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ADVISORS

Important Proposed SEC Update to 13F Filing Rules

Lincoln Churchill Advisors (LCA) views proposed changes as negative for public companies due to significantly reduced transparency into ownership

On Friday, July 10th the Securities and Exchange Commission (SEC) announced a proposed rule change regarding Form 13F filing requirements. The proposal significantly increases the 13F reporting threshold for institutional investment managers – from $100 million in assets under management (AuM) to $3.5 billion – effectively exempting an additional 4,500 investment managers from filing quarterly 13F disclosures.

The Commission's rationale hinges on the fact that the filing threshold has remained at $100 million since form 13F was adopted in 1978. During the same period, the overall value of U.S. publicly traded equities grew from $1.1 trillion to $35.6 trillion. Therefore, the SEC argues, "The relative significance of managing $100 million has declined considerably."

SEC Chairman Jay Clayton explained:
"Today's proposal will update, for the first time in over 40 years, the 13F reporting threshold to a level that furthers the statutory goal of enabling the SEC to monitor holdings of larger investment managers while reducing unnecessary burdens on smaller managers."

In response to the proposal, SEC Commissioner Allison Herren Lee published a dissenting statement, arguing that the threshold change will sacrifice transparency for purported cost savings for small investment managers. In her statement, Lee voices concern that the SEC's proposal has overstated such cost savings, which ***"do not justify the loss of visibility into portfolios controlling $2.3 trillion in assets."***

Lee asserts:
"This proposal joins a long list of recent actions that decrease transparency and reduce both the Commission's and the public's access to information about our markets."

At LCA, we agree with Lee's argument given just 10% of the largest investment managers would be required to file a 13F under the proposed rule.

Other implications:

- Increased difficulty vetting smaller investment managers, especially when it comes to verifying whether a firm actually invests as they claim to.
- While there are no proposals to change the 5% ownership threshold for filing a 13G or 13D, the rule change would make it significantly easier for small and medium asset managers to

build significant positions over a long period of time without a company's knowledge. As a result, we believe the likelihood for investor activism increases.

According to Laurel FitzPatrick, Partner at hedge fund Ropes & Gray, "For a manager under $3.5 billion, it could provide them more time to build positions so they'll be less visible…But it also might make it more difficult for them to ascertain other, smaller investors that might be supportive of changes they'd like to make."

Given that there will be a 60-day comment period following publication of the proposal, it is still quite early to ascertain the full impact of the change.

At Lincoln Churchill, we believe the proposed increase to the Form 13F filing threshold would have widespread, negative implications for public companies as a whole. The lack of transparency into which investors own stock will embolden many short-term and activist investors and, potentially, lead to more stocks being manipulated, greater shareholder activism and a larger number of unsolicited takeover bids. Given the technological advancements of the past 40 years, reporting should be easier and less expensive than ever before, and we believe the SEC should reconsider its proposal and focus on greater transparency, not less. Should the proposal go through, it will be more critical than ever for companies to engage with current and prospective shareholders to better understand who owns their stock and what is driving their investment decisions.