Innovation Beta

September 24, 2020

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

RE: Reporting Threshold for Institutional Investment Managers (File Number S7-08-20)

Dear Ms. Countryman:

On behalf of Innovation Beta, I would like to provide comments regarding the proposed rule change to raise the 13F reporting threshold for investment managers from $100 million to $3.5 billion.

a) We are AGAINST raising the threshold as we believe the data collected from the 13F process provides valuable information and transparency for regulators and other market participants.
b) We are FOR the elimination of the omission threshold.

As background, I am the founder and chief investment officer of Innovation Beta, a fintech startup that measures and identifies institutional investor conviction. We are a consumer of financial data, including 13F filings. Our methodology is blind to the filer - we do not produce copycat investment strategies. We extract valuable investment behaviors through a rigorous computational process. It is this very analysis of 13F data that allows us to make informed observations.

Our objections focus on losing the information that the 13F program has provided regulators, policymakers and investors since disclosure began in 1978, and how the higher threshold will diminish the value of the collected data. The unintended consequences of the proposal are significant.

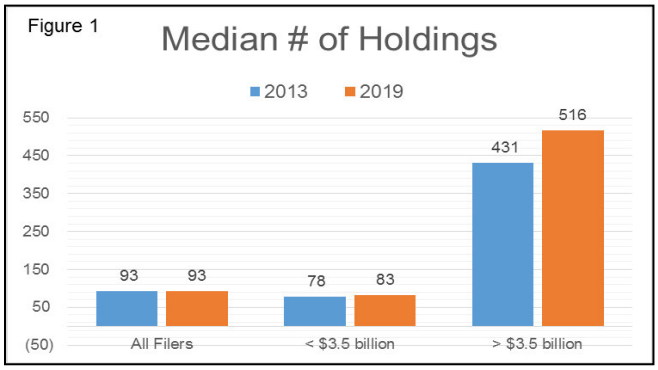
The 13F reporting program has three critical objectives: First, to create a central data repository. Second, to improve the data available regarding the holdings of institutional investment managers and thus shed light on the impact and influence of investment managers on the securities markets and public policy. Third, to increase investor confidence in the U.S. securities markets. We believe that the proposed rule change will detrimentally impact each of the three mandates.

Regarding the first objective, while the SEC analysis projects about 90% of the total dollar ***value*** of securities will still be reported, the data repository goal will “go dark” with the elimination of nearly 90% of the ***number*** of filers. Forgoing all the data points for nearly 5,000 filers each quarter will be a loss for future regulators, market participants, researchers and investors. Data becomes more useful the more you have of it. With storage costs near zero and the cost of collecting data falling, the effort to continually add to the body of knowledge has high marginal value. It is only by having that archive can it serve its valuable purpose.

Regarding the second objective, the goal of measuring the influence of institutional investors on the markets and public policy will be negatively impacted if the threshold is raised. The resulting data will simply reflect the concentration of mega advisers whose portfolios resemble an index-influenced market, saturated by large-cap holdings. Further, investors will lose the ability to detect investment mandate aberrations. Let us first ask, why is collecting data on only large advisers more desirable than gathering data on many advisers?

The higher $3.5 billion threshold will permanently distort nearly 40 years of 13F holdings data. The Q4 2019 13F submissions provide a powerful illustration of how myopic the data will become. 674 advisers exceeded the threshold with a median asset value of almost $12 billion[i]. As shown in Figure 1, the median number of portfolio holdings for these large advisers is 516, uncannily similar to the acclaimed

index, compared with just 83 holdings for the 4,638 advisers below the threshold. **With investors shifting to passive index strategies, is it any surprise that the largest advisers would have equity portfolios that resemble large indices?**



Of course, large advisers' 13F reports are a compilation of multiple strategies and products, so it is specious to suggest one 13F filing represents a single investment strategy. Sizeable holdings are another way to express how "the big got bigger." Over the past decade, the largest index-focused advisers were the prime beneficiary of the $1.8 trillion outflow from active mutual funds to passive index products. The Investment Company Institute reported the largest five fund complexes grew 51% since 2005 and now control over half of the ETF and mutual fund assets.

The 13F program tells that story at the portfolio level as large fund complexes pressed their growth bets by adding more index products. Since 2013 (the first year EDGAR mandated XML format) the median holdings count for advisers above the $3.5 billion threshold increased 20% from 431 to 516, whereas advisers under the threshold, likely active and discretionary with no index offerings to offer in scale, had a modest 6% increase to 83 holdings. (If these sub-$3.5 billion advisers had index offerings the median holdings count would be much higher than just 83 names.) It is hard to imagine that a fundamental, discretionary adviser would construct a portfolio and employ an analyst team to oversee 516 equity positions. **The proposed rule change will result in a reduction of active managers in the database.**

Our evidence suggests that the proposed rule change will skew the 13F data to mimic passive index constituents, thus the SEC is not gathering information on large investment decision-making and behaviors (which was the 1978 original 'gaps in information' the Commission sought to understand), but rather the decisions from index publishers. Future holdings analysis will not provide a nuanced portrait of capital allocation decisions, risk management, or securities analysis, but rather simply index-tracking asset advisers characterized by extreme cross-ownership of index constituent stocks. Rather than comfort, that should be a concern. Index portfolios that are tracked by real dollar investment advisers total over $34 trillion[ii]. As the SEC reviews the burden of 13F reporting, it bears reminding that none of the index providers – who technically 'manage' zero assets - are burdened with preparing an ADV, submitting a Form 13F, or obtaining any license from FINRA.

In figure 2, our analysis further shows a 20% decrease in just six years of 13F filers who own the top small and mid-cap index securities[iii]. If the proposed rule change is adopted, we believe the resulting 13F database will reflect and cement the index tilt as large advisers collectively share more large-cap exposure than mid or small. To be clear, we robustly believe low-cost transparent index-tracking ETFs have benefitted investors, but the rule change will create a future database that is less representative of the broader market.

Figure 2	**What % of Total Filers Own Top 20 Index Names?**		
	Small Cap (SLY)	Mid Cap (MDY)	Large Cap (SPY)
2013	6.3%	10.6%	43.3%
2019	4.9%	8.4%	47.7%
Change	***-22.5%***	***-20.1%***	***10.2%***

A higher threshold will result in thousands of advisers employing active investment strategies vanishing from the data set, along with the ability for investors to appraise style drift and deviations from investment mandates. Reduced transparency allows a growth adviser to own value stocks undetected and an ESG adviser to buy a coal miner. Additionally, academics and regulators will

lose the ability to study security level decision-making and other behavioral finance dimensions among active managers. As active managers disappear from the 13F radar, the mechanisms of how fundamental data such as earnings, cash flows, and economic data influence security selection and portfolio construction will become a black hole. The SEC will lose a valuable information trove that can be used to study and monitor investment behaviors from active managers and from advisers that focus on mid and small capitalization companies.

The third original policy goal, investor confidence of the markets, will suffer from a higher threshold. **In short, investors need the SEC.** We agree with many of the submitted comments that transparency is needed across all markets and their participants. The rule change will reverse that progress, particularly for listed companies that welcome transparency to identify shareholders, as crisply argued by the National Investor Relations Institute. Companies and institutional and individual investors need and expect more transparency. Here's a 13F tale about how the small stuff still matters for investor confidence:

Current Form 13F reporting gives regulators and investors a quick overview of over 5,000 investment advisors. That review can begin with an observation of simple errors. For example, for Q4 2019 there were over 5,000 raw 13F submissions. One advisor from upstate New York reported owning over 110,000 holdings – almost three times the holdings of BlackRock – despite an asset valuation of just $67 million. Another advisor from Florida reported 466 securities valued at over $14.9 trillion – twice the valuation of reported 13F assets from BlackRock, Vanguard, State Street and Fidelity ***combined***.

These two examples showcase the typical errors found in 13F reporting: Data fields are transposed and the instruction to round dollar values to the nearest 1,000 is occasionally neglected. Some are quick to claim innocent clerical errors happen; 125 amendments were filed to make corrections. **But what do errors – or their persistence – tell investors and the SEC about the compliance, oversight policies, and systems at a regulated investment manager?** The core information on a 13F is basic – how many shares are owned and what is the value? A regulated, licensed, professional money manager should have that down cold. One advisor which filed its 13F in February 2020 reported a whopping 550,527 security holdings, then a week later filed *two* amendments to correct the holdings count to only 24 securities. Is it a coincidence that three years earlier the founder at that firm settled with the SEC for Adviser Act violations and paid a fine of $250,000? In this case, we cannot discern coincidence or something more systematic, but simple, persistent errors provide the first window into evaluating the operations robustness of an investment adviser.

Getting the easy stuff correct for a professional money manager should be basic but it is not always the case. Take Apple stock: At the end of Q4 2019, there was only one closing price of Apple at $293.65 per share. Out of the 3,263 unique filers who owned Apple, their 13F reports inferred 338 *different* closing prices, some as low as $0.26 and as high as $324,000.00[iv]. To be fair, the majority of filers had the right price, but regulators and investors can still be baffled about the advisers who widely missed the mark. **Raising the 13F threshold to $3.5 billion would eliminate thousands of advisers from being able to provide a first answer to the question: "Is my house in order?"**

We favor eliminating the omissions threshold. The elimination of the threshold would increase market transparency and reduce the 13F compliance report burden, as complete portfolios would not need to be filtered twice. Currently, the first filter is reviewing portfolios to only report eligible 13F securities and the second filter is eliminating holdings with less than 10,000 shares or less than $200,000 in value. Removing filtering steps also reduces the chances for errors and the time it takes to complete the filing. The proposed rule change analysis reported that 23% of filers included at least some positions that fell within the omission threshold. In other words, they were more transparent than required. We suggest it may be more cost-effective to "reply all" and send the entire portfolio as the *de minimis* filter adds a level

of burden. Connecting complete 13F reporting to trade management and portfolio accounting systems would also reduce errors and lower burdens for advisers and SEC staff.

In closing, thank you for the opportunity to comment. The issues raised by the proposed rule change were thought-provoking and motivated us to look for clues in the 13F data to provide a reasoned response. The new threshold proposal will permanently change the complexion of the data and eliminate valuable insights for future users. More transparency, not less, will help the SEC discharge its duties and provide greater confidence in the financial markets. As a final thought, I encourage the SEC to quickly vote on the proposed rule change; in trader parlance, "Fill or Kill." In the 13F ecosphere, there are many small businesses built on tracking and reporting position changes, and large data-driven organizations have trading processes that depend on the continuity of 13F reporting. They, their clients and all market participants are surely anxious to have a quick resolution to this proposed rule change. Gathering comments for 60 days, followed by staff review and analysis before a Commission vote will keep business activity stalled pending a resolution. I urge the SEC to quickly come to a decision.

Sincerely,

Tim Galbraith
Chief Investment Officer
[redacted]

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[i] Innovation Beta analysis. Total 13F less eliminations for duplicates, options and error outliers.
[ii] Compilation of reports from S&P Global, MSCI and Russell.
[iii] Innovation Beta analysis. Raw Q4 2013 and Q42019 13F filings and the largest 20 holdings from ETFs SPY, MDY and SLY. Median number of CIKs that own a top 20 CUSIP.
[iv] Innovation Beta analysis from all CIKs that reported owning APPL on their 13Fs during Q4 2019.

Innovation Beta thanks Harold Hausman and Chris Nuerenberger at https://techascent.com for 13F data extraction and analytical systems development.