NATIONAL INVESTOR RELATIONS INSTITUTE

The Case for 13F Reform

The National Investor Relations Institute (NIRI), whose members include 2,800 investor relations professionals who represent more than 1,350 public companies and $7 trillion in stock market capitalization, is pleased to support the "Capital Markets Engagement and Transparency Act of 2021," which would modernize the Form 13F ownership disclosure rules.

Since the passage of the Dodd-Frank Act of 2010, U.S. companies have faced a surge in requests from investors for engagement on corporate governance, executive compensation, long-term strategy, and other important issues. However, the outdated 13F reporting rules have been a significant impediment to greater corporate-investor engagement, because companies don't have timely information on their investors' long and short positions when trying to allocate scarce CEO or director time among competing investor requests for meetings or calls.

Public companies now operate in an environment of great transparency governed by federal regulations, as well as stock exchange rules, but the 13F disclosure rules that apply to institutional investors have not been updated since the 1970s. Current Securities and Exchange Commission rules generally require institutional investment managers to disclose their share ownership positions on a quarterly basis, with an exception made for those that petition the SEC to delay these disclosures on the basis of confidentiality.

Neither investors nor public companies are well served by the current quarterly reporting frequency. Under the current 13F regime, much of the ownership information in Form 13F filings is out-of-date by the time that investment managers make those quarterly filings. For some public companies, a majority of their shares may change hands during the 135-day period that includes the last calendar quarter and the 45-day reporting window.

When receiving requests from an investment manager who purports to be significant shareholder, a company must rely on outdated 13F filing data or take that representation on faith, only to learn later that the investor may have overstated its position. In a 2018 NIRI survey, 46 percent of respondents reported that fund managers had misrepresented their positions to gain a meeting with C-suite; while another 40 percent suspect this has happened.

The outdated 13F rules (along with archaic 13D rules) also make it more difficult for companies to learn of activist hedge funds that may be secretly amassing a large position in preparation for a proxy contest. For instance, a hedge fund could buy up to a 4.9 percent stake in a public company on January 2, and the company would not learn of this major acquisition until May 15. In an April 2020 NIRI survey, 94 percent of investor relations professionals agreed that modernized 13F disclosure rules would help them be better prepared for activism and respond more effectively to investor requests for engagement with C-suite executives.

The lack of ownership transparency is of particular concern to smaller issuers that cannot afford to pay for stock surveillance firms that analyze trading patterns and try to determine which investors are buying or selling shares. Many small- and mid-cap companies also use 13F data to guide their efforts to attract new investors.

In 2013, NIRI, the Society for Corporate Governance, and the NYSE Group petitioned the SEC to shorten the 13F reporting deadline from 45 days to two business days after the end of the calendar quarter. In October 2015, NYSE and NIRI filed a second rulemaking petition that asked the SEC to implement Section 929X of the Dodd-Frank Act, which directs the agency to promulgate rules obligating investment managers to publicly report *short position* activity. Nasdaq filed a similar petition in December 2015. The SEC has not acted on any of these petitions to improve market transparency.

Instead, the SEC proposed in July 2020 to significantly *reduce* 13F transparency by raising the $100 million reporting threshold by *35 times* to $3.5 billion. Under the SEC's ill-advised rulemaking proposal, 4,500 fund managers overseeing $2.3 trillion in assets (89 percent of current 13F filers) would have been exempted from disclosure. According to an IHS Markit analysis of the Russell 3000, an average company would have lost visibility into 55 percent of its 13F filers and 69 percent of the hedge funds on its 13F list.

The SEC's proposal prompted widespread concern from public companies, institutional investors, and retail shareholders, who all objected to the agency's attempt to reduce market transparency. In their comment letters, many companies explained how they use 13F data to identify new investors, prioritize governance engagement efforts, and monitor hedge fund activists. In their comments, investors explained that they use 13F data to find prospective companies to invest in and to assess portfolio risks. Overall, the SEC received more than 2,260 comments on 13F; 99 percent opposed the agency's proposal.

In the face of such unified opposition, then-Chair Jay Clayton told the Senate Banking Committee in November 2020 that the SEC would not seek to finalize the 13F rulemaking before he left office. While it appears unlikely that Chair Gary Gensler would seek to revive this ill-advised proposal, a future SEC chair could certainly do so. Before that happens, Congress should take action to protect market transparency and safeguard the interests of retail investors, institutional investors, and companies.

During the outcry over the 13F rulemaking, many companies and investors argued that the SEC should have sought to *expand* ownership transparency, rather than reduce it. Many companies and investors have called for reducing the outdated 45-day reporting period, and expanding disclosure to include short and derivative positions, while maintaining the $100 million disclosure threshold.

The March 2021 collapse of Archegos Capital Management is further evidence of the need for the SEC to update its 13F ownership disclosure rules to include cash-settled equity swaps and other derivative transactions. Archegos used total return swaps to take significant positions in public companies that were not disclosed to those companies, the SEC, or other investors. When Archegos imploded and was forced to unwind these positions quickly, a number of companies, including ViacomCBS and Discovery Inc., experienced steep declines in their share prices. NIRI shares the concerns of former Delaware Chief Justice Leo Strine Jr., Americans for Financial Reform,[1] and retail investors who have urged the SEC to improve transparency around derivative transactions.

“The U.S. has gone from a leader in timely disclosure to a laggard internationally,” Strine, who is now a corporate attorney at Wachtell, Lipton, Rosen & Katz, told *The Wall Street Journal*. “Even more embarrassingly, the U.S. fails to cover derivatives and other relevant instruments that affect target companies. We have a 1975-era regulatory regime governing a 21st century economy, and it’s high time it was fixed.”[2]

Accordingly, NIRI asks lawmakers to support a draft bill, the “Capital Markets Engagement and Transparency Act of 2021.” This bill would shorten the 13F reporting period to four business days and expand disclosure to include short and derivative positions. The proposed four-day reporting period would modernize 13F reporting and bring it closer to the disclosure periods in other key market transparency rules, such as the Form 8-K rules for companies to disclose material developments to investors (four business days) and the Form 4 disclosures for executive stock trades (two business days). This draft bill also calls for the SEC to study how it handles requests for confidential treatment from investment managers. The SEC currently allows investment managers to request confidential treatment to keep positions secret for multiple quarters, which undercuts the transparency objectives of the 13F reporting rules.

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[1] *See* Americans for Financial Reform, Letter to Acting Chair Allison Lee, March 31, 2021, available at: https://ourfinancialsecurity.org/wp-content/uploads/2021/03/Letter-to-SEC_-Needed-Hedge-Fund-Reforms-in-the-wake-of-Archegos.pdf.

[2] *See 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.