political activity during the 2016 presidential election cycle. We know that the hedge fund industry aggressively lobbied the White House to kill the SEC's proposed proxy advisor rule but were not successful as the SEC approved a modified rule

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[1] Some of these questions were asked by attendees during NIRI's July 23 webinar on 13F. A replay of that webinar can be found here: https://www.niri.org/13fwebinar.

[2] See Jeremy Cohen and Jeff Zilka, Edelman, "SEC Proposed Rule Change Is A Step Backwards for Shareholder Democracy," July 30, 2020, available at: https://finance.yahoo.com/news/sec-proposed-rule-change-step-193708183.html

on proxy advisors in late July. This 13F rulemaking may be an attempt by the SEC to appease hedge funds that were upset with the proxy advisor rulemaking.

Does this rule have a real chance of passing? How often are rule proposals changed or otherwise withdrawn? In other words, what is the likelihood of success?

Most SEC rules that are proposed eventually pass in some modified form, although some recent rules have stalled after introduction, such as the universal proxy ballot rule that was proposed in late 2016. In 1997, the SEC proposed to raise the resubmission thresholds for shareholder proposals. That rule was abandoned amid intense opposition from governance activists. In 2010, the SEC attempted to reform the use of 12b-1 fees charged by the mutual fund industry. After strenuous objections from Wall Street, the proposal was dropped.

In other cases, the SEC has approved final rules that were later struck down by federal courts. Over the past 15 years, federal courts have struck down SEC rules relating to proxy access, resource extraction payment disclosure, and mutual fund director independence. Earlier this year, a federal appeals court blocked the SEC from implementing a transaction fee pilot program after NYSE and Nasdaq filed suit.

What is the counterpoint to this part of the SEC's argument: "Today's proposal would raise the reporting threshold to $3.5 billion, reflecting proportionally the same market value of U.S. equities that $100 million represented in 1975, the time of the statutory directive"?

Our response to this argument is that the SEC's approach is contrary to Congressional intent and would be inconsistent with the SEC's more measured adjustments to economic thresholds in other rules. The statutory language in Section 13(f) of the Securities Exchange Act <u>does not</u> authorize the SEC to increase the Form 13F filing threshold based on the overall size of the stock market. According to Commissioner Lee, the SEC has the authority to lower the threshold but not increase it. A 35-times increase in the 13F threshold also would be at odds with the SEC's past analysis of Form 13F filing burdens. In 2006, the SEC's Office of Economic Analysis studied the impact of potentially increasing the threshold from $100 million to $300 million to account for inflation (as measured by the consumer price index).

In other laws, such as the JOBS Act of 2012, Congress directed the SEC to use the consumer price index to adjust monetary thresholds every five years. Earlier this year, the SEC made comparably modest increases to the public float thresholds for companies that seek to reduce their compliance burdens by transitioning from accelerated filer status (from $50M to $60M) and from large accelerated status (from $500M up to $560M). Last November, the SEC proposed to increase the minimum ownership required for shareholder resolutions from $2,000 to $25,000, a 12.5-times increase, but the SEC proposed to mitigate the impact of that rule change by allowing investors who have held their shares for at least three years to continue to use the $2,000 threshold.

We also think that the overall value of the stock market is not an appropriate benchmark to use for Form 13F disclosure, as that value has been inflated in part by the extremely high valuations of a small group of mega-cap technology companies over the past decade.

If the threshold were raised to $450M, roughly how many filers would be exempted?

According to the SEC, 2,901 13F filers (57% of the current total) would be exempted from disclosure if the threshold were raised to $400M, while 2,188 investment managers would continue to make quarterly disclosures. Those 2,188 investment managers collectively manage 98.1% of the 13F equity assets now overseen by 13F filers. If the threshold was raised to $500M, then 3,185 filers would be exempted, while 1,904 institutions (that oversee 97.6% of current 13F assets) would continue filing. The SEC did not provide an estimate for a $450 million threshold.

If the SEC's proposed $3.5B threshold was adopted, then 4,539 filers (89%) would avoid disclosure, while just 550 large filers would continue to report their holdings. For more data on these thresholds, please see the chart on p. 17 of the SEC's proposed rule: https://www.sec.gov/rules/proposed/2020/34-89290.pdf.

NIRI does <u>not</u> support raising the threshold beyond $100 million unless the 13F rule was modernized by: 1) reducing the current 45-day filing period; 2) expanding disclosure to cover short positions and derivatives; and 3) moving to monthly reporting. In our view, exempting very small 13F filers from disclosure is only worth considering if companies were to receive more frequent, timelier, and comprehensive (including short and derivative positions) data from the remaining fund managers. NIRI also believes that the SEC should modernize its Schedule 13D rules by reducing the 10-day reporting period and updating disclosure to include derivatives.

Can you share a timeline by which such a proposal progresses -- so we can map it against the critical issues Congress is dealing now like economic stimulation, pandemic issues, and DHS forces in cities (etc.)?

Based on the pace of past rulemakings, it appears that the earliest that the SEC could vote to approve in this rule would be February or March 2021. However, it is possible that Chairman Jay Clayton could try to expedite this review process. We sincerely hope that an intense showing of opposition from issuers and retail investors will persuade the SEC to take more time and/or withdraw its proposal.

To approve a final rule, the SEC would need to convene an open meeting and a majority of the SEC's commissioners would have to vote to approve it. As a general practice, the SEC chair will not call an open meeting to vote on a final rule, unless the chair knows that he or she has enough votes to approve the rule.

In this case, the 13F proposal was not discussed during an open meeting, but it would appear that Clayton and the two Republican commissioners (Elad Roisman and Hester Peirce) all supported the proposing of this 13F rule.

A new Democratic commissioner, Carolyn Crenshaw, was confirmed by the U.S. Senate on August 6. We don't know what her views on 13F may be, but she previously worked as a counsel for Commissioner Robert Jackson Jr., who has called on the SEC to improve short-position disclosure.

It remains unclear that Clayton will have enough time to get this 13F rule finalized before he departs from the SEC. He has been nominated by President Trump to serve as the U.S. Attorney for the Southern District of New York, but Trump's firing of the previous U.S. Attorney was controversial and Clayton faces opposition from New York's two U.S. Senators.

Even if Clayton does not get confirmed as U.S. Attorney, we expect that he will leave the SEC by January 20, 2021, the start of a next presidential term. In recent history, most SEC chairs have departed at the end of a four-year presidential term, even when there has not been a change in the presidency. If Trump wins, it is unknown whether Clayton's successor would seek to finalize this 13F rulemaking. If Joe Biden wins the White House, he would get to nominate a new SEC chair. The new chair may be persuaded by Commissioner Lee's opposition to this proposed rule.

We doubt that Congress would have the bandwidth to pass any legislation this year that relates to ownership disclosure before lawmakers leave D.C. in early October to campaign for the November elections. Amid the Covid-19 pandemic and civic unrest, Congress has many contentious matters on its plate in 2020 beyond the annual fights over appropriations bills to keep the U.S. government running.

Nevertheless, we encourage companies and NIRI chapters to share their concerns with Congress. This outreach may persuade lawmakers to contact the SEC, which could prompt Clayton or his successor to reconsider the wisdom of this rulemaking.

What is the worst-case scenario where the comments letters do not work, and the SEC proceeds with this? When would we expect this new regulation to go into effect?

If the SEC votes to finalize changes to Form 13F disclosure, it would be up the Commission to specify the timing for when these changes would take effect. Given that the SEC is seeking to reduce burdens on 13F filers, rather than increase them, we expect that the effective date could be *as soon as 60 days* after than the SEC's final rule is published in the Federal Register.

However, the final rule could be delayed if the rulemaking is challenged in federal court by companies that would be negatively impacted. We believe that this rule, as presently written, may be vulnerable to a court challenge. We share Commissioner Lee's views that the SEC does not have the authority to disregard the plain language of Section 13(f) of the Exchange Act and use its exemptive authority to raise the threshold by 35 times.

Where is the NIRI's joint issuer letter on the NIRI website?

That letter can be found at:
https://www.niri.org/NIRI/media/NIRI/Advocacy/NIRI_13F_Issuer_Letter_SEC_1.docx

If your company or counseling firm wishes to join this letter, please email Ted Allen at tallen@niri.org by **August 19**. An email from a member of your company's IR team will suffice to indicate your company's consent to participate in the letter. The supporting companies will be listed in alphabetical order at the end of the letter; the names of corporate executives or IROs will not be included in the joint letter.

May IR counselors sign NIRI's joint letter?

Yes, IR counselors may sign NIRI's joint letter and will be listed separately at the end of the letter.

Will NIRI be providing template letters to send to both the SEC and Congress?

Yes, NIRI has prepared comment letter templates that companies and chapters can use for their letters to the SEC and members of Congress. Those letters can be found on NIRI's Advocacy Call to Action page.

What should you say if your general counsel or CFO voices concern that signing NIRI's joint letter (or submitting your own comment letter) will attract unwanted attention to your company at the SEC?

Every September when NIRI's Board of Directors meets with the SEC senior staff, the staff always tells us that they want to hear directly from issuers (through comment letters or phone calls with the staff) about the impact of the SEC's proposed rules or existing rules. Other capital markets participants, such as asset managers, hedge funds, public/labor pension funds, and retail investor advocates, are not shy about expressing their views on particular regulatory issues to the SEC. In addition, many of these investors are represented on two formal SEC advisory committees (the Investor Advisory Committee and the Asset Management Advisory Committee) that they use to submit policy recommendations to the SEC chair and commissioners. There is no equivalent advisory committee to channel the views of issuers, so public companies need to step up and express their concerns through the SEC's comment letter process or by requesting meetings with agency staff. These are the only means issuers presently have to make their views known to the SEC staff.

In this case, the SEC staffers who will review comment letters on 13F are employed by the Investment Management Division, which is separate from the SEC's Corporation Finance Division (which reviews corporate disclosures) and the Enforcement Division. We have never heard of a case where the SEC has been accused of retaliating against a company for expressing opposition to a proposed SEC rule.

What should you say if your C-suite indicates that they do not want to submit a comment letter because they would prefer to stand back and let their industry association represent their views to the SEC?

While NIRI works closely with other business and industry associations, such as the Chamber of Commerce, on issues of common interest, we need as many public companies as possible to express their views to the SEC on the negative consequences of this 13F rulemaking. Although industry association letters can provide an important overview of corporate concerns, the SEC staff has told us they want to see specific data from individual companies about how a proposed regulation would directly impact them. Letters submitted by the C-suite carry more "weight" than those from an industry association by virtue of their specificity.

Would you advise signing the NIRI letter if you are sending a company letter?

Yes, we hope that your company will sign the joint NIRI letter and send your own comment letter that details how the proposed rule will affect your 13F list. The SEC needs to see specific examples and that's where company letters will help out.

What points should a company make in its own comment letter?

For an issuer that opts to submit its own comment letter, it should include data on the number (or percentage) of the company's investors that would no longer have to provide quarterly disclosure if the Form 13F threshold was raised to $3.5 billion. The company should explain how it uses 13F data to prioritize investor requests for meetings or calls with the C-suite. The company also should discuss how a reduction in 13F reporting would hinder the IR team's efforts to identify and recruit prospective investors.

If the company been targeted by short sellers or activist hedge funds in the past, the company should mention that experience and point out that the SEC should seek to improve transparency (i.e., by reducing the outdated filing periods for 13F and 13D disclosures), rather than exempt 4,500 investment managers from disclosure.

If you need assistance with preparing a comment letter, please review NIRI's issuer comment letter template, or contact Ted Allen, NIRI's vice president for communications and member engagement.

In addition, Gladstone Place Partners has prepared a comment letter template for issuers.

When sending letters to the SEC, how should those letters be addressed?

It is best to use the SEC's online portal or email for submitting comment letters. (One can also send a hard copy, but those letters are processed at an external facility and there is a significant delay in those letters getting to the SEC.) The online portal can be found at:
https://www.sec.gov/cgi-bin/ruling-comments

The email address for comment letters is: rule-comments@sec.gov

Letters should be addressed to the attention of:

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

These comment letters should reference: **Reporting Threshold for Institutional Investment Managers, Release No. 34-89290; File No. S7-08-20**. If you send a letter via email, you should reference the Release and File numbers in the subject line of your message.

As a foreign issuing company located outside the United States, can we send a letter to SEC as well? If not, is there any other way we can help?

Absolutely! If you can show in your comment letter how this proposed rule negatively affects your company, that is more evidence and information the SEC will have that will show the problem with the proposed rule. We are in discussions with the U.K. IR Society, where ownership transparency is significantly greater than in the U.S., to submit a comment letter. Letters like that from outside the U.S., showing that this proposed rule is counter to transparency standards elsewhere, will help our overall effort.

When does the comment period end?

The 60-day public comment period expires **September 29.**

Is it best for a company letter to come from the CEO, the CFO, or the IRO?

That does not matter; it is up to your company. What is most important is that you provide data or specific details about this proposal would negatively impact your company's ability to engage with investors and prepare for potential activism.

Will letters submitted to the SEC during the 60-day comment period closes carry equal weight? Or, is there urgency to get them submitted sooner than later? Also, preferred timing of letters to Congress?

Yes, comment letters submitted before the 60-day deadline will carry equal weight. With regard to submitting them sooner or later, given that we would like comment letters to endorse NIRI's position (as well as that of the exchange on which your company is listed), that gives you time to put your letter together. The joint NIRI letter (signed by issuers and counselors) will not be submitted to the SEC until mid-August. The key is making certain the SEC receives your letter before the 60-day window closes on **September 29**.

With regard to letters to Congress, based on the points for those letters that we showed on the webinar, once you have all the necessary facts about your company, its holdings, and the potential impact of the proposed rule on your institutional holder list, we recommend that you send those letters out. As we pointed out on the webinar, the comment letters to the SEC are should oppose the 13F threshold increase and back our respective positions up with data. The letters to Congress are to alert senators and representatives that companies not only oppose this proposed rule, but we also question whether the SEC has the statutory authority to increase the threshold. Hopefully, these letters will get the attention of lawmakers and result in pressure on the SEC to change course on this rulemaking.

What else will NIRI be doing in addition to transmitting letters? Meeting with SEC? Meeting with congressional committees? Focused action with other organizations?

NIRI's Board and chapter advocacy ambassadors normally meet with the senior SEC staff every September. Given that the pandemic will preclude an in-person meeting this year, NIRI is scheduling a virtual meeting with the SEC staff in late September; 13F will be the primary focus of this year's meeting.

NIRI will also hold virtual fly-in meetings with lawmakers and their staffers in September. We also are collaborating with other organizations, such as the Society for Corporate Governance and the exchanges, to mobilize opposition to this proposal. In addition, we are sharing our concerns with other organizations, such as the U.S. Chamber of Commerce, the CFA Institute, the National Association of Manufacturers, the Biotechnology Innovation Organization, the Edison Electric Institute, and the Business Roundtable.

Companies are encouraged to reach out to their own specific industry groups and their networks of lobbyists to share their concerns on Capitol Hill.

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