

SEC PROPOSES TO INCREASE FORM 13F REPORTING THRESHOLD

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July 2020

Proposed Changes

On July 10, 2020, the SEC proposed amendments to Form 13F for institutional investment managers. If adopted, the proposed change would raise the Form 13F reporting threshold for investment managers – from the current \$100 million to \$3.5 billion – and as stated in the SEC’s press release, would thereby provide relief for smaller managers who are currently subject to Form 13F reporting. Other proposed changes include:

- Directing the staff to review the Form 13F reporting threshold every five years and recommend an appropriate adjustment, if any, to the Commission
- Eliminating the ability of managers to omit certain small positions, thereby increasing the overall holdings information required from larger managers
- Requiring managers to report additional numerical identifiers to enhance the usability of the information provided on the form, and amend the instructions relating to requests for confidential treatment of Form 13F information

Opposition to the Proposed Change

The proposed reporting threshold change from \$100 million to \$3.5 billion is a significant increase, but as the announcement pointed out, the threshold level has not been updated since the Commission adopted the form over 40 years ago. In the time since the form was adopted, the overall value of U.S. public corporate equities has grown over 30 times (from \$1.1 trillion to \$35.6 trillion).

The Commission has received recommendations to revisit the Form 13F reporting thresholds over the years, but has refrained from adopting them for various reasons. Like its predecessors, the newest proposal faces opposition. Commissioner Allison Lee issued a

dissenting statement saying the proposal decreases transparency and that it lacks sufficient analysis. The National Investor Relations Institute (NIRI) tweeted its disagreement and said it “shared Commissioner’s Lee’s concerns about the ill-advised proposal.” NIRI also published a position paper on 13F reforms last fall that advocates for shortening the 13F reporting deadline.

Alliance Advisors’ Analysis of the Shareholder Visibility

To gauge the magnitude that the proposed change will have on the shareholder base, Alliance Advisors quantitatively analyzed the level of visibility of the top five and bottom five market capitalization companies in the S&P 500 Index, S&P 400 Mid-Cap Index, and the S&P 600 Small Cap Index based on 3/31/20 schedule 13F reporting data.

The data presented in the following three tables represent a limited sample and there will be outliers for some companies based on the construction of their shareholder base.

Top Five / Bottom Five Market Capitalizations of the S&P 500

See Table 1. Our analysis revealed that the rule change will have a minimal impact on large-cap companies because it takes a large investment to accumulate a sizable position in large-cap companies. The top five S&P 500 companies by market capitalization would experience an average decline of only 4.10% in visibility to 65.42% shares outstanding versus 69.52% of the shares outstanding under the current system. However, the number of holders required to submit schedule 13F would plunge by 85% to 579 from 3,860.

While the average shareholder visibility among the bottom five market capitalization companies in this segment declined by slightly more than two percentage points (-6.11% vs. -4.10%) than its top five

counterparts, the overall impact likewise was non-material.

Top Five / Bottom Five Market Capitalizations of the S&P 400 Mid-Cap Index

See Table 2. While the level of visibility among mid-cap companies would suffer by an average of 6.38%, which represented an increase of 1.27% compared to the average decline in visibility of the large-cap companies, the overall impact was minor. The bottom rung companies in the S&P 400 Mid-Cap Index averaged a decline of 6.87% compared to a decrease of 5.88% among the top five.

Top Five / Bottom Five Market Capitalizations of the S&P 600 Small-Cap Index

See Table 3. Without question, the rule change will have the largest impact on the shareholder visibility among the small cap companies. In part, the relatively thinly traded nature of small caps serves as a deterrent of deep-pocketed institutions that worry about the adverse impact on a stock's price will have if they try to build/unload a large block of stock. In addition, institutions with limited capital can more easily amass a meaningful position in small-caps. Thus, smaller institutions tend to dominate the shareholder bases of these companies.

Interestingly, there was a material difference of 13.51% (-6.52% versus -20.03%) in the visibility between the top five small cap companies and the bottom five of the S&P 600 Small Cap Index. Overall, the group exhibited an average decline of 13.28% in visibility.

The “Invisible” Activist Investor

While the level of ownership visibility will decrease for all corporations should the reporting threshold be raised to \$3.5 billion in equities under management from its current \$100 million requirement, the most alarming unintended consequence will be the “disappearance” of the activist investor.

CapitalIQ has flagged 322 institutions as activists, though only 23, or 7.14%, of those have equities under management exceeding the \$3.5 billion threshold. Consequently, the ownership positions of well-known

activist investors such as Ancora Advisors, Carlson Capital, Davidson Kempner Capital Management, JANA Partners, and Karpus Management, among others would go undetected unless their position exceeds 5% of the total shares outstanding that would trigger the submission of the Schedule 13D.

While reliance on public ownership filings represents a vital piece of information utilized by issuers and market surveillance firms, the proposed change would not disturb analysis of trade settlement data. This information would continue to provide companies with a mechanism for forewarning of any “creeping accumulations” that may be underway even if the proposed amendment was adopted. Hence, given the possibility of diminished public ownership data, the monitoring the share flow among custodians will become even more important as the first line of activist defense for Corporate America.

Hindrance of Institutional Outreach:

Companies rely on ownership information to effectively communicate with their stakeholders. As we have proven, the increased reporting threshold would result in a material decrease in the number of institutions required to publicly disclose their positions. Consequently, issuer/investor engagement would be adversely impacted. This is yet another unintended consequence of the rule, and one that issuers and institutional investors would lament because it would inhibit issuers' ability to speak with a larger population of its ownership about their concerns or thoughts on company performance.

Table 1: Top Five / Bottom Five Market Capitalizations of the S&P 500

Symbol	Market Cap (\$MM)	> \$100M in Equities Under Mgmt.			> \$3.5 Billion in Equities Under Mgmt.			Differential		
		# of Holders	Total # of Shares Owned	% O/S *	# of Holders	Total # of Shares Owned	% O/S *	Holdings	Shares	% Chg in O/S
Top Five S&P 500 Companies by Market Capitalization										
AAPL	1,686,446	4,093	2,521,336,752	58.17%	556	2,366,788,731	54.61%	(3,537)	(154,548,021)	-3.57%
MSFT	1,603,159	4,467	5,521,947,457	72.82%	637	5,222,260,915	68.86%	(3,830)	(299,686,542)	-3.95%
AMZN	1,546,161	3,953	330,691,155	66.30%	590	314,699,731	63.09%	(3,363)	(15,991,424)	-3.21%
FB	683,950	3,273	1,917,734,511	79.75%	586	1,807,884,411	75.19%	(2,687)	(109,850,100)	-4.57%
JNJ	395,216	3,515	1,859,531,901	70.58%	525	1,721,970,568	65.36%	(2,990)	(137,561,333)	-5.22%
Averages		3,860		69.52%	579		65.42%	(3,281)		-4.10%
Bottom Five S&P 500 Companies by Market Capitalization										
ADS	2,028	465	44,039,305	92.47%	248	38,713,655	81.28%	(217)	(5,325,650)	-11.18%
JWN	2,377	574	113,432,634	72.23%	276	103,546,252	65.94%	(298)	(9,886,382)	-6.30%
HRB	2,764	528	192,896,004	100.22%	272	184,538,301	95.88%	(256)	(8,357,703)	-4.34%
UAA	4,505	630	318,755,671	70.20%	281	303,735,875	66.89%	(349)	(15,019,796)	-3.31%
NWSA	7,564	486	466,713,692	79.27%	269	434,771,657	73.85%	(217)	(31,942,035)	-5.43%
Averages		537		82.88%	269		76.77%	(267)		-6.11%
Averages of the Top Five/Bottom Five S&P 500 Companies by Market Capitalization										
Averages		2,198		76.20%	424		71.09%	(1,774)		-5.11%

* O/S exceeds 100% due to double counting of shares that are out on loan

Table 2: Top Five / Bottom Five Market Capitalizations of the S&P 400 Mid-Cap Index

Symbol	Market Cap (\$MM)	> \$100M in Equities Under Mgmt.			> \$3.5 Billion in Equities Under Mgmt.			Differential		
		# of Holders	Total # of Shares Owned	% O/S *	# of Holders	Total # of Shares Owned	% O/S *	Holdings	Shares	% Chg in O/S
Top Five S&P 400 Mid-Cap Companies by Market Capitalization										
TER	14,835	655	163,213,190	98.46%	322	157,083,738	94.76%	(333)	(6,129,452)	-3.70%
TYL	14,627	588	37,674,442	94.75%	292	33,973,142	85.44%	(296)	(3,701,300)	-9.31%
CTLT	13,842	400	160,297,396	103.49%	224	151,492,241	97.80%	(176)	(8,805,155)	-5.68%
FDS	13,469	624	36,315,407	95.58%	282	34,257,301	90.17%	(342)	(2,058,106)	-5.42%
MASI	13,005	510	47,047,315	86.94%	258	44,188,369	81.66%	(252)	(2,858,946)	-5.28%
Averages		555		95.84%	276		89.97%	(280)		-5.88%
Bottom Five S&P 400 Mid-Cap Companies by Market Capitalization										
NBR	276	228	5,861,082	80.29%	132	5,332,776	73.05%	(96)	(528,306)	-7.24%
DDS	572	186	11,298,667	58.79%	125	10,321,292	53.70%	(61)	(977,375)	-5.09%
MDP	773	259	42,397,072	105.19%	149	38,364,960	95.19%	(110)	(4,032,112)	-10.00%
PTEN	683	305	210,428,167	112.83%	181	199,563,435	107.00%	(124)	(10,864,732)	-5.83%
DLX	893	281	38,795,810	92.74%	168	36,193,311	86.52%	(113)	(2,602,499)	-6.22%
Averages		252		89.97%	151		83.09%	(101)		-6.87%
Averages of the Top Five/Bottom Five S&P 400 Mid-Cap Companies by Market Capitalization										
Averages		404		92.91%	213		86.53%	(191)		-6.38%

* O/S exceeds 100% due to double counting of shares that are out on loan

Table 3: Top Five / Bottom Five Market Capitalizations of the S&P 600 Small-Cap Index

Symbol	Market Cap (\$MM)	> \$100M in Equities Under Mgmt.			> \$3.5 Billion in Equities Under Mgmt.			Differential		
		# of Holders	Total # of Shares Owned	% O/S *	# of Holders	Total # of Shares Owned	% O/S *	Holdings	Shares	% Chg in O/S
Top Five S&P 600 Small-Cap Companies by Market Capitalization										
EBS	4,927	335	46,161,388	88.05%	195	42,001,311	80.11%	(140)	(4,160,077)	-7.93%
RUN	4,855	272	114,829,278	95.43%	150	105,109,945	87.35%	(122)	(9,719,333)	-8.08%
EXPO	4,149	336	47,205,414	91.58%	189	44,610,799	86.55%	(147)	(2,594,615)	-5.03%
NEOG	3,965	316	50,310,980	95.09%	176	47,982,683	90.69%	(140)	(2,328,297)	-4.40%
WING	4,052	302	34,494,993	116.60%	182	32,373,703	109.43%	(120)	(2,121,290)	-7.17%
Averages		312		97.35%	178		90.83%	(134)		-6.52%
Bottom Five S&P 600 Small-Cap Companies by Market Capitalization										
TLRD	34	154	25,372,868	52.24%	90	18,569,183	38.23%	(64)	(6,803,685)	-14.01%
CBL	35	174	92,511,352	48.19%	109	66,564,138	34.67%	(65)	(25,947,214)	-13.52%
NE	71	186	169,538,028	64.90%	107	101,824,758	38.98%	(79)	(67,713,270)	-25.92%
REI	79	126	41,841,282	61.55%	93	34,190,667	50.30%	(33)	(7,650,615)	-11.25%
EXPR	82	142	70,837,738	109.90%	99	47,972,591	74.42%	(43)	(22,865,147)	-35.47%
Averages		156		67.35%	100		47.32%	(57)		-20.03%
Averages of the Top Five/Bottom Five S&P 600 Small-Cap Companies by Market Capitalization										
Averages		234		82.35%	139		69.07%	(95)		-13.28%

% O/S exceeds 100% due to double counting of shares that are out on loan