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ATTORNEYS AND COUNSELORS AT LAW

August 19, 2020

By Email and Postal Mail

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-0609
Attention: Vanessa Countryman, Secretary

Re: S7-08-20 Reporting Threshold for Institutional Investment Managers Proposed Rule

Dear Ladies and Gentlemen:

Introductory Comments

We believe that the Securities and Exchange Commission's (the "SEC") current proposal to substantially raise the Form 13F reporting threshold from $100 million to $3.5 billion for institutional filers would be detrimental for market transparency from multiple market stakeholders' perspective, which are described below. We also believe (and highlight) that such an increase will raise the operating burden for beneficial asset owners, including our clients, who invest a substantial portion of their capital through small managers and derive utility from the public transparency afforded by 13F disclosure. We do not see how creating a disincentive for beneficial asset owners to invest in a small manager compared to a larger manager serves the longer-term interests of small managers who are cited key beneficiaries of the reporting threshold change advocated by the SEC's proposal.

Our comments on the recent 13F proposal are informed by the professional experience and observations of our clients accumulated through multiple decades of investing with small managers as well as making selective long-term oriented investments directly in security markets. Our clients are institutional filers making 13F disclosures on directly held positions as well as consumers of 13F disclosures to support the process of diligence and monitoring for their fund investments, as well as the process of managing their direct risk exposures.

We strongly urge the SEC to reconsider its proposal to change the reporting threshold and briefly list our arguments against the proposal below. We also provide a more comprehensive commentary in the body of this comment letter to clarify the rationale and provide support for the views expressed herein.

Our principal arguments in favor of maintaining the current reporting threshold are as follows:

- Beneficial asset owners, such as our clients, routinely allocate much of their capital to fund managers and use 13F disclosures as an unbiased public source of holdings information to inform due diligence into prospective new managers and support monitoring of their existing manager relationships. This is especially the case for small managers who have limited resources to engage directly to understand and meet individual clients' transparency needs.
- Through our clients' own direct experience and dialogue with other institutional filers, we believe that the SEC's concern that the direct and indirect costs associated with 13F compliance are burdensome on small managers is seriously overstated and the typical costs are in practice not material.
- The proposal if enacted will effectively eradicate a broad-based, unbiased, and unique public source of institutional holdings information that cannot be substituted, thus diluting the quality of independent research into the role and function of active managers in US capital markets.
- Transparency into $2.3 trillion in aggregate market positioning would be lost with disproportionate implication for understanding trading behavior and mitigating security price volatility in the typical US listed equity security by market capitalization.
- 13F disclosures serve as the only reliable source of public institutional holdings information for corporate issuers. As market participants with a stake in maintaining diversity in the investment opportunity set represented by US publicly listed corporations, our clients believe there should be transparency for all issuers, regardless of their size, to readily identify a wide cross-section of their shareholder base and direct their shareholder engagement efforts effectively. Effective shareholder engagement allows for more efficient capital markets, reduces the cost of capital for corporates seeking to fund their growth, and this economic growth in turn benefits a diverse community of stakeholders ranging from employees, to pension plans and the investing public.

Detailed Rationale & Support for Our Arguments Against the Proposal to Raise the 13F Reporting Threshold

Beneficial asset owners who allocate capital to fund managers use 13F disclosures as an unbiased public source of holdings information to inform due diligence into prospective new managers and support monitoring of their existing manager relationships. This is especially the case for small managers who have limited resources or otherwise lack the operational sophistication to engage directly to understand and meet individual clients' transparency needs

Historical trends in holdings information can be used to analyze past investment behaviors (such as portfolio construction), performance, and risk attribution at the stock and sector level for active managers, as well as monitor whether managers maintain exposures that are consistent with their stated investment strategy and risk parameters. Removing the sole and trusted source of public transparency would raise not lower the operational cost burden on small managers as well as their clients because these parties will now have to privately negotiate on a one on one basis for increased transparency, execute and monitor non-disclosure agreements to safeguard disclosures that are not in the public domain, and labor to identify and resolve inconsistencies in transparency provided by different managers or to different clients. In some situations, the viable solution will be to establish investment vehicles that allow for full transparency of investment holdings and trading activity only for certain clients, but these are operationally burdensome to administer for all involved. Faced with this menu of alternatives, some clients may simply elect not to incur the additional time and expense to negotiate, diligence, and structure investments with small and less operationally sophisticated managers. We do not believe such an outcome serves the long-term interests of small managers, which the SEC proposal says it seeks to benefit, or the efficient allocation of capital by investors such our clients into the US equity market.

We believe that SEC's stated concern that the direct and indirect costs associated with 13F are burdensome on small managers is not borne out in practice

Our clients bear the direct costs of 13F compliance, and they advise us that the compliance related expense associated with 13F requirements is significantly lower than even the low-end estimate cited in the SEC proposal. Our clients' discussions with several small managers further confirm the view that 13F reporting requirements are relatively straightforward and inconsequential to the manager's time allocation and operating overhead. In fact, for many small managers the process is automated and leverages existing systems of record, software, or third-party service provider relationships they need to manage their portfolios and run their

businesses in the normal course. Thus, their marginal 13F compliance related costs are trivial. It seems to us that the current SEC cost estimates must assume that a specialized system of records or software needs to be operated for 13F compliance which is not in our experience typical for managers.

The SEC has also voiced concern about the indirect costs smaller managers bear in meeting 13F requirements. One such concern is that small funds are potentially disadvantaged due to front-running and copycatting. We believe this concern is overstated and at odds with the trading acumen with which we see small professional money managers operate.

Firstly, in almost all cases the 45-day reporting lag for 13F disclosure affords enough time delay to render front-running implausible. That said, "small" managers as defined within the SEC proposal also have several cost-effective ways to delay or avoid disclosure of a position. For example, where trades might otherwise be made close to the end of a quarter, the manager can defer their trades to after an end of a calendar quarter to avail themselves of up to a full 135 days before the effect of their trading would be disclosed in a 13F. They can also employ effective trading tools or strategies to alter the underlying economic exposure of their holdings, such as using swap transactions or engaging in a "short sale against the box," none of which are currently required to be disclosed in a 13F and thus are not visible to others.

Secondly, with respect to the implications of potential copycatters for managers, it is questionable to what extent prospective copycatting benefits or disadvantages small managers. For example, to the extent that copycatting of a manager's position by other investors drives up stock prices, then a small manager can trim their own holdings by selling shares to the copycatters as prices rise. In this way they can benefit by realizing profits on their holdings sooner and potentially also look to repurchase previously sold shares at lower prices when the upward stock price pressure from a temporary surge in demand by copycatting inevitably abates.

To be clear, in our clients' experience small managers are not pervasively utilizing such methods because they are not significantly concerned about indirect costs given the frequency and reporting lag associated with 13F disclosure. However, should they have such concerns they have several readily exercisable tools at their disposal to mitigate these concerns.

In supporting the case for indirect costs of compliance the SEC proposal cites an academic paper that purports to attribute 13F disclosure as a reason for decline in hedge fund performance. However, we think any causal linkage between hedge fund performance and 13F disclosures is questionable considering the evolution of the hedge fund industry over the last two decades. Specifically, according to third party research[1] between 2001 and 2017 global hedge fund assets

[1] Representative research sources include Barclays 2019 Global Hedge Fund Industry Outlook Report and HFR Research.

(the majority of which is invested in US markets) grew from $0.5 trillion to $3.2 trillion while the corresponding number of hedge fund operators more than quintupled. A substantial number of these thriving funds have been subject to 13F disclosure requirement for most of their existence and so we find it puzzling how it is possible for the industry and many funds to thrive if 13F disclosure was a material impediment to hedge funds' ability to perform and attract capital. Rather we would argue to those who seek to draw a link between 13F disclosure and trends in hedge fund performance, that factors such as increased competitive intensity[2], diminishing investment returns to scale[3], and macro conditions[4] are more credible causal factors explaining potential sources of headwinds to hedge fund industry performance than the disclosure requirement for 13Fs. Thus, we do not think it is advisable to subjugate market transparency considerations (discussed below) for unsubstantiated and questionable concerns regarding the direct and indirect costs of 13F compliance borne by small managers.

The SEC's proposal eliminates public transparency into an unbiased and unique source of institutional holdings information that cannot be substituted

13F data is unique in that it is the only reliable public source of institutional holdings data that is systematically collected from institutional participants. This source is frequently used in academic and market research studies and drives insights from time series and holdings-based analysis that sharpens understanding of collective risk-taking behavior and causal drivers of performance for active managers, including hedge funds and activist investors. It also informs understanding of these managers' role in bridging gaps in market efficiency. Without holdings-based data analysis, insights are substantially diminished or altogether obfuscated as researchers are forced to rely solely on more questionable sources of performance data (discussed below) and blunt statistical analysis that lack the granularity to discern cause and effect from mere correlation.

Contrary to the SEC proposal's assertion, the historical 13F filings disclosure is in our clients' many years of experience investing with funds not readily substitutable by other publicly available or commercial databases of self-reported time series manager data. Specifically, 13F data is free from several sources of bias that are pervasive in other self-reported databases. For example, it is free from selection bias which occurs when managers choose at their discretion when and if to report in a period, thus limiting the accuracy of the insights that can be drawn from

[2] Competitive intensity can be proxied by growth in number of hedge fund operators and adoption of hedge fund strategies by traditional managers.
[3] Scale is proxied by assets under management.
[4] Specifically, we would argue that a prolonged low interest rate environment, narrow or uneven sources of economic growth and an extended bull market by historical standards (which weighs on profitability of short selling) have served as contributory headwinds for hedge fund performance.

time series trends. It is also free from survivorship bias which routinely occurs in commercial databases that purge their databases of historical reporting by managers that have ceased to operate. These sources of bias create material gaps in the historical record that greatly hinder robust study of active manager industry evolution, risk taking, and performance analysis.

The proposal would result in loss of visibility into 90% of institutional filers' holdings and their collective $2.3 trillion in market positioning that has implications for the orderly trading of many US listed equity securities.

Within its 13F proposal the SEC states its belief that it is only necessary to provide regulators and the public information regarding the equity holdings of large managers that have potential to affect the securities market. Implicit in this statement is that only large managers pose risk to operation of orderly markets for US equity securities while small managers do not. Presumably, this assertion rests on the logic that large investors are more likely to have disruptive market impact as their trades have greater potential to be outsized relative to available market liquidity. We agree that large managers can pose risk, but we also believe that small managers can pose risk to the orderly trading of many US publicly traded securities through the aggregate effect of their collective investment actions borne from optimizing for their individual risk seeking and mitigating preferences.

Large funds can be categorized as either passive index investors whose activity mirrors market capitalization weighted indices, or alternatively as sophisticated active market participants who are keenly aware of their footprint in the market and have a strong disincentive to trade frequently in and out of securities due to high friction cost they incur in doing so. These dynamics are markedly different for small and more nimble managers. Firstly, small managers can respond to uncertainty by exiting a position with the expectation of reentering relatively quickly and at low friction costs as the uncertainty dissipates. Secondly, small managers have flexibility to manage relatively concentrated portfolios as they are not bound by the same liquidity constraints as their larger brethren. Concentrated portfolios are attractive to small managers as they offer greater potential to make outsized return, but concentration also exposes small managers to greater risk from individual stock price volatility so they have an increased incentive to mitigate this risk by reducing exposure swiftly when they believe they can.

Given these dynamics, individual small and nimble managers often seek to be flexible in their positioning. However, when stocks are significantly owned or traded by more nimble institutional investors, then the collective effect of these managers exercising investment flexibility in response to unexpected news or market events has profoundly disruptive influence on an issuer's stock price. We believe such risk is meaningful for many US listed issuers given the modest market capitalization of a typical corporate issuer compared to the

cumulative $2.3 trillion in purchasing power represented by small and nimble managers. Specifically, the median market capitalization of index constituents for the Russell 3000 (a widely used institutional benchmark for the largest and most investable 3000 US listed stocks) is only $1.5 billion[5]. Given the modest market capitalization of at least half the investable US listed stocks, collective participation by small and nimble managers can easily represent a substantial percentage of the shares of a typical US listed issuer, and an even higher proportion of their average daily trading volume.

We believe that removing holdings disclosure for 90% of institutional filers removes important market transparency by eliminating all investors ability to quantify positioning risks in the stock market. In turn this undermines confidence in investing across a wide cross section of companies by market cap and does a disservice to the vibrancy of the US public markets.

13F's are the only reliable source of public institutional holdings information for corporate issuers and we believe that there should be transparency for corporate issuers to readily identify a diverse cross section of their shareholder base and direct their engagement efforts accordingly to optimize their cost of capital

The needs of market transparency and ensuring all participants have confidence to support a well-functioning and two-sided (issuer and investor driven) market are often paramount in establishing necessary disclosure requirements for corporates. To that end, the SEC has mandatory quarterly as well as annual public disclosure requirements for listed corporate issuers where the associated complexity and cost of compliance for issuers can be substantial. Many of these issuers can also credibly argue that certain public disclosure required by regulation or otherwise expected by their public shareholders is not in their direct or immediate interest as it contains information that is sensitive for competitive purposes.

In contrast to the SEC's stance in promoting a high standard for corporate disclosure, the current 13F proposal threatens to upend two-sided market transparency by eliminating the ability of corporate issuers to identify a broad cross section of their actively managed institutional shareholders. This in turn undermines an issuers' ability to determine how to effectively engage with their diverse shareholder constituents and thereby reduce their cost of capital. We think such an outcome is highly inequitable and potentially discourages or significantly delays a decision by prospective issuers to make the transition from private to public markets. This is not in the interest of all market participants as it impedes the future vibrancy and breadth of investment opportunity embodied by the US market. We also believe that responsible active managers should welcome the opportunity to constructively engage with the companies in which they invest and should not

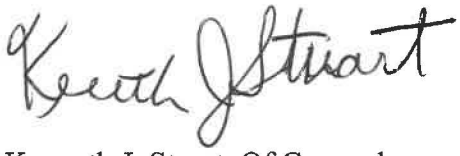
[5] Source: Bloomberg - RAY Index <Go> Summary Statistics, August 2020

support an outcome that obfuscates their public ownership of a company, particularly when the disclosures are not onerous given their infrequency and reporting lag of 45 days.

As investors our clients are interested in seeing a well-functioning and two-sided public securities market where corporates can access capital efficiently and drive economic growth. This dynamic not only benefits our clients as capital allocators but also serves the interests of a broad set of constituents, ranging from public company employees to pension plan investors and members of the investing public. We believe the SEC should seek to balance the interests of corporate issuers and a broad cross section of the investment community and not, as the current proposal threatens to do, enact a proposal that would disproportionately disadvantage many constituents with little obvious or substantiated benefit to a single constituency.

The SEC's proposal represents a significant step-backward from transparency and, if adopted, will result in less data being available to both small and medium-size advisers and to the general investor. Such a result, we respectfully submit, is very contrary to the mission of the SEC.

Very truly yours,



Kenneth J. Stuart, Of Counsel