



## **The Case for 13D Reform**

The National Investor Relations Institute (NIRI), whose members include 2,800 investor relations professionals who represent over 1,350 public companies and \$7 trillion in stock market capitalization, is pleased to support the bipartisan “Brokaw Act.”

The Brokaw Act, which is sponsored by Senator Tammy Baldwin of Wisconsin, seeks to modernize the Securities and Exchange Commission’s outdated Schedule 13D reporting rules, which are a relic of the Williams Act of 1968. Brokaw is the name of a village in Wisconsin that was harmed by a group of hedge funds that seized control of the Wausau Paper Company in 2011.

Under the archaic 13D rules, an activist investor doesn’t have to report until **10 days** after accumulating a 5% threshold. As a result, hedge funds can secretly accumulate large positions (often significantly more than 5%) at the expense of other investors and then ambush companies. These funds often pressure executives and directors to agree to plant closings, job cuts, reduced R&D spending, and other concessions that may not be in the long-term interests of shareholders and their employees.

This threat of ambush activism is a real deterrent to private companies that are considering going public. The number of U.S.-listed companies is about half of what it was 20 years ago; 13D reform is needed to reverse this trend and help encourage more IPOs.

The Securities and Exchange Commission has long recognized that its 13D reporting rules need to be updated, but the agency has failed to act. “We think it’s important to modernize our rules, and we are considering whether they should be changed in light of modern investment strategies and innovative financial products,” then-SEC Chair Mary Schapiro said in a speech in 2011.

13D reform is needed now because hedge fund activism has risen significantly over the past decade, and more proxy contests are expected as the pandemic recedes, which creates a greater urgency for companies to engage with their shareholders. In an April 2020 NIRI member survey, more than 82 percent of investor relations practitioners agreed that modernizing the 13D rules would help their company be better prepared to respond to an activist taking a significant position.

The Brokaw Act, which would cut the 13D reporting period to **four business days**, strikes a reasonable balance between improving transparency, while allowing activists enough time to report their positions. Major overseas markets, such as the United Kingdom (2 days), Australia (2 days), Hong Kong (3 days), and Germany (4 days), all have adopted shorter reporting deadlines than the 10-day period now in place in the United States.

This legislation also would expand 13D disclosures to include derivatives and other modern financial instruments that activists use to conceal their equity positions. The recent collapse of Archegos Capital Management, which used derivatives to amass significant secret positions in public companies, is further evidence of the need for the SEC to modernize its ownership transparency rules.<sup>1</sup>

The Brokaw Act 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. With more timely notice (under a four-day reporting regime), companies will be able to respond more effectively to activists' demands and more thoughtfully consider the potential impact on long-term investors, employees, and other stakeholders.

To be clear, the Brokaw Act would not chill shareholder activism, as hedge funds will continue to take positions in underperforming companies. This legislation would simply level the playing field between activists and the companies they target, while also ensuring that other investors have more timely information about activist campaigns and make more informed decisions about whether to sell or hold their shares.

The Brokaw Act would help give companies, their executives, and directors more breathing room to engage with their institutional investors and resist pressure by activists to take actions to temporarily boost the company's share price but not promote long-term value creation. During the SEC's July 2019 roundtable on short-termism, panelists discussed how updating the 13D rules could help foster long-termism. While there is wide public support across the political spectrum for promoting long-termism and greater capital formation, the current lack of transparency around activists' positions undercuts these worthy objectives.

NIRI encourages lawmakers to support the Brokaw Act, which will give corporate executives and their boards greater flexibility to manage their companies for the long-term benefit of investors, employees, and other stakeholders.

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<sup>1</sup> See, e.g., *The Wall Street Journal*, "Executives Wonder if Their Stock Selloffs Were Linked to Archegos," April 21, 2021, available at: [https://www.wsj.com/articles/executives-wonder-if-their-stock-selloffs-were-linked-to-archegos-11618997403?mod=hp\\_lead\\_pos4](https://www.wsj.com/articles/executives-wonder-if-their-stock-selloffs-were-linked-to-archegos-11618997403?mod=hp_lead_pos4)

## **Summary of the “Brokaw Act”**

**Shortens the Schedule 13D Reporting Window.** Current Securities and Exchange Commission rules require beneficial owners (i.e., street name shareholders) of more than 5% of a registered class of equity security to disclose such ownership interest by filing a beneficial ownership report on Schedule 13D.

A Schedule 13D is required to be filed with the SEC within 10 days after the beneficial owner crosses the 5% threshold. This 10-day window has been the subject of criticism for allowing too much time for activist investors to accumulate large positions in U.S. public companies before being required to disclose anything publicly. To address this problem, the Brokaw Act directs the SEC to shorten this disclosure window to **four business days**, which is the current deadline for companies to file an 8-K report to disclose material news to investors.

**Expands the Definition of Beneficial Ownership.** Under current SEC rules, investors are considered to be a beneficial owner of a security if they have voting and/or investment power over such security. The definition of beneficial ownership does not include anyone with a purely economic interest in the security.

To address this problem, the Brokaw Act would expand the definition of beneficial ownership to include any person who has a “pecuniary or indirect pecuniary interest in such security.” This would require investors to include in their beneficial ownership calculation certain derivative instruments, such as cash-settled equity swaps, that do not provide an investor with any voting or investment power over the underlying equity security, but do provide the investor with economic exposure to the underlying equity security.

**Expands the Definition of “Person” for Reporting Purposes.** The Brokaw Act would restrict the activities of certain hedge funds by defining “person” for purposes of beneficial ownership reporting to include hedge funds as well as the coordination of certain activities by two or more persons. Specifically, the Brokaw Act defines “person” to include:

2 or more persons acting as a partnership, limited partnership, syndicate, or other group, or otherwise coordinating the actions of the persons, for the purpose of (i) acquiring, holding, or disposing of securities of an issuer; (ii) seeking to control or influence the board, management, or policies of an issuer; or (iii) evading, or assisting others in evading, designation as a ‘person’ ....

The definition of “person” in the bill incorporates the definition of a hedge fund contained in the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)). The definition also includes a group of hedge funds or persons working together to evade the disclosure requirements in Section 13 of the Securities Exchange Act of 1934.

**Prohibition of Insider Trading.** This legislation would prohibit trading based on knowledge of a pending 13D filing or tipping off others about a pending filing.

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