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Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street NE, Washington, DC 20549–1090

August 28, 2020

Re: S7–08–20, Reporting Threshold for Institutional Investment Managers

Dear Ms. Countryman,

We appreciate the opportunity to comment on the SEC's proposal to amend Form 13F and raise the reporting threshold for institutional investment managers from $100 million to $3.5 billion. We are a group of finance professors at the MIT Sloan School of Management. Collectively, we have published research and advised policymakers on a broad range of issues including market structure, corporate finance, and asset management.

In the press release, Chairman Clayton stated that the goal of the SEC's proposed rule is to "[…] 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 the proposal, the Commission further spells out the rationale for adopting the 13F disclosure program in the first place:

> "The section 13(f) disclosure program had three primary goals. First, to create a central repository of historical and current data about the investment activities of institutional investment managers. Second, to improve the body of factual data available regarding the holdings of institutional investment managers and thus facilitate consideration of the influence and impact of institutional investment managers on the securities markets and the public policy implications of that influence. Third, to increase investor confidence in the integrity of the U.S. securities markets."

We believe that the substantial increase of the reporting threshold of institutional investment managers is not warranted because (i) the regulatory burden of quarterly reporting is small in the digital age but (ii) the lost transparency associated with the increase in threshold is very costly.

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Unclear benefit of reduced regulatory burden

We appreciate the SEC's conscious and continued effort in streamlining and simplifying regulation to the benefit of smaller institutional investors. That said, the logic of increasing the regulatory reporting threshold in tandem with the equity market valuation over the last four decades misses the important fact that, thanks to the digital revolution, the direct costs of electronic data processing, storage, and transmission have fallen by several orders of magnitude over the same period. Because asset managers generate and submit similar information for their own investors anyway, it is not clear that quarterly filing of form 13F incurs an incremental cost, even for the small asset managers.

Moreover, the current disclosures in form 13F are already quite limited in scope and frequency. For example, it does not ask investment managers to disclose short positions in equities, positions in most fixed-income securities, or positions in derivatives. Quarterly filing and the 45-day delay already build in a safety valve against leaking commercially valuable proprietary strategies. If investment managers wish to further reduce information leakage, the current SEC rules allow them to request permission from the SEC to further delay their disclosures and achieve de facto delays while the SEC's decision is pending. Academic evidence has shown that some investment managers, in particular hedge funds, actively take this approach and that their "hidden portfolios" earn excess returns (see Agarwal, Jiang, Tang, and Yang 2013; Aragon, Hertzel, and Shi 2013).[1] In other words, investment managers are already actively managing and mitigating the risk of information leakage and "front running" (if any).

Finally, the regulatory and compliance cost of 13F reporting seems much smaller compared to some other initiatives of the SEC. For example, the SEC's recent consolidated audit trail (CAT, 2016) seems much more burdensome for market participants because all events must be recorded (e.g. canceling an order). The compliance cost for form 13F seems trivial compared to that for CAT.

Large Cost of Reduced Transparency

On the other hand, the substantial increase in the 13F reporting threshold incurs large and tangible costs. A major cost is the lost market transparency for many investment managers that are important in dimensions other than size. For example, proprietary trading firms are highly active players in quantitative trading strategies and high-frequency liquidity provision, but they need not be large under conventional measures. For instance, as of Q2

[1] See Agarwal, Jiang, Tang, and Yang, 2013, "Uncovering hedge fund skill from the portfolio holdings they hide." Journal of Finance, 68(2), 739-783; Aragon, Hertzel, and Shi, 2013, "Why do hedge funds avoid disclosure? Evidence from confidential 13F filings." Journal of Financial and Quantitative Analysis, 48(5), 1499-1518.

2020, Virtu Financial and Tower Research reported asset positions of $865,348,000 and $2,436,580,000, respectively.[2] Should the threshold be raised to $3.5 billion, both firms would no longer be required to file form 13F. This example is not meant to single out individual firms or proprietary trading firms in general, but illustrate the risk of losing track of some major market participants.

A related case in mind is the October 2014 Flash Rally event in U.S. Treasury market, when the yield on the 10-year Treasury note experienced a range of 37 bps. Only after that event did U.S. regulators realize the jarring data gap in the world's most liquid market; even the official sector did not have the Treasury market data readily at hand to analyze the event of the day. In the subsequent joint staff report, five regulatory agencies, including the U.S. Treasury and the SEC, find that the growth of proprietary trading firms has fundamentally changed the landscape of U.S. Treasury market. The start of TRACE data collection of Treasury trades implemented by FINRA can be largely read as a response, if not a remedy, to the Flash Rally event. This episode highlights the risks, including financial stability risks, associated with gaps in data collection.

Missing data means missing evidence and insights. For decades, academic research has used form 13F information to shed light on a host of questions related to investment management. A Google Scholar search of "SEC 13F" yields over 20,000 research publications and working papers. For example, using 13F data, Brunnermeier and Nagel (2004)[3] and Ben-David, Franzoni, and Moussawi (2012)[4] examine the behavior of hedge funds in the technology bubble and the financial crisis of 2007-09, respectively. Brav, Jiang, and Kim (2010)[5] survey the literature on hedge fund activism, which relies heavily on 13F data. Schmidt and Fahlenbrach (2017)[6] use 13F data to study how ownership by passive investors affects corporate governance. There are many other examples.

Summary

In conclusion, we believe that the proposed rule reduces compliance cost by a very narrow margin at best, but it significantly reduces the transparency of U.S. capital markets. Hence, the proposed rule goes against the very purpose of adopting 13F in the first place. We recommend the SEC not to proceed with it.

[2] See https://fintel.io/i13fs/virtu-financial-llc and https://fintel.io/i13fs/tower-research-capital-llc-trc-.

[3] Brunnermeier and Nagel, 2004, "Hedge Funds and the Technology Bubble." Journal of Finance, 59, 2013-2040.

[4] Ben-David, Franzoni, and Moussawi, 2012, "Hedge Fund Stock Trading in the Financial Crisis of 2007–2009." Review of Financial Studies, 25, 1-54.

[5] Brav, Jiang, and Kim, 2010, "Hedge Fund Activism: A Review." Foundations and Trends in Finance, 4, 1-66.

[6] Schmidt and Fahlenbrach, 2017, "Do exogeneous changes in passive institutional ownership affect corporate governance and firm value?", Journal of Financial Economics, 124, 285-306.

Sincerely,

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