



U.S. Securities and Exchange Commission  
Office of Inspector General  
Office of Audits

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# Review of the SEC's Section 13(f) Reporting Requirements



September 27, 2010  
Report No. 480



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**MEMORANDUM**

September 27, 2010

**To:** Mary Schapiro, Chairman  
Andrew J. Donohue, Director, Division of Investment Management  
Henry Hu, Director, Division of Risk, Strategy, and Financial  
Innovation  
Sharon Sheehan, Associate Executive Director, Office of  
Administrative Services  
Jeffery Heslop, Chief Operating Officer, Office of the Chief  
Operating Officer  
Barry D. Walters, Chief FOIA/PA Officer, Office of FOIA and  
Records Management Services  
David Becker, General Counsel, Office of the General Counsel  
Ethiopsis Tafara, Director, Office of International Affairs

**From:** H. David Kotz, Inspector General, Office of Inspector General *HDK*

**Subject:** *Review of the SEC's Section 13(f) Reporting Requirements, Report  
No. 480*

This memorandum transmits the U.S. Securities and Exchange Commission Office of Inspector General's (OIG) final report detailing the results of our review of Section 13(f) reporting requirements. The review was conducted by the OIG as part of our continuous efforts to assess management of the Commission's programs and operations and was based on our audit plan.

This report contains 12 recommendations that were developed to strengthen the SEC's oversight of Section 13(f) reporting. The Chairman's Office and all Office and Division Directors fully concurred with the recommendations pertaining to its Office or Division. The Office of Information Technology, Office of the General Counsel, Office of International Affairs, and the Office of FOIA and Records Management Services did not provide OIG with written comments. The written responses OIG received to the draft report are included in its entirety in Appendix V.

Within the next 45 days, please provide the OIG with a written corrective action plan that is designed to address the agreed-upon recommendations. The corrective action plan should include information such as the responsible official/point of contact, time frames for completing the required actions, and milestones identifying how you will address the recommendations cited in this report.

Should you have any questions regarding this report, please do not hesitate to contact me. We appreciate the courtesy and cooperation that was extended to our auditor.

Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman  
Diego Ruiz, Executive Director, Office of the Executive Director  
Barry D. Miller, Associate Director, Office of Legal and Disclosure,  
Division of Investment Management

# Review of the SEC's Section 13(f) Reporting Requirements

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## Executive Summary

**Background.** In 1975, Congress enacted Section 13(f) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78m(f), to increase the public availability of information regarding the securities holdings of institutional investors. According to the legislative history for Section 13(f), Congress intended to create in the Securities and Exchange Commission (SEC or the Commission) a centralized repository of historical and current data regarding the activities of institutional investment managers in order to improve the body of publicly available factual data and thereby increase investor confidence in the integrity of the U.S. securities markets. This legislative history also reflects that Congress anticipated that government agencies, including the SEC, would be expected to make extensive use of the institutional disclosure data in fulfilling their responsibilities to protect the public interest within a consistent and coordinated regulatory framework.

Section 13(f) and the Commission's implementing regulation require institutional investment managers that exercise investment discretion with respect to accounts holding certain equity securities having an aggregate fair market value of \$100 million or more on the last trading day in a calendar year to file quarterly reports of their holdings with the SEC on Form 13F electronically through the Commission's Electronic Database Gathering and Retrieval (EDGAR) system. Under Commission Rule 13f-1, 17 C.F.R. § 240.13f-1, the Form 13F reports must be filed within 45 days after the last day of such calendar year and within 45 days after the last day of each of the first three calendar quarters of the subsequent calendar year. Section 13(f)(3) mandates that the Commission tabulate the information contained in the quarterly reports and disseminate that information to the public.

For the purposes of Section 13(f), an institutional investment manager is an entity that invests in or trades securities for its own account, or a person or entity that exercises investment discretion over someone else's account. The institutional investment managers that are required to file the Form 13F reports typically include investment advisers, banks, insurance companies, broker-dealers, pension funds and corporations. Institutional investment managers exercise investment discretion if they have the power to determine which securities are bought or sold for accounts under management, or if they make decisions about which securities are bought or sold, even if someone else is responsible for the investment decision.

The securities that must be reported under Section 13(f) generally include equity securities that are traded on an exchange or quoted on National Association of Securities Dealers Automated Quotations (NASDAQ), equity options and warrants, shares of closed-end investment companies, and some convertible debt securities. Under Section 13 (f)(3) of the Exchange Act, the Commission is responsible for publishing an official list of the securities that must be reported pursuant to Section 13(f)(1). Form 13F requires disclosure of the name and address of the institutional investment manager filing the report and, for each security being reported, specific information, including the name of the issuer, the class, the CUSIP<sup>1</sup> number, the number of shares or principal amount, and the aggregate fair market value.

Pursuant to Commission Rule 24b-2, 17 C.F.R. § 240.24b-2, an institutional investment manager may request confidential treatment of information required to be reported on Form 13F. Section 13(f)(3) of the Exchange Act, 15 U.S.C. § 78m(f)(3), provides that the Commission may prevent or delay the public disclosure of the information reported under Section 13(f)(1) in accordance with the Freedom of Information Act (FOIA). Section 13(f)(3) further provides that information identifying securities held by the account of a natural person or an estate or trust (other than a business trust or investment company) shall not be publicly disclosed. The Commission has delegated authority to the SEC's Division of Investment Management (IM) to grant or deny applications for confidential treatment pursuant to Section 13(f), and to revoke any grants of confidential treatment for such applications.

**Objectives.** The Office of Inspector General (OIG) conducted a review in order to examine whether the Commission's implementation of and current practices under Section 13(f) meet Congress's intent in establishing Section 13(f), to examine the sufficiency of the Commission's existing policies and procedures that implement Section 13(f), and to determine whether the reporting of entities covered under Section 13(f) is appropriately designed to comply with the statutory requirements. The objectives also included an examination of whether the Commission's policies and procedures for reviewing and processing requests for confidential treatment of information required to be reported under Section 13(f) are adequate and appropriate. In addition, we performed the review to determine whether the oversight over the Section 13(f) process is sufficient.

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<sup>1</sup> According to the Commission's website, "CUSIP stands for Committee on Uniform Securities Identification Procedures. A CUSIP number identifies most securities including: stocks of all registered U.S. and Canadian companies, and U.S. government and municipal bonds. The CUSIP system—owned by the American Bankers Association and operated by Standard & Poor's—facilitates the clearing and settlement process of securities." CUSIP Number, <http://www.sec.gov/answers/cusip.htm>. A CUSIP "number consists of nine characters (including letters and numbers) that uniquely identify a company or issuer and the type of security." *Id.*

**Results.** Overall, our review found that significant improvements can be made with respect to the SEC's review and monitoring of the information reported under Section 13(f). Significantly, our review found that despite Congressional intent that the SEC would be expected to make extensive use of the Section 13(f) information for regulatory and oversight purposes, no SEC division or office conducts any regular or systematic review of the data filed on Form 13F. We found that while IM has delegated authority to grant or deny confidential treatment pursuant to Section 13(f), no SEC division or office has been delegated authority to review and analyze the 13F reports, and no division or office considers this task as falling under its official responsibility. Our review found that the information filed on Form 13F can be useful and should be reviewed in a routine and systematic manner.

The OIG's review also disclosed that no SEC division or office monitors the Form 13F filings for accuracy and completeness. As a result, many Forms 13F are filed with errors or problems, which may not be detected or corrected in a timely manner. Because no routine monitoring is conducted, errors or problems with the Form 13F filings are typically detected only in connection with IM's processing of Section 13(f) confidential treatment requests (CTRs), or when a member of the public notifies IM of an error in or problem with a Form 13F. Our review also found that there are no checks built into the EDGAR system, through which the Forms 13F are filed, to scan for obvious errors in the forms. Moreover, we found that the current text file format of Form 13F limits the facility to extract, organize and analyze the data being reported.

In addition, our review disclosed that a third party prepares the official list of Section 13(f) securities that the Commission is required to provide to the public, and has been doing so since 1981, based upon specifications received from the SEC in 1979. The official list prepared by the third party is posted to the Commission's website each quarter; however, no SEC division or office conducts any review of the list for accuracy and completeness before it is posted. We believe that such a review is important, given that institutional investment managers rely on the official list in preparing their Form 13F reports in accordance with Commission Rule 13f-1. We further found that the SEC has no contract or agreement with the third party with respect to the preparation of the official list of Section 13(f) securities. The lack of a formal contract poses a risk to the SEC that the third party could stop preparing the list at any time, and this informal arrangement appears to violate the voluntary services prohibition of the Antideficiency Act, 13 U.S.C. § 1342.

The OIG's testing of a sample of CTRs processed by IM revealed that files and supporting documentation could not be located for approximately one-half of the CTRs selected in our initial sample of 25 items. When we selected an additional 12 CTRs, files could not be located for two-thirds of the additional 12 items. The missing files raised concerns that confidential information reported on Form 13F

could be inadvertently disclosed. Our testing also indicated that the SEC is not complying with its records retention schedule for CTRs. In addition, our review found that with respect to several CTRs, IM had not rendered a final decision on a timely basis, thus affording certain filers *de facto* confidential treatment of their 13F reports.

Finally, our review disclosed that the current Section 13(f) reporting requirements are outdated and do not currently require disclosure of all significant activities of institutional investment managers, thus rendering the data less useful than it could be to investors and regulators.

**Summary of Recommendations.** Our review determined that several improvements in the Section 13(f) reporting process are needed to ensure, consistent with Congress' intent in enacting this Section, that useful and reliable data is provided to the public and government regulators.

Specifically, we recommend that:

- (1) The Chairman's Office delegate primary responsibility for reviewing and analyzing Form 13F information to the appropriate division or office;
- (2) The Chairman's Office assign to the appropriate divisions or offices responsibility for monitoring Section 13(f) filings for accuracy and completeness in order to limit the errors in or problems with the filings, thereby enhancing the usefulness and reliability of the data;
- (3) IM and the Office of Information Technology (OIT) continue previous efforts to implement checks in the EDGAR system to detect and/or correct obvious errors in Forms 13F;
- (4) IM, in consultation with the Chairman's Office, work with OIT to pursue updating Form 13F to a more structured format that will make the data easier to extract and analyze;
- (5) The Chairman's Office assign to an appropriate division and/or office responsibility for reviewing the official list of Section 13(f) securities that is prepared quarterly by a third party and test it on a sample basis;
- (6) IM, in consultation with the Office of Administrative Services and the Chairman's Office, ensure that the SEC enters into a formal contract or agreement with the third party that prepares the official list of Section 13(f) securities;

- (7) IM and the SEC's Records Management Branch modify their respective policies and procedures to ensure that files for processing CTRs are properly maintained and retained in accordance with the SEC's record retention schedule;
- (8) IM, in consultation with the Chairman's Office, take appropriate steps to improve its policies and procedures to ensure that written requests for confidential treatment (particularly certain novel requests) under Section 13(f) are granted or denied within an appropriate time frame so that filers are not afforded *de facto* confidential treatment as a result of IM not issuing a written response;
- (9) IM, in consultation with the Office of the General Counsel (OGC), the Office of International Affairs and the Chairman's Office, take appropriate steps to improve its policies and procedures to ensure that requests for relief under Section 13(f) made by certain large foreign institutional investment managers are addressed in a timely and appropriate manner;
- (10) IM, in consultation with the Division of Risk, Strategy, and Financial Innovation (Risk Fin), OGC and the Chairman's Office, determine whether legislative changes to Section 13(f) should be pursued;
- (11) IM, in consultation with the Chairman's Office, request that Risk Fin update its previous analysis of the impact of increasing the Section 13(f) reporting threshold of \$100 million; and
- (12) IM, in consultation with Risk Fin and the Chairman's Office, determine whether to recommend that the Commission adopt a rule requiring institutional investment managers to report aggregate purchase and aggregate sales of securities under Section 13(f).

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# Background and Objectives

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## Background

### Section 13(f) Reporting Requirement

Congress adopted Section 13(f) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. § 78m(f), as part of the Securities Acts Amendments of 1975. According to the Securities and Exchange Commission (SEC or the Commission), this Section required a reporting system that was “intended to create in the Commission a central repository of historical and current data about the investment activities of institutional investment managers,” thereby advancing two separate objectives.<sup>2</sup> First, the reporting system was “designed to improve the body of factual data available 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.”<sup>3</sup> Second, “by making the Commission responsible for all gathering, processing, and dissemination of the data, Congress intended to permit establishment of uniform reporting standards and a centralized data base.”<sup>4</sup> The legislative history for Section 13(f) indicates that Congress believed that the dissemination of data about institutional investment managers would “stimulate a higher degree of confidence among all investors in the integrity of [the U.S.] securities markets.”<sup>5</sup> Congress also believed that the institutional disclosure data would be used extensively by government agencies, including the SEC, in fulfilling their regulatory responsibilities.<sup>6</sup>

Specifically, Section 13(f)(1) requires that institutional investment managers that exercise investment discretion with respect to accounts holding equity securities of a class described in Section 13(d)(1) of the Exchange Act having an aggregate fair market value of at least \$100,000,000 (or a lesser amount that the Commission may by rule determine but in no case less than \$10,000,000) “shall file reports with the Commission, in such form, for such periods, and at such times after the end of such periods as the Commission, by rule, may prescribe,

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<sup>2</sup> Filing and Reporting Requirements Relating to Institutional Investment Managers, Release No. 34-14852 (June 15, 1978), 43 Fed. Reg. 26700, 26701 (June 22, 1978).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* (citing Report of the Senate Comm. on Banking, Housing, and Urban Affairs, Senate Report No. 75, 94<sup>th</sup> Cong. 1<sup>st</sup> Sess. 85 (1975)).

<sup>5</sup> Report of Senate Comm. on Banking, Housing and Urban Affairs, S. Rep. No. 94-75 at 78 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 261. See also Division of Investment Management: Frequently Asked Questions About Form 13F (May 2005)(Frequently Asked Questions), <http://www.sec.gov/divisions/investment/13faq.htm>, Question 1 at p.1 (“Congress believed that this institutional disclosure program would increase investor confidence in the integrity of the United States securities markets.”).

<sup>6</sup> Report of Senate Comm. on Banking, Housing and Urban Affairs, S. Rep. No. 94-75 at 79 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 261.

but in no event shall such reports be filed for periods longer than one year or shorter than one quarter.”<sup>7</sup> For each equity security held on the last day of the reporting period with respect to which the institutional investment manager exercises investment discretion (other than securities held in amounts the Commission, by rule, determines to be insignificant), the following information must be reported: “the name of the issuer and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value of each such security.”<sup>8</sup>

The Commission’s website describes an “institutional investment manager” as follows:

In general, an institutional investment manager is: (1) an entity that invests in, or buys and sells, securities for its own account; or (2) a person or an entity that exercises investment discretion over the account of any other person or entity. Institutional investment managers can include investment advisers, banks, insurance companies, broker-dealers, pension funds, and corporations.<sup>9</sup>

With regard to the term “investment discretion,” Division of Investment Management’s (IM) Frequently Asked Questions (FAQs) About Form 13F state that “[a]n institutional investment manager exercises investment discretion if: (i) the manager has the power to determine which securities are bought or sold for the account(s) under management; or (ii) the manager makes decisions about which securities are bought or sold for the account(s), even though someone else is responsible for the investment decisions.”<sup>10</sup>

The securities that must be reported pursuant to Section 13(f), *i.e.*, Section 13(f) securities, “generally include equity securities that trade on an exchange or are quoted on the Nasdaq National Market, some equity options and warrants, shares of closed-end investment companies, and some convertible debt securities;” however, “[t]he shares of open-end investment companies (*i.e.*, mutual funds) are not Section 13(f) securities.”<sup>11</sup> The securities that must be reported are those contained in an official list of securities that the Commission is required to make available to the public for a reasonable fee and update no less frequently than reports are required to be filed pursuant to Section 13(f)(1).<sup>12</sup>

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<sup>7</sup> 15 U.S.C. § 78m(f)(1).

<sup>8</sup> *Id.* Section 13(f)(1) also list other information that the Commission may, by rule, require to be reported for accounts with respect to which the institutional investment manager exercises investment discretion.

<sup>9</sup> Form 13F—Reports Filed by Institutional Investment Managers, <http://www.sec.gov/answers/form13f.htm>. See also Frequently Asked Questions, Question 3 at pp. 1-2.

<sup>10</sup> Frequently Asked Questions, Question 6 at p. 3 (citing Section 3(a)(35) of the Exchange Act and Commission Rule 13f-1(b)).

<sup>11</sup> Form 13F—Reports Filed by Institutional Investment Managers, <http://www.sec.gov/answers/form13f.htm>. See also Frequently Asked Questions, Question 7 at p. 3.

<sup>12</sup> 15 U.S.C. § 78m(f)(3); see also 17 C.F.R. § 240.13f-1(c).

Commission Rule 13f-1 requires that institutional investment managers that exercise investment discretion with respect to accounts holding Section 13(f) securities having an aggregate fair market value on the last trading day of any month of a calendar year of at least \$100 million file a report with the Commission on Form 13F within 45 days after the end of the calendar year, and within 45 days after the end of the first three quarters of the subsequent calendar year.<sup>13</sup> According to the Commission's website, "Form 13F requires disclosure of the names of institutional investment managers, the names of the securities they manage and the class of securities, the CUSIP number, the number of shares owned, and the total market value of each security."<sup>14</sup>

Form 13F must be filed electronically using the Commission's EDGAR system; paper filings are only permitted if the filer has been granted a hardship exemption.<sup>15</sup> Form 13F consists of three separate parts: a cover page, a summary page, and an information table (which contains the reportable information for the Section 13F securities).<sup>16</sup> There are three different types of Form 13F reports: a 13F Holdings Report (used if all of an institutional investment manager's Section 13(f) securities are listed on its Form 13F); a 13F Combination Report (used if some of the institutional investment manager's Section 13(f) securities are listed on its Form 13F, and the rest are listed on someone else's Form 13F; and a 13F Notice (used if all of the institutional investment manager's Section 13(f) securities are reported on someone else's Form 13F).<sup>17</sup>

## Section 13(f) Confidential Treatment Requests

Confidential treatment is available for information required to be reported under Section 13(f) under certain circumstances. According to guidance issued by IM, while Congress intended for the Section 13(f) information to be promptly disseminated to the public, it also recognized that, in some instances, disclosure of certain information could have harmful effects, both on an institutional investment manager and on the investors whose assets are under its management.<sup>18</sup> Accordingly, "[t]o balance these competing interests, Section 13(f)(3) authorizes the Commission to delay or prevent the public disclosure of

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<sup>13</sup> 17 C.F.R. § 13f-1(a). See also Frequently Asked Questions, Question 28 at p. 8 (noting that an institutional investment manager should file its first Form 13F for the December quarter for the calendar during which it first reaches the \$100 million filing threshold, and will then need to submit filings for the March, June, and September quarters of the following calendar year, even if the market value of its Section 13(f) securities falls below the \$100 million level).

<sup>14</sup> Form 13F—Reports Filed by Institutional Investment Managers, <http://www.sec.gov/answers/form13f.htm>. See also Frequently Asked Questions, Question 8 at pp. 3-4.

<sup>15</sup> Frequently Asked Questions, Questions 13 and 14 at p. 5.

<sup>16</sup> Frequently Asked Questions, Question 31 at p. 9.

<sup>17</sup> Frequently Asked Questions, Question 33 at p. 9.

<sup>18</sup> Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management to Section 13(f) Confidential Treatment Filers (June 17, 1998)(Scheidt Letter), <http://www.sec.gov/divisions/investment/guidance/13fpt2.htm>, at p. 2.

information as it determines to be necessary or appropriate in the public interest or for the protection of investors.”<sup>19</sup>

Section 13(f)(3) allows for confidential treatment of information required to be filed under that Section in two respects. First, Section 13(f)(3) provides that “the Commission, as it determines to be necessary or appropriate in the public interest or for the protection of investors, may delay or prevent public disclosure of any . . . information [filed in reports required by Section 13(f)] in accordance with section 552 of Title 5 [the Freedom of Information Act (FOIA)].”<sup>20</sup> According to the IM’s FAQs About Form 13F, “[a]t a minimum, requests for confidential information must satisfy the requirements of FOIA Exemption 4 which protects ‘trade secrets and commercial or financial information obtained from a person and privileged or confidential.’”<sup>21</sup>

Second, Section 13(f)(3) further provides that “[n]otwithstanding the preceding sentence, any such information identifying the securities held by the account of a natural person or an estate or trust (other than a business trust or investment company) shall not be disclosed to the public.”<sup>22</sup> This category of confidential information is referred to as the “personal holdings exemption.”<sup>23</sup> Confidential treatment based on the personal holdings exemption lasts indefinitely, although the filer may not “always receive confidential treatment because changed circumstances may make the personal holding exemption inapplicable.”<sup>24</sup>

CTRs must be made in accordance with Rule 101(c)(1)(i) of Regulation S-T,<sup>25</sup> and the Confidential Treatment Instructions 1 and 2 to Form 13F. In addition, confidential treatment applications must follow the procedural requirements contained in Rule 24b-2 under the Exchange Act.<sup>26</sup> CTRs must be submitted in paper, although the filer must still submit the public Form 13F electronically via EDGAR, omitting the information for which confidential treatment is sought.<sup>27</sup>

The Commission has delegated to the Director of IM the authority to grant or deny applications for confidential treatment of information filed under Section 13(f), and to revoke a grant of confidential treatment for any such application.<sup>28</sup>

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<sup>19</sup> *Id.*

<sup>20</sup> 15 U.S.C. § 78m(f)(3).

<sup>21</sup> Frequently Asked Questions, Question 52 at pp. 14-15 (quoting 5 U.S.C. § 552(b)(4)).

<sup>22</sup> 15 U.S.C. § 78m(f)(3).

<sup>23</sup> Frequently Asked Questions, Question 52 at p. 14.

<sup>24</sup> *Id.*, Question 55a at p. 16.

<sup>25</sup> 17 C.F.R. § 232.101(c)(i). This rule requires that CTRs, and the information with respect to which confidential treatment is sought, be filed in paper form only.

<sup>26</sup> 17 C.F.R. §240.24b-2. Under this rule, an application for confidential treatment must include, among other things, an analysis of the applicable exemption(s) from disclosure under the Commission’s rules and regulations adopted under the FOIA, and a justification of the time period for which confidential treatment is sought.

<sup>27</sup> Frequently Asked Questions, Question 53 at p. 15. See *also* Form 13F, Instructions for Confidential Treatment Requests at p. 2.

<sup>28</sup> 17 C.F.R. § 200.30-5(c)(1) and (2).

IM has put in place well-constructed review procedures for processing CTRs, especially in novel or complicated cases involving ongoing investment strategies for acquisitions and dispositions. IM carefully reviews the information the filers provide as a basis for seeking confidential treatment and researches public data in order to validate the basis provided by the filer.

Additionally, IM's procedures appropriately provide for the assignment of CTR applications to the pertinent staff, and for the proper supervision of those staff. Specifically, CTR applications are reviewed by IM attorneys, who are each assigned the applications of a number of institutional investment managers. This practice allows continuity and enables the attorney to build rapport with the filers. More complicated requests are assigned to senior attorneys, while routine requests, such as personal holdings exemption requests, are assigned to new attorneys or paralegal specialists. The IM attorneys who work on CTRs are generally knowledgeable of the confidential treatment process and encouraged to consult with one another and their supervisors. Further, an IM Branch Chief reviews all CTRs, except for personal holdings exemption requests that have been granted in the past. An IM Assistant Director and the Chief Counsel review the CTRs and response letter in certain novel cases, and the Chief Counsel reviews all denial letters and any appeals filed by the institutional investment managers.

## **Objectives**

The objectives of the review were to examine whether the Commission's implementation of and current practices under Section 13(f) meet Congress's intent in establishing Section 13(f), to examine the sufficiency of the Commission's existing policies and procedures that implement Section 13(f), and to determine whether the reporting of entities covered under Section 13(f) is appropriately designed to comply with the statutory requirements. The objectives also included an examination of whether the Commission's policies and procedures for reviewing and processing requests for confidential treatment of information required to be reported under Section 13(f) are adequate and appropriate. In addition, we performed the review to determine whether the oversight over the Section 13(f) process is sufficient.

# Findings and Recommendations

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## **Finding 1: Despite the Intent of Congress in Prescribing the Section 13(f) Reporting System that the SEC Would Make Extensive Use of the Section 13(f) Information for Regulatory and Oversight Purposes, the SEC Conducts No Continuous or Systematic Review or Analysis of the Form 13F Reports**

No SEC division or office has been delegated authority to review the Section 13(f) reports, and no regular or systematic review or analysis of this information is conducted.

Section 13(f)(3) requires the Commission to tabulate the information contained in any reports filed pursuant to Section 13(f) “in a manner which will, in the view of the Commission, maximize the usefulness of the information to other Federal and State authorities and the public.”<sup>29</sup> That subsection further requires the Commission to make this information available to the public for a reasonable fee in such form as the Commission, by rule, may prescribe, except where the Commission determines that information should be afforded confidential treatment.<sup>30</sup>

Consistent with the statutory language, the legislative history for Section 13(f) makes clear that Congress anticipated that regulatory agencies, including the SEC, would be expected to make extensive use of the information required to be disclosed under Section 13(f). That legislative history stated, in part, as follows:

Moreover, the SEC, bank regulatory agencies, and other agencies (both federal and state) could be expected to make extensive use of the institutional disclosure data in fulfilling their responsibilities to consider and develop standards designed to protect the public interest within a consistent and coordinated regulatory framework. It would be expected that the SEC might use the institutional disclosure data in generally two different ways: to analyze the characteristics of institutional investment managers, and to analyze

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<sup>29</sup> 15 U.S.C. § 78m(f)(3).

<sup>30</sup> *Id.*

the impact of institutional investment managers on the securities markets.<sup>31</sup>

The Commission itself has recognized in various orders it has issued that “[t]he legislative history of [S]ection 13(f) suggests that the provision was designed to further regulatory and policymaking uses of the information, as well as to contribute to the transparency and integrity of, and investor confidence, in the U.S. equity markets.”<sup>32</sup> In addition, in a cease-and-desist proceeding involving a hedge fund’s repeated failure to file Forms 13F, the Commission noted the current importance of Section 13(f) information as follows:

The information is valuable to the Commission because it “facilitate[s] consideration of the influence and impact of institutional investment managers on the securities markets and the public policy implications of that influence.” Reporting by Institutional Investment Managers of Information With Respect To Accounts Over Which Investment Discretion is Exercised, Release No. 34-13396, at 1 (Mar. 22, 1977). **The need for such information in the regulatory oversight of market practices is at least as acute today, when institutional investment managers oversee in excess of \$1 trillion of hedge fund investments, as it was in 1975 when Section 13(f) was enacted.**<sup>33</sup>

Moreover, the Commission has represented that the Commission staff is using Section 13(f) information for a variety of regulatory purposes, stating as follows:

The information collected on Forms 13F has been and continues to be used by U.S. regulators, academics, the media and financial information distributors, and investors, and other U.S. equity markets participants, as intended by Congress. The Commission’s staff use Form 13F information for a variety of research, oversight, and enforcement purposes. The Commission’s staff also use Form 13F-based academic research, for example, to analyze the Commission’s rulemaking initiatives under the federal securities laws.<sup>34</sup>

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<sup>31</sup> Report of Senate Comm. on Banking, Housing and Urban Affairs, S. Rep. No. 94-75 at 79 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 261.

<sup>32</sup> *In re Wynnefield Capital Management LLC and Wynnefield Capital, Inc.*, Release No. 34-61930 (Apr. 16, 2010), at 1-2 (citing S. Rep. No. 75 at 80-84); *In re Full Value Advisors, LLC*, Release No. 34-61327 (Jan. 11, 2010) at 2 (same citation). See also *In re Quattro Global Capital, LLC*, Release No. 34-56252 (Aug. 15, 2007), at 2 (“The Congressional purpose in enacting Section 13(f) of the Exchange Act was ‘to create a central depository of historical and current data about the investment activities of institutional investment managers’ to assist investors and government regulators.” (quoting S. Rep. No. 94-75, 94<sup>th</sup> Cong., 2d [sic] Sess. 82-85 (1975))).

<sup>33</sup> *In re Quattro Global Capital, LLC*, Release No. 34-56252 (Aug. 15, 2007), at 2-3 (emphasis supplied).

<sup>34</sup> *In re Full Value Advisors, LLC*, Release No. 34-61327 (Jan. 11, 2010), at 4 (footnote omitted).

Our review found that, despite the statements above concerning the use of Form 13F information for a variety of oversight and other purposes, the SEC does not, in fact, conduct any continuous or systematic review or analysis of that information. As noted above, the Director of IM has been delegated authority to grant or deny applications for confidential treatment of information filed under Section 13(f), and to revoke a grant of confidential treatment for any such application. However, no Commission division or office has been delegated authority to review the Form 13F filings. As a consequence, no SEC division or office considers reviewing Form 13F as falling under its official responsibility, and no division or office conducts such a review on a systematic or ongoing basis.

IM management informed us that the “oversight” uses referred to in the Commission order described above referred to the review of certain Forms 13F performed by other Commission divisions or offices. IM stated its belief that the Office of Compliance Inspections and Examinations (OCIE), during its periodic examinations and surveillance, checks to see whether a registered investment adviser or broker-dealer files Form 13F, but generally does not substantively review the Form 13F reports that such registrant files. Our review found that only in rare occasions would Forms 13F be reviewed during OCIE Examinations. While OCIE on occasion encounters instances when registered entities that should have filed Form 13F failed to do so, these instances are infrequent because compliance with Section 13(f) is not the focus of OCIE’s examinations of registered entities, and OCIE lacks jurisdiction over institutional investment managers that are not registered.<sup>35</sup>

Our review also disclosed that Risk Fin economists have used Form 13 F data to conduct analyses,<sup>36</sup> and that SEC staff use Form 13F data to inform Commission rule making.<sup>37</sup> In addition, Risk Fin pointed out that Commission staff routinely use Form 13F data to formulate penalty recommendations in corporate fraud cases. Nonetheless, there is no systematic review or analysis of Form 13F data being conducted. One Risk Fin staff member expressed the belief that the data in Form 13F filings is useful to research the holdings of large institutional investment managers in particular, as the large managers have the resources and knowledge to report Form 13F data correctly.<sup>38</sup>

A Risk Fin staff member provided an example of useful information that may be provided by review and analysis of the information filed on Form 13F. In that instance, a Risk Fin employee who was conducting research on the valuation of

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<sup>35</sup> OCIE staff estimated that they find issues with Form 13F in less than 5 percent of OCIE’s examinations.

<sup>36</sup> According to Risk Fin, Form 13F data have formed the basis of numerous academic studies, some of which were conducted by economists at the SEC and some of which were prepared by economists working outside the SEC. Risk Fin stated that the SEC staff regularly rely on economic research of this nature.

<sup>37</sup> Risk Fin cited the proxy access rule as a recent example of Form 13F data being used to support a rulemaking. See *Facilitating Shareholder Director Nominations*, File No. S7-10-09 (Aug. 25, 2010).

<sup>38</sup> This Risk Fin staff member indicated that errors in Form 13F filings (see Findings 2 and 3) appeared to be more prevalent in the filings of small managers who have less resources and expertise.

warrants noted a zero value for certain warrants reported by institutional investment managers on Form 13F. The Risk Fin employee contacted OCIE, which reviewed Form 13F filings to determine the valuation of similar warrants and determined that institutional investment managers reported different values for the same warrants. OCIE is in the process of obtaining supporting documentation from registered filers and plans to contact the Division of Trading and Markets in an effort to obtain similar information from non-registrants. IM staff acknowledged that the valuation of warrants would be materially important, for example, if it were to impact whether an institutional investment manager has exceeded the Section 13(f) reporting threshold of \$100 million. In addition, IM indicated that research into the methodology used to value the warrants might reveal that one model is better than other models, such that IM might wish to notify certain institutional investment managers of the preferred methodology.

Our review concluded, therefore, that a systematic review of Form 13F information can provide valuable information and should be conducted to ensure that the SEC is making the maximum use of the Form 13F information, consistent with the intent of Congress.

**Recommendation 1:**

The Chairman's Office should delegate primary responsibility for reviewing and analyzing Form 13F information to the appropriate division or office.

**Management Comments.** The Chairman's Office concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased that the Chairman's Office concurred with this recommendation.

## **Finding 2: The Lack of Monitoring of the Form 13F information by the SEC Renders this Data Less Useful and Reliable than Congress Had Intended**

There is no periodic monitoring of the Section 13(f) reporting process, including no review of the Form 13F filings for accuracy and completeness.

As mentioned in Finding 1, the OIG review has found that no Commission division or office is responsible for reviewing Form 13F filings and that, as a consequence, no systematic review of the Form 13F filings is conducted. The OIG review also found that the SEC conducts no periodic monitoring of the Form

13F filings to ensure the accuracy and completeness of the information that is reported. As a general matter, apart from the review of Form 13F as a result of an institutional investment manager's request for confidential treatment of Form 13F information, the majority of the monitoring or checking of this information by IM is performed only after a member of the public notifies IM of an error in or problem with a Form 13F, or IM receives a referral from another SEC division or office.

Further, as discussed above, our review found that only on rare occasions during examinations does OCIE identify entities subject to 13(f) that failed to file the required reports. On these very few occasions, OCIE issues a deficiency letter, requesting that the entity file the required Form 13F. The entity then typically sends a written response to the examination team and makes the necessary filing(s) or amended filing(s). The examination team then checks in EDGAR to ensure that the required filing or filings were made. However, no continuous monitoring is performed to ensure that the entities that failed to file Form 13F make the required filings in the future, and OCIE does not notify IM of these situations.<sup>39</sup>

### **IM's Current Procedures for Addressing Errors in or Problems with Forms 13F**

We found in our review that IM has no formal procedures for monitoring or checking the Form 13F filings, as IM's Section 13(f) work focuses almost exclusively on CTRs. Apart from the reviews of Forms 13F conducted pertinent to the review of CTRs, the only examination of the Form 13F filings we identified was the informal work of one paralegal specialist in IM, who primarily collects information from entities or individuals outside of the Commission about errors with the Form 13F filings. According to this one paralegal specialist, while she does not conduct any systematic monitoring or checking of the forms, members of the public, including certain research centers, graduate students, individual researchers, academia, investors, and financial institutions periodically review Form 13F filings and notify her of issues or problems identified with the filings. In addition, on occasion, errors in or problems with Form 13F are identified as a result of filers contacting the paralegal requesting assistance on other issues, or by staff in IM or other SEC divisions or offices who are performing other work.<sup>40</sup>

We found that the errors or problems identified with Form 13F filings are not infrequent. The paralegal indicated that she receives approximately 20 to 25 calls a week near the time period when quarterly filings are due and posted on

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<sup>39</sup> IM staff believe that OCIE should monitor these entities and their filings, since IM is not responsible for reviewing Forms 13F apart from assessing CTRs, and the failure to file the Form 13F was detected through an OCIE examination.

<sup>40</sup> According to the paralegal, the public identified about 70 percent of the Form 13F issues brought to her attention, while the remaining 30 percent are discovered in working with filers or by Commission staff.

the SEC's website. The paralegal specialist maintains e-mails and logs of calls from the public on issues with certain Form 13F filings and researches the issues or follows up with the institutional investment managers. She enters complicated issues related to Section 13(f) CTRs and errors in Form 13F filings in IM's Office of Chief Counsel's internal database. However, our review found that complaints and issues noted by the public regarding Form 13F filings are not separately identified in the database.

The paralegal specialist indicated that she attempts to correct the errors or problems that are identified through an informal process. This process includes contacting the institutional investment managers, notifying them of the deficiencies or errors identified, and setting a general time table to address the issues. However, according to the paralegal specialist, issues identified with Form 13F filings may take many months to resolve, as the errors or problems identified may cover many quarterly filings.

## **Examples of the Errors in or Problems Related to the Form 13F Filings**

Based upon the number of issues identified with the Form 13F filings, including those found by entities outside the SEC and the lack of any formal or systematic monitoring by the SEC, the review has determined that the public may not always be obtaining accurate and complete data, or the most useful information, on Form 13F. Our review of IM's log and supporting documents revealed the following examples of concerns with or errors in certain Form 13F filings that were identified by the public:

- A graduate student regularly reviewed Form 13F filings and informed the IM paralegal specialist of numerous issues, including those relating to the Form 13F of a particular bank. In that instance, the bank used an expired Form 13F in paper format, rather than the EDGAR form that became available in 1999. IM's inquiry of the bank revealed that the bank had been using the old form since it began filing Form 13F and had not previously been notified of the error.
- An employee from a stock research firm notified IM that a European bank affiliate operating in the United States did not file Form 13F for the period ended December 31, 2009. When the paralegal specialist contacted the U.S. bank, she was informed that its holdings were now aggregated with those of the European bank. However, the European bank had also not filed Form 13F. According to IM, the filing deficiencies with respect to such European bank and its U.S. affiliate have been corrected as of June 14, 2010 (after the commencement of our fieldwork).

Our review disclosed that as of June 7, 2010, the paralegal specialist was working on approximately 22 cases involving issues with Form 13F that were noted by the public and had not been fully addressed. A formalized process for systematic monitoring of Form 13F, even if merely on a test basis, would detect errors or other issues and problems with Form 13F and ensure that these types of issues are addressed and corrected on a timelier basis. As a consequence, the public would be provided with more accurate, complete and useful information, consistent with the intent of Congress in enacting Section 13(f). While the OIG acknowledges that it would be too cumbersome and time-consuming to perform a review of every Form 13F (in its current form), as there are at least 3,000 to 4,000 filers each quarter, the SEC could audit the Form 13F files of a sample of filers and review the Form 13F filings of new filers.

**Recommendation 2:**

The Chairman's Office should assign to the appropriate divisions or offices responsibility for monitoring Section 13(f) filings for accuracy and completeness in order to limit the errors in or problems with the filings and thereby enhance the usefulness and reliability of the data.

**Management Comments.** The Chairman's Office concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are please that the Chairman's Office concurred with this recommendation.

### **Finding 3: There Is No Mechanism by Which the SEC Scans for Obvious Errors in Forms 13F, Resulting in These Forms Being Uploaded in EDGAR with Errors**

Currently, the Forms 13F that are uploaded through EDGAR are not scanned for obvious errors. Therefore, there is no system in place to limit the amount of errors contained on the forms.

In addition to the lack of monitoring of Form 13F (see Finding 2 above), the SEC has not implemented any tool to scan for and/or correct obvious errors on Form 13F. As noted above, errors on Forms 13F are generally only detected if they are identified by the public or noted by IM during its review of CTRs. Moreover, the errors that are identified are often not corrected on a timely basis. As a result of the errors on the Forms 13F, the benefits of the reporting system are minimized.

In connection with discussions regarding the possible modernization of Form 13F that took place in 2005 but were not pursued (see Finding 4 below), OIT, in consultation with IM, prepared a document detailing the types of errors that might be made in filing Form 13F (e.g., failing to complete a required field, entering a date in an improper format) and possible help messages for those errors. These efforts should be pursued and checks should be implemented in EDGAR to prevent incomplete or plainly erroneous filings from being submitted, such as filings that are inadvertently dated far into the future or contain mismatched or inappropriate table alignments. In addition, other measures should be taken to scan for and/or correct readily identifiable errors on the Forms 13F that are filed through EDGAR.

### **Recommendation 3:**

The Division of Investment Management and the Office of Information Technology should renew the efforts that were begun in 2005 and implement checks in the Electronic Data Gathering and Retrieval (EDGAR) system that will detect and/or correct obvious errors contained in the Forms 13F that are uploaded in EDGAR.

**Management Comments.** IM and OIT concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased that IM and OIT concurred with this recommendation.

## **Finding 4: The Current Text File Format of Form 13F Limits the Usefulness of the Data Reported on the Form**

The data submitted on the current electronic Form 13F is difficult to analyze and manipulate due to the text file format of Form 13F and the lack of uniformity in reporting data on the form.

Form 13F was initially submitted in paper format. During a phase-in to mandatory electronic filing, the Commission permitted institutional investment managers to report their holdings electronically on former Form 13F-E, on a voluntary basis.<sup>41</sup> In January 1999, the Commission adopted amendments to mandate the electronic filing of Form 13F using the EDGAR system.<sup>42</sup> Effective

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<sup>41</sup> Final Rule: Rulemaking for EDGAR System, Release No. 34-40934 (Jan. 12, 1999), <http://www.sec.gov/rules/final/34-40934.htm>, at p. 2.

<sup>42</sup> *Id.* at pp. 1-2.

April 1, 1999, institutional investment managers were required to file Form 13F electronically on EDGAR.<sup>43</sup>

At the time electronic submission of Form 13F on EDGAR became mandatory in 1999, the SEC decided to use a text file format for Form 13F. EDGAR imposes a maximum line length of 132 characters, thus limiting the amount of information that can be submitted on a line. In addition, IM staff indicated the text file format of Form 13F limits its usefulness because the data is not manageable and cannot be easily analyzed.

Our review also found that the text format of Form 13F limits the ability of other SEC divisions and offices to utilize the information effectively. For example, one Risk Fin staff member observed that Form 13F should be submitted in machine-readable form instead of an unformatted text file. This is because data submitted on Form 13F cannot easily be aggregated across filers or merged with other data sets due to the limitations on the text file format of Form 13F and the lack of universal identifiers for the filers. The Risk Fin staff member believes that if Form 13F filings were in a tagged format, various users, individual researchers and data vendors would be able to extract and merge Form 13F data into a single database. Risk Fin pointed out, however, that some third-party providers make Form 13F data available in a standardized format that is readily usable by Risk Fin economists.

In addition, we found that OCIE sometimes uses Form 13F data in its examinations of investment advisers. An OCIE staff member who is familiar with Form 13F noted that the current EDGAR text file makes it nearly impossible to manipulate the data in order to perform comparison analysis or data mining because the data in the text file must be entered into an Excel spreadsheet or another similar format. Our review also found that while filers are assigned an identification number for use when filing Form 13F, they do not always include the identification number on the form. In addition, Form 13F does not require filers to note their Central Index Key numbers, which identify corporations and/or individuals that have submitted disclosure filings with the SEC. The absence of identification numbers makes it difficult for users to identify particular entities and compare data submitted on Form 13F with information submitted on other types of SEC filings.

We learned through discussions with IM and OIT staff that in or about 2005, IM explored with OIT the possibility of modernizing the format of Form 13F. Specifically, IM and OIT discussed changing the text file format of Form 13F to a more structured format that would use an Extensible Markup Language (XML) form<sup>44</sup> and would be posted on the SEC's website. However, OIT staff informed

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<sup>43</sup> *Id.* at p. 1.

<sup>44</sup> XML is a set of rules for encoding documents in machine-readable form; it is a textual data format that is widely used in web services.

us that due to other priorities, such as former Chairman Christopher Cox's efforts to use XBRL (Extensible Business Reporting Language) for company filings, the Form 13F project was never completed. OIT staff indicated that the project delay was not a result of funding issues, as converting Form 13F to XML would not have been very costly.

OIT staff further stated that they have retained requirements documentation from their meetings with IM in 2005. OIT also indicated that it would be possible to pursue this project further if IM is still interested in changing the format of Form 13F. However, based upon the resources that are currently available, OIT has stated that the earliest it could pursue this project actively would be in March 2011.

#### **Recommendation 4:**

The Division of Investment Management, in consultation with the Chairman's Office, should work with the Office of Information Technology and update Form 13F to a more structured format, such as Extensible Markup Language (XML), to make it easier for users and researchers to extract and analyze Section 13(f) data.

**Management Comments.** IM concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased that IM concurred with this recommendation.

## **Finding 5: The SEC Conducts No Review of the Official List of Section 13(f) Securities Prepared by a Third Party**

A third party prepares the official list of securities that is required by Section 13(f)(3) by searching relevant databases based upon criteria the SEC provided. The SEC performs no review of the list and does not monitor it for accuracy and completeness.

Section 13(f)(3) requires that "[t]he Commission shall make available to the public for a reasonable fee a list of all equity securities of a class described in [Section 13(d)(1)], updated no less frequently than reports are required to be filed pursuant to [Section 13(f)(1)]."<sup>45</sup> The "Official List of Section 13(f) Securities" is

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<sup>45</sup> 15 U.S.C. § 78m(f)(3).

published on the SEC's website on a quarterly basis.<sup>46</sup> Section 13(f) securities are equity securities that are described in Section 13(d)(1) of the Exchange Act.<sup>47</sup> Under Commission Rule 13f-1(c), "[i]n determining what classes of securities are section 13(f) securities, an institutional investment manager may rely on the most recent list of such securities published by the Commission pursuant to [Section 13(f)(3)]."<sup>48</sup> Only securities of a class included on the list shall be counted in determining whether an institutional investment manager must file a 13(f) report, and only those securities shall be reported.<sup>49</sup>

Our review disclosed that a third party prepares and maintains the official list of Section 13(f) securities, without any review by SEC staff. The third party that prepares and maintains the list informed us that it has provided the official list to the SEC quarterly via FTP transmission<sup>50</sup> (on the 15<sup>th</sup> of each December, March, June and September) since 1981, based upon specifications originally provided by the SEC in 1979. Hence, a security that qualifies as a Section 13(f) reporting security in the last two weeks of a quarter will be included in the official list for the following quarter.

The third party informed us that it prepares the list quarterly by electronically screening its relevant databases for securities that match the categories provided by the SEC, which include: (1) common stocks or similar securities, (2) convertible preference stocks or preferred stocks, (3) convertible bonds, (4) warrants or rights to purchase common stocks, and (5) options. The third party collects and maintains securities reference data on a daily basis from direct and indirect sources, including exchange feeds, public filings, agency information, prospectuses and official statements, government filings, outside vendors, investment publications and direct issuer sources. The third party stated that it performs quality assurance on the databases used to prepare the official list daily, through the use of measures such edit checks, statistical sampling and change reports.

In order to assess whether the third party has proper controls and processes in place for producing the official listing of Section 13(f) securities, the OIG requested a copy of its Statement of Auditing Standards (SAS) 70 Report Type II, which is an audited report on internal controls and processes prepared by an independent auditor. The third party informed us that its processes and controls are not currently audited by an independent auditor and, therefore, it had no SAS 70 Report Type II.

OIT staff stated that the third party sends the official list on approximately the 18<sup>th</sup> of the last month of the quarter and that OIT generally posts the official list on the

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<sup>46</sup> See <http://www.sec.gov/divisions/investment/13flists.htm>.

<sup>47</sup> Frequently Asked Questions, Question 7 at p. 3.

<sup>48</sup> 17 C.F.R. § 240.13f-1(c).

<sup>49</sup> *Id.*

<sup>50</sup> FTP (File Transfer Protocol) is a standard network protocol used to copy files from one host to another.

SEC website by the eighth day of the following month. OIT has read-only access to the FTP transmission, and OIT does not compare the data received from the third party with any other information or otherwise review it or check it for accuracy. OIT staff indicated that if there is an issue with the official list (e.g., a delay in receiving the FTP transmission), OIT will contact the third party.

Our review further disclosed that IM performs no review of the official list provided by the third party and had very little involvement with the compilation of the list. We learned of only infrequent contacts (e.g., once in 2007) between IM staff and the third party regarding whether certain securities or types of securities should be included in the official list. Also, we were not able to identify any contract or agreement with the third party that prescribes how the list is to be prepared (see Finding 6 below). Because institutional investment managers are permitted by Commission rule to rely on the official list to prepare their 13F reports, it is important that the official list be up-to-date and accurate. Therefore, the SEC should be performing oversight of the official list, rather than relying exclusively upon a third party.

#### **Recommendation 5:**

The Chairman's Office should assign to an appropriate division and/or office responsibility for reviewing the official list of Section 13(f) securities that is prepared by a third party each quarter and testing the list for accuracy and completeness on a sample basis.

**Management Comments.** The Chairman's Office concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased the Chairman's Office concurred with this recommendation.

## **Finding 6: The SEC Has No Contract with the Third Party that Compiles the Official List of Section 13(f) Securities**

There is no contract between the third party that prepares the official list of Section 13(f) securities and the Commission.

During our review, both IM staff and the third party that provides the official list of Section 13(f) securities informed us that they were not aware of any contract or agreement between the SEC and the third party regarding the preparation of the list. The SEC's Office of Acquisitions within the Office of Administrative Services confirmed that there was no contract between the SEC and the third party and

that none had ever been awarded. The third party did provide an informal memorandum, dated March 13, 1979, which enclosed the specifications for the official list of Section 13(f) securities. This specifications document discussed the background and requirements of Section 13(f), the definition of Section 13(f) securities, what types of securities should be included on the official list and how the list should be compiled. The document also indicated that a sample layout for the computer tape containing the official list was included. We also found that no payments are being made to the third party by the Commission in connection with the preparation or delivery of the official list of Section 13(f) securities.<sup>51</sup>

Because there is no formal contract between the third party and the Commission regarding the official list of Section 13(f) securities, the third party could stop preparing the official list and providing it to the SEC at any time and the SEC would have no recourse.

Moreover, the current arrangement with the third party appears to violate the voluntary services prohibition of the Antideficiency Act, 13 U.S.C. § 1342, which provides, in part, that “[a]n officer or employee of the United States Government or the District of Columbia government may not accept voluntary services for either government or employ personal services exceeding that authorized by law except for emergencies involving the safety of human life or the protection of property.”

Comptroller General opinions have defined a “no-cost contract” as “a formal arrangement between a government entity and a vendor under which the government makes no monetary payment for the vendor’s performance.”<sup>52</sup> According to the Comptroller General, “[a]t issue when a federal agency agrees to a no-cost contract and receives services without having to pay is whether the agency has violated the Antideficiency Act’s voluntary services prohibition, 13 U.S.C. § 1342.”<sup>53</sup> Specifically, a no-cost contract raises the question of whether it is void due to a lack of consideration.<sup>54</sup> In addressing this issue, the Comptroller General has held that an agency may enter into a valid, binding no-cost contract without violating the Antideficiency Act’s voluntary services prohibition, because services performed pursuant to a formal contract, in which the agency has no financial obligation and the contractor has no expectation of payment from the government, are not “voluntary” within the meaning of the prohibition.<sup>55</sup>

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<sup>51</sup> The third party located two purchase orders for 1981 and 1982, which reflected an annual fee of \$1,200 for providing a quarterly tape covering Form 13F filings. Nonetheless, the third party confirmed that, to its knowledge, the third party is not receiving payment from the SEC or any other party for the delivery of the Section 13(f) securities file to the SEC.

<sup>52</sup> No-Cost Contracts for Event Planning Services, B-308968, 2007 U.S. Comp. Gen. LEXIS 220 (Nov. 27, 2007), at \*4.

<sup>53</sup> *Id.* at \*4-\*5.

<sup>54</sup> *Id.* at \*5, n.2.

<sup>55</sup> *Id.* at \*14. See also General Services Administration and Real Estate Brokers’ Commission, B-302811, 2004 U.S. Comp. Gen. LEXIS 164 (July 12, 2004) (“The acceptance of services without payment pursuant to Review of the SEC’s Section 13(f) Reporting Requirements September 27, 2010 Report No. 480

The current arrangement with the third party would appear to violate 13 U.S.C. § 1342 because there is no formal binding contract between the parties. If it wishes to continue the current arrangement, the SEC should enter into a formal contract or agreement with the third party that specifies that the SEC has no financial obligation and the firm has no expectation of payment from the government.

**Recommendation 6:**

The Division of Investment Management, in consultation with the Office of Administrative Services and the Chairman's Office, should ensure that the Securities and Exchange Commission (SEC) enters into a formal contract or agreement with the third party that prepares the official list required by Section 13(f)(3) of the Securities Exchange Act of 1934. This contract or agreement should document the third party's responsibilities for providing the official list on a quarterly basis and explicitly state that the SEC has no financial obligation and the firm has no expectation of payment from the government.

**Management Comments.** IM and OAS concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased IM and OAS concurred with this recommendation.

## **Finding 7: A Majority of the Confidential Treatment Requests that Were Selected for Testing Lacked Files with Supporting Documents and Forms**

Of the 25 CTRs selected in our initial sample, IM or the SEC's Records Management Branch (RM) could not provide files or any supporting documents for 12 of the sample items. When we selected an additional 12 CTRs to replace the initial sample items, IM or RM could not locate files for eight of the 12 additional sample items.

In order to determine whether IM properly processed CTRs, we selected a sample of 25 CTRs to perform testing for compliance with the applicable statutory, regulatory and procedural requirements. For each item selected, we requested a file from IM, and in some cases RM, containing the CTR letter

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a valid, binding no-cost contract does not augment an agency's appropriation nor does it violate the voluntary services prohibition.").

submitted by the institutional investment manager, the applicable Form 13F, supporting documents and, for completed requests, IM's letter responding to the CTR.

In response to our request for these 25 files, IM or RM could not locate any files or provide any supporting documentation for 12 of these sample items (48 percent). For another two sample items (eight percent), no file could be located, but IM did provide supporting documents.

Because we were unable to perform testing on 12 of the items selected in our initial sample of 25 CTRs due to the lack of availability of files or any supporting documentation, we selected an additional 12 CTRs in order to perform compliance testing.

Of the 12 additional sample items, IM provided files for only four items (33.3 percent), and indicated that the files for the remaining eight items (66.7 percent) should be under the custody of RM. The confidential treatment process had been completed with respect to these eight items and IM stated that, consistent with its existing procedures, it had sent the files to RM at various times. When contacted, however, RM could not find the files for any of the eight sample items and indicated that they had no record of ever receiving the files.<sup>56</sup> The large number of missing files limited the amount of testing we were able to perform.

In addition, the large amount of missing files raises concerns that confidential information that may exist in a completed Section 13(f) CTR could be misplaced, lost, or inadvertently disclosed. As institutional investment managers are required to submit to IM the Form 13F containing their holdings in Section 13(f) securities at the time they submit their CTRs, safeguarding these materials after a Section 13(f) CTR is completed is important. As part of our testing, we reviewed supporting documents, such as IM's response letter to the CTR (if such a letter had been issued) or the status of the request according to IM's database listing, to determine how many of the CTRs for which the filings were missing resulted in a grant of confidential treatment. We were able to verify that, as of June 2010, confidential treatment had been granted for six of the original 14 sample items with missing files (43 percent) and for three of the additional 12 sample items with missing files (25 percent). As a consequence, there was no control over nine files that should have contained information for which IM determined confidential treatment was warranted.

Further, based upon the missing files noted during our review, it does not appear that the SEC is complying with its records retention schedule for confidential

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<sup>56</sup> RM officials indicated that, under the Commission's records retention schedule, the CTR files should have been in IM's possession if they were less than two years old. RM officials also acknowledged receipt of a box from IM, which they claim did not include an index of the materials contained in the box. RM officials indicated that the box had essentially been untouched since its arrival from IM until the OIG's request for the files and, therefore, RM did not believe that IM ever sent the files in question to RM.

treatment materials, as IM has not been retaining CTR files for the appropriate in-house retention period and RM indicated that it had no record of receiving the missing files.<sup>57</sup> Our inquiries of IM and RM staff during our review also revealed that they had been unaware that the existing practices and procedures regarding the files for Section 13(f) CTRs were not in accordance with the records retention schedule.

#### **Recommendation 7:**

The Division of Investment Management and the Records Management Branch should modify their respective policies and procedures to ensure that files for the processing of confidential treatment requests under Section 13(f) of the Securities Exchange Act of 1934 are properly maintained and retained in accordance with the applicable record retention schedule, and should ensure that the established policies and procedures are followed.

**Management Comments.** IM and RM have concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased IM and RM concurred with this recommendation.

### **Finding 8: Certain Filers Received *De Facto* Confidential Treatment Even Though Their Applications Did Not Meet the Criteria for Confidential Treatment Under Section 13(f)**

Certain requesters received *de facto* confidential treatment although their requests did not meet the substantive criteria for confidential treatment of Section 13(f) information.

#### **Requirements for Obtaining Confidential Treatment Under Section 13(f)**

As discussed above, Section 13(f)(3) provides that the Commission, as it determines to be necessary or appropriate in the public interest or for the protection of investors, may delay or prevent the public disclosure of information filed in Section 13(f) reports in accordance with the FOIA. According to IM, FOIA

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<sup>57</sup> See National Archives and Records Administration Standard Form 115, Job Number N1-266-98-1, Approved by the Archivist of the United States on Feb. 22, 1999 (requiring transfer of confidential treatment materials to the Federal Records Center after two years and destruction after 20 years.) Based upon the responses to our draft report, we determined that there is considerable disagreement and confusion between RM and IM regarding the appropriate retention schedule for CTR files. This confusion must be remedied in order for appropriate action to be taken consistent with Recommendation 7 of this Report.

Exemption 4 is the FOIA exemption that generally applies to Section 13(f) CTRs. IM's FAQs About Form 13F state that "[a]t a minimum, requests for confidential treatment must satisfy the requirements of FOIA Exemption 4 which protects 'trade secrets and commercial or financial information obtained from a person and privileged or confidential.'"<sup>58</sup> The standards for Section 13(f) confidential treatment are set forth in Rule 24b-2 under the Exchange Act and the Instructions to Form 13F. Rule 24b-2(c) states that "[p]ending a determination as to the objection [to public disclosure] filed[,] the material for which confidential treatment has been applied will not be made available to the public."

According to IM's guidance to confidential treatment filers, the legislative history of Section 13(f) emphasizes the importance of granting confidential treatment to an ongoing investment strategy of an investment manager because "[d]isclosure of such strategy would impede competition and could cause increased volatility in the market place."<sup>59</sup> IM's guidance further provides that IM's position is that Section 13(f) CTRs "can be granted only under certain limited circumstances."<sup>60</sup>

The Form 13F confidential treatment request instructions state that "a [m]anager requesting confidential treatment must provide enough factual support for its request to enable the Commission to make an informed judgment as to the merits of the request."<sup>61</sup> The instructions further provide that the request should address all pertinent factors, including several listed relevant factors.<sup>62</sup> These factors include, among other things, the investment strategy being followed with respect to the relevant securities holdings, an explanation of why public disclosure of the securities would likely reveal the investment strategy, a demonstration that such revelation of an investment strategy would be premature, and a demonstration that failure to grant the CTR would likely cause substantial harm to the manager's competitive position.<sup>63</sup> IM's guidance to confidential treatment filers makes clear that a confidential treatment application that does not provide enough information to satisfy the required elements will be denied.<sup>64</sup>

Pursuant to Rule 24b-2(b)(2)(ii) under the Exchange Act, the confidential treatment applicant must justify the time period for which confidential treatment is

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<sup>58</sup> Frequently Asked Questions, Question 52 at pp. 14-15 (quoting 5 U.S.C. § 552(b)(4)).

<sup>59</sup> Scheidt Letter at p. 2 (quoting Report of Senate Comm. on Banking, Housing and Urban Affairs, S. Rep. No. 75, 94<sup>th</sup> Cong., 1<sup>st</sup> Sess. 87 (1975)).

<sup>60</sup> Scheidt Letter at p. 1.

<sup>61</sup> Form 13F, Instructions for Confidential Treatment Requests at p. 2.

<sup>62</sup> *Id.* See also Scheidt Letter at pp. 3-5.

<sup>63</sup> Form 13F, Instructions for Confidential Treatment Requests, at p. 2, Item 2. The confidential treatment instructions to Form 13F also provide for confidential treatment for open risk arbitrage positions if certain good faith representations are made. If the required representations are made in writing at the time the Form 13F is filed, the Commission will automatically accord the subject securities holdings confidential treatment for a period of up to one year from the date the institutional investment manager is required to file the Form 13F with the Commission. *Id.* at pp. 2-3, Item 2(f).

<sup>64</sup> Scheidt Letter at p. 3.

sought.<sup>65</sup> Confidential treatment based upon a claim that the subject information is confidential, commercial or financial information may initially be requested for a period not to exceed one year from the date the manager is required to file the Form 13F report with the Commission.<sup>66</sup> However, the request “should be limited to the period of time necessary to effectuate the institutional investment manager’s investment strategy.”<sup>67</sup> In order to extend the time period for which confidential treatment has been granted, the institutional investment manager must file a new request for confidential treatment at least 14 days in advance of the expiration date.<sup>68</sup> If the Commission denies a CTR, or upon expiration of the confidential treatment previously granted for a filing, absent a hardship exemption, the institutional investment manager must submit electronically within six business days of the expiration or notification of the denial, as applicable, a Form 13F report, or an amendment to a publicly-filed Form 13F report.<sup>69</sup>

## **Certain Filers Have Been Afforded *De Facto* Confidential Treatment**

As mentioned above, IM, acting under delegated authority from the Commission, grants or denies applications for confidential treatment of information filed under Section 13(f), and can revoke grants of confidential treatment for any such applications. According to IM, Rule 24b-2(c) under the Exchange Act provides for confidentiality pending review of a Section 13(f) CTR in order to, among other things, safeguard the interest of the requester. Thus, any passage of time before IM issues a written response to a CTR will result in the requester receiving *de facto* confidential treatment for some or all of its reportable securities positions. Our review of records pertaining to approximately 400 Section 13(f) CTRs that were submitted between January 2008 and December 2009 revealed that this has, in fact, occurred in certain situations. One of those ongoing situations, discussed below, resulted in six to 16 managers per quarter receiving confidential treatment for a single holding over some part of a two-calendar year period. The other ongoing situation, also discussed below, involves a particular class of filer.

During our review, we obtained from IM a database listing of CTRs submitted between January 2008 and December 2009. Our review of this listing revealed that, for certain filers, there was no information showing whether the request had been granted or denied. Upon inquiry of the IM staff who maintain the database, we learned that a majority of the filers with missing status were holding securities of one particular issuer, and that IM had not officially granted or denied the CTRs

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<sup>65</sup> 17 C.F.R. § 240.24b-2(b)(2)(ii).

<sup>66</sup> Form 13F, Instructions for Confidential Treatment Requests, at p. 2, Item 2(e).

<sup>67</sup> Frequently Asked Questions, Question 57a at p. 21. See also Scheidt Letter at p. 3.

<sup>68</sup> Form 13F, Instructions for Confidential Treatment Requests at p. 3, Item 2(g).

<sup>69</sup> *Id.* at p. 3, Item 4.

submitted by these filers. We found that some CTRs pertaining to the securities of the issuer that had neither been granted nor denied dated back to March 2008. Most of the managers that requested confidential treatment for their position in the issuer filed *de novo* requests when the initial one-year period of confidential treatment requested was due to expire. In the absence of a written response to their quarterly requests, such managers received *de facto* confidential treatment. In some instances, such period of *de facto* confidential treatment was longer than one year.

During the review, IM officials provided us with details regarding their communications with the issuer, as well as IM's exploration of potential options to address the situation. Our review determined that these requests for confidential treatment did not meet the substantive criteria for granting a CTR. Therefore, based upon the applicable procedures and IM's own guidance, we believe these requests should have been denied.

Another instance in which Form 13F filers received *de facto* confidential treatment involved a particular class of filer, certain large foreign institutional investment managers. The portfolios of these foreign managers generally consist of assets such as stocks, bonds, property or other financial instruments, and such managers generally invest on a global basis. Our review of IM's CTR database listing for the period from March 2008 to December 2009 revealed that IM had not granted or denied CTRs submitted by a particular large foreign institutional investment manager for its March, June and December 2009 filings, thus affording these filings some period of *de facto* confidential treatment.

IM staff explained to the OIG their work to date in analyzing the large foreign institutional investment manager's CTRs. Our review determined that such requests for confidential treatment under Section 13(f)(3) did not meet the substantive criteria for the granting of confidential treatment. Rather than denying the requests, however, IM did not respond to the requests in writing and, as a result, the foreign manager received *de facto* confidential treatment.

### **Recommendation 8:**

The Division of Investment Management (IM), in consultation with the Chairman's Office, as necessary, should take appropriate steps to improve its policies and procedures to ensure that written requests for confidential treatment under Section 13(f) of the Securities Exchange Act of 1934 (particularly certain novel requests) are granted or denied within an appropriate timeframe, so that institutional investment managers are not afforded *de facto* confidential treatment as a result of IM not issuing a written response.

**Management Comments.** IM concurred with this recommendation. See Appendix V for management’s full comments.

**OIG Analysis.** We are pleased that IM concurred with this recommendation.

**Recommendation 9:**

The Division of Investment Management, in consultation with the Office of the General Counsel, the Office of International Affairs and the Chairman’s Office, as necessary, should take appropriate steps to improve its policies and procedures to ensure that requests for relief under Section 13(f) of the Securities Exchange Act of 1934 made by certain large foreign institutional investment managers are addressed in a timely and appropriate manner.

**Management Comments.** IM concurred with this recommendation. See Appendix V for management’s full comments.

**OIG Analysis.** We are pleased that IM concurred with this recommendation.

## **Finding 9: Form 13F Does Not Currently Require Disclosure of All Significant Investment Activities of Institutional Investment Managers and Could Be Improved**

The current Form 13F does not provide for the disclosure of all significant investment activities of institutional investment managers, and it could be improved to be more useful to the public.

### **Limitation on Securities Currently Required to be Reported Under Section 13(f)**

The types of information and categories of investments required to be reported under Section 13(f) have not been updated since the enactment of that Section in 1975. The types of securities required to be reported under Section 13(f) include “exchange-traded (e.g., NYSE, AMEX) or NASDAQ-quoted stocks, equity options and warrants, shares of closed-end investment companies, and certain convertible debt securities.”<sup>70</sup> More sophisticated investment vehicles, such as derivatives or shares of open-end investment companies and mutual funds that

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<sup>70</sup> Frequently Asked Questions, Question 7 at p. 3.

might have been used to hedge equity securities, are not required to be reported on Form 13F. As a consequence, the public cannot obtain a complete picture of all significant investment activities of institutional investment managers.

## **Aggregation of Securities Reported on Form 13F**

Section 13(f) allows institutional investment managers to report securities over which the institutional investment managers have discretion in the aggregate, making Form 13F filings less helpful for users to analyze institutional investment managers' activities. According to IM's FAQs About Form 13F, an investment advisory firm that has sole investment discretion may aggregate all of its holdings in each issuer and report all of its holdings in a security in one entry on Form 13F.<sup>71</sup> An investment advisory firm may also aggregate its holdings on Form 13F if it shares investment discretion with someone that does not have an independent obligation to file under Section 13(f).<sup>72</sup> According to a Risk Fin staff member, a requirement that institutional investment managers separately report holdings in proprietary accounts and holdings in customer accounts would provide the public with a more meaningful picture of the activities of institutional investment managers.

## **Average Positions in Section 13(f) Securities**

Institutional investment managers are required to report Section 13(f) securities held at the end of a quarter. Hence, an institutional investment manager that purchased a significant amount of Section 13(f) securities after the beginning of a quarter, but disposed of them before the quarter end, would not be required to report those holdings. As a consequence, the public does not have complete information about the activities of the institutional investment managers during a quarter and the effect of those activities on the market. A Risk Fin staff member noted that a simple way to fix this problem would be to add a requirement to Section 13(f) that would require the institutional investment managers to report average positions held in Section 13(f) securities during a quarter. This additional information would provide a clearer picture of the institutional investment managers' activities.

## **Increasing the Threshold for Section 13(f) Reporting**

According to an IM attorney who reviewed the issue, the current Section 13(f) reporting threshold of \$100 million is outdated as it does not reflect inflation and appreciation in securities since the inception of Section 13(f) in 1975. In 2006, at IM's request, Risk Fin (then the Office of Economic Analysis) performed an analysis of the impact of increasing the threshold required for Section 13(f)

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<sup>71</sup> *Id.*, Question 38 at p. 10.

<sup>72</sup> *Id.*, Question 38 at pp. 10-11.

reporting from \$100 million to an amount reflecting inflation. According to that analysis, a threshold of \$300 million, which reflected inflation using the consumer price index, would result in a significant decrease in the number of institutional investment managers that would be required to file Form 13F, but a relatively modest decrease in the total dollar amount of assets covered. We believe that this analysis should be updated to determine whether an increase in the threshold amount should be pursued.

## **Aggregate Purchases and Sales of Section 13(f) Securities**

Section 13(f)(1)(D) gives the Commission the authority to require institutional investment managers to report the aggregate purchases and aggregate sales of holdings in Section 13(f) securities during the reporting period.<sup>73</sup> However, the Commission currently has not adopted a rule to require the disclosure of aggregate purchases and sales of Section 13(f) securities. This additional disclosure would assist the public in better understanding the frequency and volume of trading activities of the institutional investment managers.

### **Recommendation 10:**

The Division of Investment Management, in consultation with the Division of Risk, Strategy, and Financial Innovation, the Office of the General Counsel and the Chairman's Office, should determine whether legislative changes to Section 13(f) of the Securities Exchange Act of 1934 should be sought, specifically with respect to expanding the definition of Section 13(f) securities, requiring separate reporting of securities held in proprietary accounts and customer accounts, reporting average positions in Section 13(f) securities, and increasing the Section 13(f) reporting threshold.

**Management Comments.** IM and Risk Fin concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased that IM and Risk Fin concurred with this recommendation.

### **Recommendation 11:**

The Division of Investment Management, in consultation with the Chairman's Office, should request that the Division of Risk, Strategy, and Financial Innovation update its analysis of the impact of increasing the reporting threshold of \$100 million for Section 13(f) of the Securities Exchange Act of 1934.

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<sup>73</sup> 15 U.S.C. § 78m(f)(1)(D).

**Management Comments.** IM and Risk Fin have concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased IM and Risk Fin concurred with this recommendation.

**Recommendation 12:**

The Division of Investment Management, in consultation with the Division of Risk, Strategy, and Financial Innovation and the Chairman's Office, should determine whether to recommend to the Commission that it adopt a rule requiring institutional investment managers to report aggregate purchases and aggregate sales of securities required to be reported under Section 13(f) of the Securities Exchange Act of 1934.

**Management Comments.** IM and Risk Fin concurred with this recommendation. See Appendix V for management's full comments.

**OIG Analysis.** We are pleased that IM and Risk Fin concurred with this recommendation.

## Acronyms

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AMEX	American Stock Exchange
CTR	Confidential Treatment Request
CUSIP	Committee on Uniform Securities Identification Procedures
EDGAR	Electronic Database Gathering and Retrieval
Exchange Act	Securities Exchange Act of 1934
FAQs	Frequently Asked Questions
FOIA	Freedom of Information Act
FTP	File Transfer Protocol
IM	Division of Investment Management
NASDAQ	National Association of Securities Dealers Automated Quotations
NYSE	New York Stock Exchange
OCIE	Office of Compliance Inspections and Examinations
OGC	Office of the General Counsel
OIG	Office of Inspector General
OIT	Office of Information Technology
Risk Fin	Division of Risk, Strategy, and Financial Innovation
RM	Records Management Branch
SAS	Statement of Auditing Standards
SEC or Commission	U.S. Securities and Exchange Commission
XBRL	Extensible Business Reporting Language
XML	Extensible Markup Language

## Scope and Methodology

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This review was not conducted in accordance with the government auditing standards.

**Scope.** The scope of this review covered the period from January 2008 to December 2009, and included a review of Congress's intent in enacting Section 13(f) of the Exchange Act, the reporting process for Section 13(f), the Form 13F filings and requests for confidential treatment of information reported on Form 13F. We obtained from IM a listing of CTRs from January 2008 to December 2009, information concerning IM's internal procedures for processing CTRs, and other information necessary to determine whether the CTRs were being properly processed. We conducted our fieldwork from May 2010 to June 2010.

**Methodology.** To meet the objectives to examine whether the Commission's implementation of and current practices under Section 13(f) meet Congress's intent in establishing Section 13(f); determine whether the reporting of entities covered under Section 13(f) is appropriately designed to comply with the statutory requirements; and determine whether the Commission's policies and procedures for reviewing and processing requests for confidential treatment of information required to be reported under Section 13(f) are adequate and appropriate, the OIG conducted a survey of IM staff members who have duties or responsibilities pertaining to Section 13(f). We then interviewed the IM staff responsible for executing policies and procedures with respect to Section 13(f), primarily including the processing of CTRs. We also interviewed staff in Risk Fin and OCIE regarding the Section 13(f) reporting process, and RM staff regarding the procedures pertaining to CTR files. Additionally, we reviewed IM's procedures for processing CTRs. We selected and tested a sample of CTRs that were processed by IM to determine if IM adhered to the applicable rules and regulations in affording confidential treatment to the Section 13(f) filings of institutional investment managers.

**Internal or Management Controls.** We reviewed internal and management controls as they pertained to the objectives of our review.

**Use of Computer-Processed Data.** We relied on data from the SEC's EDGAR system, which included the name of the filer and Form 13F data for a selected sample of CTRs. The EDGAR system does not process any of the data contained in the Form 13F filings, but rather only stores the filings in electronic format. As a result, we considered the relevant risks to be:

- An EDGAR system failure to receive or retain a Form 13F filing from an issuer; and

- Information security risks related to whether Form 13F information in the EDGAR system could be compromised.

We considered the risk surrounding information security and noted that, in November 2007, OIT certified and accredited the EDGAR system, as required by the Federal Information Security Management Act of 2002. Therefore, we concluded that we could rely upon the information in the EDGAR system as it pertains to information security.

We also relied on IM's internal database listing for CTRs. We performed testing of the database listing for accuracy and completeness by comparing information in the database listing to information contained in source documents, such as Forms 13F and CTR letters.

**Judgmental Sampling.** IM provided us with a list of CTRs submitted under Section 13(f) for the period from January 2008 to December 2009, which included approximately 446 CTRs. We determined that a sample size of 25 (5.6 percent) was reasonable for the purposes of our testing.

## Criteria

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**Section 13(f) of the Securities Exchange Act of 1934, 15 U.S.C. § 78m(f).**

Established a reporting requirement for securities holdings of institutional investment managers in order to increase the public availability of information regarding the securities holdings of institutional investors. Requires this data to be made publicly available unless the Commission prevents or delays disclosure as necessary or appropriate in the public interest to protect investors. Enacted by Public Law 94-29, the Securities Acts Amendments of 1975, on June 4, 1975.

**Voluntary Services Prohibition of the Antideficiency Act, 31 U.S.C. § 1342.**

Prohibits a U.S. Government officer or employee from accepting voluntary services except for emergencies involving the safety of human life or the protection of property.

**Report of the Senate Committee on Banking, Housing and Urban Affairs, Senate Report No. 94-75, 94<sup>th</sup> Cong., 1<sup>st</sup> Sess. (Apr. 14, 1975), reprinted in 1975 U.S.C.C.A.N. 179.** Contains the legislative history for Section 13(f) of the Exchange Act.

**Commission Rule 13f-1, 17 C.F.R. § 240.13f-1, Reporting by Institutional Investment Managers of Information with Respect to Accounts Over Which They Exercise Investment Discretion.** Requires quarterly reporting of institutional investment managers that exercise investment discretion of securities holdings of \$100 million or more on Form 13F. Initially adopted on June 15, 1978, and revised on January 5, 1979, and January 12, 1999.

**Commission Rule 24b-2, 17 C.F.R. § 240.24b-2, Nondisclosure of Information Filed with the Commission and with Any Exchange.** Specifies the procedure for requesting confidential treatment of information required to be filed with the Commission under the Exchange Act. Provides that the procedure set forth in the rule is the exclusive procedure for requesting confidential treatment of information required to be filed under the Exchange Act. Initially adopted on April 28, 1976, and revised on February 23, 1993, June 9, 1995, September 7, 1995, and May 31, 1996.

**Commission Rule of Organization 30-5(c)(1) and (2), 17 C.F.R. § 200.30-5(c)(1) and (2), Delegation of Authority to Director of Division of Investment Management.** Delegates authority to the Director of IM to grant and deny applications for confidential treatment of information filed pursuant to Section 13(f) and Rule 13f-1 thereunder, and to revoke a grant of confidential treatment for any such application. Added on February 5, 1981.

**Instructions for Form 13F, Information Required of Institutional Investment Managers Pursuant to Section 13(f) of the Securities Exchange Act of 1934 and Rules Thereunder.** Contains both general instructions for filing Form 13F and instructions for CTRs submitted under Form 13F. Initially adopted on June 15, 1978, and revised on January 5, 1979, June 28, 1979, and May 14, 1985, and January 12, 1999.

**Division of Investment Management Frequently Asked Questions About Form 13F, May 2005.** Contains the staff's views on frequently asked questions to assist institutional investment managers that are required to file Form 13F.

**Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Manager to Section 13(f) Confidential Treatment Filers.** Discusses IM's position regarding Form 13F confidential treatment requests. Issued on June 17, 1998.

## List of Recommendations

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**Recommendation 1:**

The Chairman's Office should delegate primary responsibility for reviewing and analyzing Form 13F information to the appropriate division or office.

**Recommendation 2:**

The Chairman's Office should assign to the appropriate divisions or offices responsibility for monitoring Section 13(f) filings for accuracy and completeness in order to limit the errors in or problems with the filings and thereby enhance the usefulness and reliability of the data.

**Recommendation 3:**

The Division of Investment Management and the Office of Information Technology should renew the efforts that were begun in 2005 and implement checks in the Electronic Data Gathering and Retrieval (EDGAR) system that will detect and/or correct obvious errors contained in the Forms 13F that are uploaded in EDGAR.

**Recommendation 4:**

The Division of Investment Management, in consultation with the Chairman's Office, should work with the Office of Information Technology and update Form 13F to a more structured format, such as Extensible Markup Language (XML), to make it easier for users and researchers to extract and analyze Section 13(f) data.

**Recommendation 5:**

The Chairman's Office should assign to an appropriate division and/or office responsibility for reviewing the official list of Section 13(f) securities that is prepared by a third party each quarter and testing the list for accuracy and completeness on a sample basis.

**Recommendation 6:**

The Division of Investment Management, in consultation with the Office of Administrative Services and the Chairman's Office, should ensure that the Securities and Exchange Commission (SEC) enters into a formal contract or agreement with the third party that prepares the official list required by Section 13(f)(3) of the Securities Exchange Act of 1934. This contract or agreement should document the third party's responsibilities for providing the official list on a quarterly basis and explicitly state that the SEC has no financial obligation and the firm has no expectation of payment from the government.

**Recommendation 7:**

The Division of Investment Management and the Records Management Branch should modify their respective policies and procedures to ensure that files for the processing of confidential treatment requests under Section 13(f) of the Securities Exchange Act of 1934 are properly maintained and retained in accordance with the applicable record retention schedule, and should ensure that the established policies and procedures are followed.

**Recommendation 8:**

The Division of Investment Management (IM), in consultation with the Chairman's Office, as necessary, should take appropriate steps to improve its policies and procedures to ensure that written requests for confidential treatment under Section 13(f) of the Securities Exchange Act of 1934 (particularly certain novel requests) are granted or denied within an appropriate timeframe, so that institutional investment managers are not afforded *de facto* confidential treatment as a result of IM not issuing a written response.

**Recommendation 9:**

The Division of Investment Management, in consultation with the Office of the General Counsel, the Office of International Affairs and the Chairman's Office, as necessary, should take appropriate steps to improve its policies and procedures to ensure that requests for relief under Section 13(f) of the Securities Exchange Act of 1934 made by certain large foreign institutional investment managers are addressed in a timely and appropriate manner.

**Recommendation 10:**

The Division of Investment Management, in consultation with the Division of Risk, Strategy, and Financial Innovation, the Office of the General Counsel and the Chairman's Office, should determine whether legislative changes to Section 13(f) of the Securities Exchange Act of 1934 should be sought, specifically with respect to expanding the definition of Section 13(f) securities, requiring separate reporting of securities held in proprietary accounts and customer accounts, reporting average positions in Section 13(f) securities, and increasing the Section 13(f) reporting threshold.

**Recommendation 11:**

The Division of Investment Management, in consultation with the Chairman's Office, should request that the Division of Risk, Strategy, and Financial Innovation update its analysis of the impact of increasing the reporting threshold of \$100 million for Section 13(f) of the Securities Exchange Act of 1934.

**Recommendation 12:**

The Division of Investment Management, in consultation with the Division of Risk, Strategy, and Financial Innovation and the Chairman's Office, should determine whether to recommend to the Commission that it adopt a rule requiring institutional investment managers to report aggregate purchases and aggregate sales of securities required to be reported under Section 13(f) of the Securities Exchange Act of 1934.

# Management Comments

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## MEMORANDUM

**TO:** H. David Kotz  
Inspector General

**FROM:** Kayla J. Gillan   
Deputy Chief of Staff, Office of the Chairman

**DATE:** September 24, 2010

**SUBJECT:** Response to Report No. 480, *Review of the SEC's Section 13(f) Reporting Requirements*

This memorandum is in response to the Office of Inspector General's Draft Report No. 480, entitled *Review of the SEC's Section 13(f) Reporting Requirements*. We appreciate the work of the Office of Inspector General (OIG) in reviewing the Commission's program and processes with regard to Section 13(f) of the Securities Exchange Act of 1934.

Section 13(f), which provides for the public availability of information regarding the securities holdings of certain institutional investors, is a vital part of the SEC's full disclosure program. The data that is provided by institutional investors on Form 13F is extraordinarily valuable to investors and other financial market participants. We welcome the OIG's focus on this important topic, and appreciate the Report's recommendations for ensuring the effectiveness of the agency's program to implement Section 13(f).

The purpose of this memorandum is to comment on the three recommendations that the Report directs to the Office of the Chairman.

**Recommendation 1:** *The Chairman's Office should delegate primary responsibility for reviewing and analyzing Form 13F information to the appropriate division or office.*

We concur with this recommendation. While the Report acknowledges the variety of important ways in which SEC staff make use of Form 13F data, including to support the agency's enforcement and rulemaking activities, we agree that it would be beneficial to clarify the appropriate roles and responsibilities with regard to data provided under Section 13(f), including identification of a primary office responsible for reviewing and analyzing Form 13F information.

To implement the recommendation, we will work with the relevant SEC offices, including the Division of Investment Management, Division of Corporation Finance, Division of

Risk, Strategy, and Financial Innovation, and Office of Compliance Inspections and Examinations, to assist in identifying and delineating the appropriate scope of responsibilities with respect to Section 13(f), and will consult with the Office of General Counsel as to whether formal Commission action would be required to execute any new or amended responsibilities.

**Recommendation 2:** *The Chairman's Office should assign to the appropriate divisions or offices responsibility for monitoring Section 13(f) filings for accuracy and completeness in order to limit the errors in or problems with the filings, thereby enhancing the usefulness and reliability of the data.*

We concur with this recommendation. In taking the actions described in the response to Recommendation 1, we will include a specific focus on the responsibility for monitoring of Section 13(f) filings. Since there are approximately 3,000 to 4,000 Form 13Fs filed each quarter, we appreciate the OIG's acknowledgement that any actions that might be considered in connection with enhanced monitoring of Form 13F filings need not entail "cumbersome and time-consuming" reviews of each filing. We will also give particular attention to the specific suggestions made by the OIG to provide for more systematic monitoring of Form 13F, such as consideration of a pilot program or other initiative on a test basis.

**Recommendation 5:** *The Chairman's Office should assign to an appropriate division and/or office responsibility for reviewing the official list of Section 13(f) securities that is prepared quarterly by a third party and test it on a sample basis.*

We concur with this recommendation. In taking the actions described in the response to Recommendation 1, we will include a specific focus on office responsibilities with respect to the "Official List of Section 13(f) Securities" that is posted on the SEC's website. We agree that it is important that the official list be up-to-date and accurate, since institutional investment managers rely on it in preparing their 13F reports. In addition, as the SEC moves forward to implement Recommendation 6, which recommends that the SEC enter into a formal contract or agreement with the third party that prepares the list, it will provide an appropriate opportunity for the SEC, acting through our Office of Acquisitions, to obtain assurances with respect to the quality and reliability of the data provided.

Thank you, again, for your focus on these important topics, and for the OIG's work on this audit. Please don't hesitate to contact me if you have any questions.

*Memorandum*

To: H. David Kotz  
From: Andrew Donohue; Douglas Scheidt; David Grim; Stephan Packs  
Date: September 24, 2010  
Re: Division of Investment Management Response to the Office of Inspector General's Report No. 480 – Review of SEC's Section 13(f) Reporting Requirements

This memorandum is in response to the Office of Inspector General's Report No. 480. Thank you for the opportunity to respond to the report. We concur with the recommendations of the report insofar as they pertain to the Division of Investment Management ("IM"), and add the following comments.

We are pleased that the OIG found that, "IM has put in place well constructed review procedures for processing CTRs."

In addition, we concur with the Risk Fin comments on the report. In particular, we agree that consideration of significant changes to Form 13F should be part of a coordinated review of the overall SEC system for disclosing ownership and transactions in the securities of public companies, rather than in isolation, and that it may not be possible to undertake a review of the necessary scope immediately. IM will play an important role in this coordinated review. Although as the OIG report recognizes IM's delegated authority with respect to section 13(f) is limited to consideration of confidential treatment requests under the section, IM has experience that is relevant to each of the recommendations in the report. We look forward to collaborating with our colleagues on the staff who possess relevant expertise in implementing the recommendations.

Our comments on the specific recommendations are described below.

**Recommendation 1:** The Chairman's Office should delegate primary responsibility for reviewing and analyzing Form 13F information to the appropriate division or office.

*IM Comments:* Because this is a recommendation for the Chairman's Office, we defer to its judgment. We concur with the Risk Fin comments as they relate to this recommendation, particularly the discussion of how the Commission staff currently does use Section 13(f) information in a number of important ways.

**Recommendation 2:** The Chairman's Office should assign to the appropriate divisions or offices responsibility for monitoring Section 13(f) filings for accuracy and completeness in order to limit the errors in or problems with the filings and thereby enhance the usefulness and reliability of the data.

*IM Comments:* Because this is a recommendation for the Chairman's Office, we defer to its judgment.

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**Recommendation 3:** The Division of Investment Management and the Office of Information Technology should renew the efforts that were begun in 2005 and implement checks in the Electronic Data Gathering and Retrieval (EDGAR) system that will detect and/or correct obvious errors contained in the Forms 13F that are uploaded in EDGAR.

*IM Comments:* We concur with this recommendation.

**Recommendation 4:** The Division of Investment Management, in consultation with the Chairman's Office, should work with the Office of Information Technology and update Form 13F to a more structured format, such as Extensible Markup Language (XML), to make it easier for users and researchers to extract and analyze Section 13(f) data.

*IM Comments:* We concur with this recommendation. IM will share its relevant experience in collaborating with the Chairman's Office and the Office of Information Technology to implement this recommendation. Per Risk Fin's comments, we also will benefit from their expertise on these issues.

**Recommendation 5:** The Chairman's Office should assign to an appropriate division and/or office responsibility for reviewing the official list of Section 13(f) securities that is prepared by a third party each quarter and testing the list for accuracy and completeness on a sample basis.

*IM Comments:* Because this is a recommendation for the Chairman's Office, we defer to its judgment.

**Recommendation 6:** The Division of Investment Management, in consultation with the Office of Administrative Services and the Chairman's Office, should ensure that the Securities and Exchange Commission (SEC) enters into a formal contract or agreement with the third party that prepares the official list required by Section 13(f)(3) of the Securities Exchange Act of 1934. This contract or agreement should document the third party's responsibilities for providing the official list on a quarterly basis and explicitly state that the SEC has no financial obligation and the firm has no expectation of payment from the government.

*IM Comments:* We concur with this recommendation. IM will share its relevant experience in collaborating with the Office of Administrative Services and the Chairman's Office to implement this recommendation.

**Recommendation 7:** The Division of Investment Management and the Records Management Branch should modify their respective policies and procedures to ensure that files for the processing of confidential treatment requests under Section 13(f) of the Securities Exchange Act of 1934 are properly maintained and retained in accordance with the applicable record retention schedule, and should ensure that the established policies and procedures are followed.

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*IM Comments:* We concur with this recommendation. IM has already begun coordinating with Records Management on modifying the relevant policies and procedures.

**Recommendation 8:** The Division of Investment Management (IM), in consultation with the Chairman's Office, as necessary, should take appropriate steps to improve its policies and procedures to ensure that written requests for confidential treatment under Section 13(f) of the Securities Exchange Act of 1934 (particularly certain novel requests) are granted or denied within an appropriate timeframe, so that institutional investment managers are not afforded *de facto* confidential treatment as a result of IM not issuing a written response.

*IM Comments:* We concur with this recommendation. As the OIG recognizes, IM has well constructed review procedures for processing CTRs. In the cases at issue in recommendation 8, IM has expended substantial resources in analyzing novel, complicated issues that go beyond the issues that typically are the subject of a Form 13F CTR. IM has and will continue to act prudently and appropriately in attempting to resolve these matters, focusing on ensuring that no filer is afforded unwarranted *de facto* confidential treatment.

**Recommendation 9:** The Division of Investment Management, in consultation with the Office of the General Counsel, the Office of International Affairs and the Chairman's Office, as necessary, should take appropriate steps to improve its policies and procedures to ensure that requests for relief under Section 13(f) of the Securities Exchange Act of 1934 made by certain large foreign institutional investment managers are addressed in a timely and appropriate manner.

*IM Comments:* We concur with this recommendation. As the OIG recognizes, IM has well constructed review procedures for processing CTRs. In the cases at issue in recommendation 9, IM has expended substantial resources in analyzing novel, complicated issues that go beyond the issues that typically are the subject of a Form 13F CTR. IM has and will continue to act prudently and appropriately in attempting to resolve these matters, focusing on ensuring that no filer is afforded unwarranted *de facto* confidential treatment.

**Recommendation 10:** The Division of Investment Management, in consultation with the Division of Risk, Strategy, and Financial Innovation, the Office of the General Counsel and the Chairman's Office, should determine whether legislative changes to Section 13(f) of the Securities Exchange Act of 1934 should be sought, specifically with respect to expanding the definition of Section 13(f) securities, requiring separate reporting of securities held in proprietary accounts and customer accounts, reporting average positions in Section 13(f) securities, and increasing the Section 13(f) reporting threshold.

*IM Comments:* We concur with this recommendation. IM will share its relevant experience in collaborating with Risk Fin, OGC, and the Chairman's Office to implement this recommendation. We also concur with the Risk Fin comments as they relate to this recommendation. In particular, we emphasize that consideration of significant changes to Form 13F should be part of a

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coordinated review of the overall SEC system for disclosing ownership and transactions in the securities of public companies, rather than in isolation, and that it may not be possible to undertake a review of the necessary scope immediately.

**Recommendation 11:** The Division of Investment Management, in consultation with the Chairman's Office, should request that the Division of Risk, Strategy, and Financial Innovation update its analysis of the impact of increasing the reporting threshold of \$100 million for Section 13(f) of the Securities Exchange Act of 1934.

*IM Comments:* We concur with this recommendation. IM will share its relevant experience in collaborating with the Chairman's Office and Risk Fin to implement this recommendation. We also concur with the Risk Fin comments as they relate to this recommendation. In particular, we emphasize that consideration of significant changes to Form 13F should be part of a coordinated review of the overall SEC system for disclosing ownership and transactions in the securities of public companies, rather than in isolation, and that it may not be possible to undertake a review of the necessary scope immediately.

**Recommendation 12:** The Division of Investment Management, in consultation with the Division of Risk, Strategy, and Financial Innovation and the Chairman's Office, should determine whether to recommend to the Commission that it adopt a rule requiring institutional investment managers to report aggregate purchases and aggregate sales of securities required to be reported under Section 13(f) of the Securities Exchange Act of 1934.

*IM Comments:* We concur with this recommendation. IM will share its relevant experience in collaborating with Risk Fin and the Chairman's Office to implement this recommendation. We also concur with the Risk Fin comments as they relate to this recommendation. In particular, we emphasize that consideration of significant changes to Form 13F should be part of a coordinated review of the overall SEC system for disclosing ownership and transactions in the securities of public companies, rather than in isolation, and that it may not be possible to undertake a review of the necessary scope immediately.

MEMORANDUM

TO: H. David Kotz, Inspector General

FROM: Henry Hu, Director, Division of Risk, Strategy, and Financial Innovation  
H. H.

DATE: September 17, 2010

RE: Draft Review of the SEC's Section 13(f) Reporting Requirements (Report No 480)

Thank you for the opportunity to review the September 2 "formal draft" of the *Review of the SEC's Section 13(f) Reporting Requirements*. We appreciate, in particular, your taking into account many of the comments we provided previously to your staff. We concur in the recommendations of the report insofar as they pertain to the Division of Risk, Strategy, and Financial Innovation (Risk Fin), and add the following comments.

Risk Fin has assumed the structured data responsibilities of the former Office of Interactive Data and so will assist the Division of Investment Management (IM) in working with the Office of Information Technology as contemplated by Recommendation 4.<sup>1</sup>

Staff of our Division, notably our economists, make extensive use of Section 13(f) data. The examples you have included in the Report reflect that these data are used extensively in our support of both the SEC's enforcement and rulemaking activities. As to Recommendations 10, 11, and 12, we believe that consideration of significant changes to Form 13F should be part of a coordinated review of the overall SEC system for disclosing ownership and transactions in the securities of public companies, rather than in isolation. You will understand that it may not be possible to undertake a review of the necessary scope immediately.

Once again, I want to thank you and your staff for your careful work on this report. Please don't hesitate to contact me if I can provide further clarification.

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<sup>1</sup> In this regard, we point out that the last paragraph on page 14 could be misread to imply that the XBRL initiative somehow conflicted with the goal of structuring 13F data. In fact, the XBRL work already completed in connection with mutual fund holdings reporting substantially overlaps with the 13F structured data initiative contemplated by Recommendation 4, and means that most of this work is actually already done.

MEMORANDUM

September 16, 2010

**TO:** H. David Kotz  
Inspector General

**FROM:** Sharon Sheehan   
Associate Executive Director  
Office of Administrative Services

**SUBJECT:** OAS Management Response to Draft Report No. 480, *Review of the SEC's Section 13(f) Reporting Requirements*

This memorandum is in response to the Office of Inspector General's Draft Report No. 480, *Review of the SEC's Section 13(f) Reporting Requirements*. Thank you for the opportunity to review and respond to this report. We concur with the recommendation addressed to OAS.

**Recommendation 6:**

OAS concurs. We view our role in implementing the recommendation as support to IM. Once a requirements document and proper RQ are submitted to OAS Office of Acquisitions, we will work with IM to execute a formal contract or agreement for the required services.

## OIG Response to Management's Comments

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The Office of Inspector General is pleased that the Chairman's Office, the Division of Investment Management, the Division of Risk, Strategy, and Financial Innovation, the Office of Administrative Services, the Office of Information Technology, the Office of FOIA and Records Management Services, and the Office of International Affairs concurred with all of the report's 12 recommendations. We believe that the implementation of these recommendations will result in significant improvements to the Section 13(f) reporting program and will ensure that, consistent with the intent of Congress in enacting Section 13(f), the investing public is provided with reliable and accurate information regarding the investment activities of institutional investment managers and the Form 13F data is fully utilized for a variety of regulatory purposes. We are pleased that the relevant SEC Offices and Divisions have agreed to work together to implement our recommendations and to ensure the effectiveness of the Section 13(f) program.

# Audit Requests and Ideas

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The Office of Inspector General welcomes your input. If you would like to request an audit in the future or have an audit idea, please contact us at:

U.S. Securities and Exchange Commission  
Office of Inspector General  
Attn: Assistant Inspector General, Audits (Audit Requests/Ideas)  
100 F Street, N.E.  
Washington D.C. 20549

Tel. #: 202-551-6061  
Fax #: 202-772-9265  
Email: [oig@sec.gov](mailto:oig@sec.gov)

## Hotline

To report fraud, waste, abuse, and mismanagement at SEC,  
contact the Office of Inspector General at:

Phone: 877.442.0854

Web-Based Hotline Complaint Form:  
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