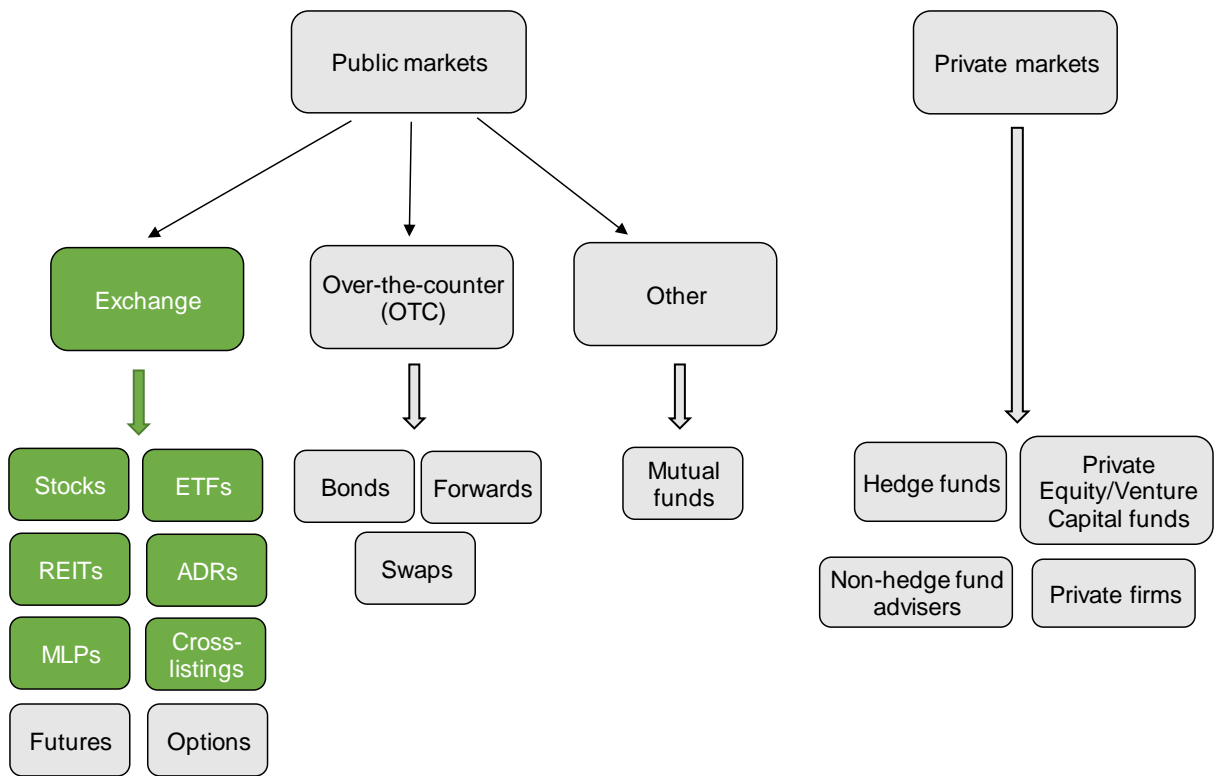David Kwon
December 20, 2022

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

Re: File Number S7-08-22, Short Position and Short Activity Reporting by Institutional
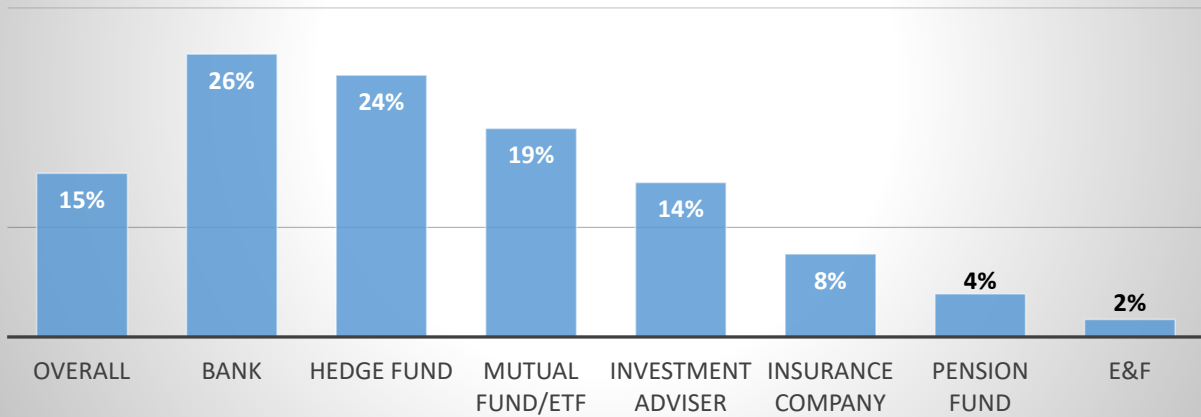Investment Managers

Dear Ms. Countryman,

I am writing to you regarding the U.S. Securities and Exchange Commission (SEC)'s short sale
disclosure rule proposal which was announced earlier this year. My recent dissertation on the
13(f) rule (completed while I was in a PhD program in accounting at Yale University) has
relevant findings for this proposed short sale rule. My dissertation addresses the recent debate
among SEC regulators and Congress and others about disclosure costs – specifically, copycatting
costs – under the 13(f) rule, which is a rule that requires institutional investors to disclose their
stock holdings on a quarterly basis.

My dissertation found many issues with the 13(f) rule as it currently stands. First of all, despite
the US government's desire under the 13(f) rule to monitor institutional trading activity and
monitor the impact of institutions on market stability especially in times of stress, the
government curiously decided to only require stocks to be disclosed, resulting in only about
15% of institutional assets being disclosed on 13(f) forms today. A full 85% of institutional
investments is not being monitored by the government. The chart below shows in green the
instruments that must be disclosed, and the instruments in grey that are not, and the following
chart shows the percentage of institutional portfolios that is disclosed across institutional
categories. The 13(f) rule thus creates a discriminatory disclosure environment among
institutional investors simply based on the instruments they use; a small-cap value manager has
to disclose all of its portfolio (assuming it meets the 13(f) threshold), while a global macro
hedge fund that uses only derivatives can keep its portfolio secret. The stock-specific nature of
the 13(f) disclosure rule also means that institutions of similar size, similar type, or facing
similar economic exposures can face different disclosure treatment under the rule.

Public markets

Exchange

- Stocks
- ETFs
- REITs
- ADRs
- MLPs
- Cross-listings
- Futures
- Options

Over-the-counter (OTC)

- Bonds
- Forwards
- Swaps

Other

- Mutual funds

Private markets

- Hedge funds
- Private Equity/Venture Capital funds
- Non-hedge fund advisers
- Private firms

13f securities as a percentage of total AUM, by institution type

| OVERALL	BANK	HEDGE FUND	MUTUAL FUND/ETF	INVESTMENT ADVISER	INSURANCE COMPANY	PENSION FUND	E&F
15%	26%	24%	19%	14%	8%	4%	2%

Second, I find evidence that copycats do exist. I find that a subset of institutional stock investors – long-term stock investors (that are top-performing) – are the primary target of copycats due to lower replication risk. Copycats face lower risk when trying to copy long-term investors like Warren Buffett than when copying short-term investors because copycats are better able to successfully match the portfolio of long-term investors. For example, a simple strategy copying Buffett's 13(f) holdings would have generated 95% of Buffett's annualized return performance over 40 years. In fact, top-performing long-term stock investors, including long-term hedge funds and pension funds, face significant positive market reactions to their disclosures of newly purchased stock, while top-performing short-term stock investors do not see positive market reactions. In the two charts below, I first show market reactions to Warren Buffett's stock disclosures and we can see that only his new stock purchases receive substantial market reactions upon disclosure, suggesting evidence of copycats, and in the next chart I show that among pension funds, only top-performing long-term pension funds experience a significant market reaction upon disclosure of newly purchased stock (shown by the blue line).
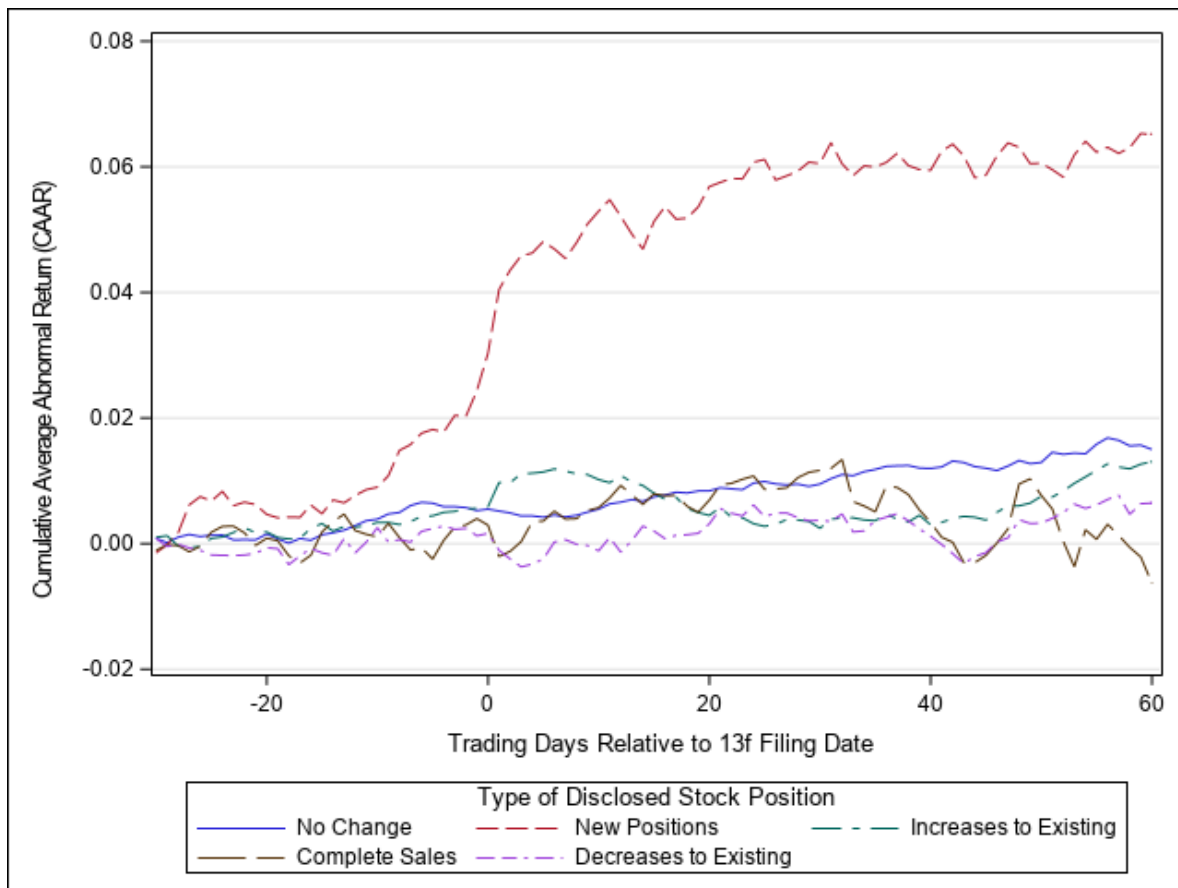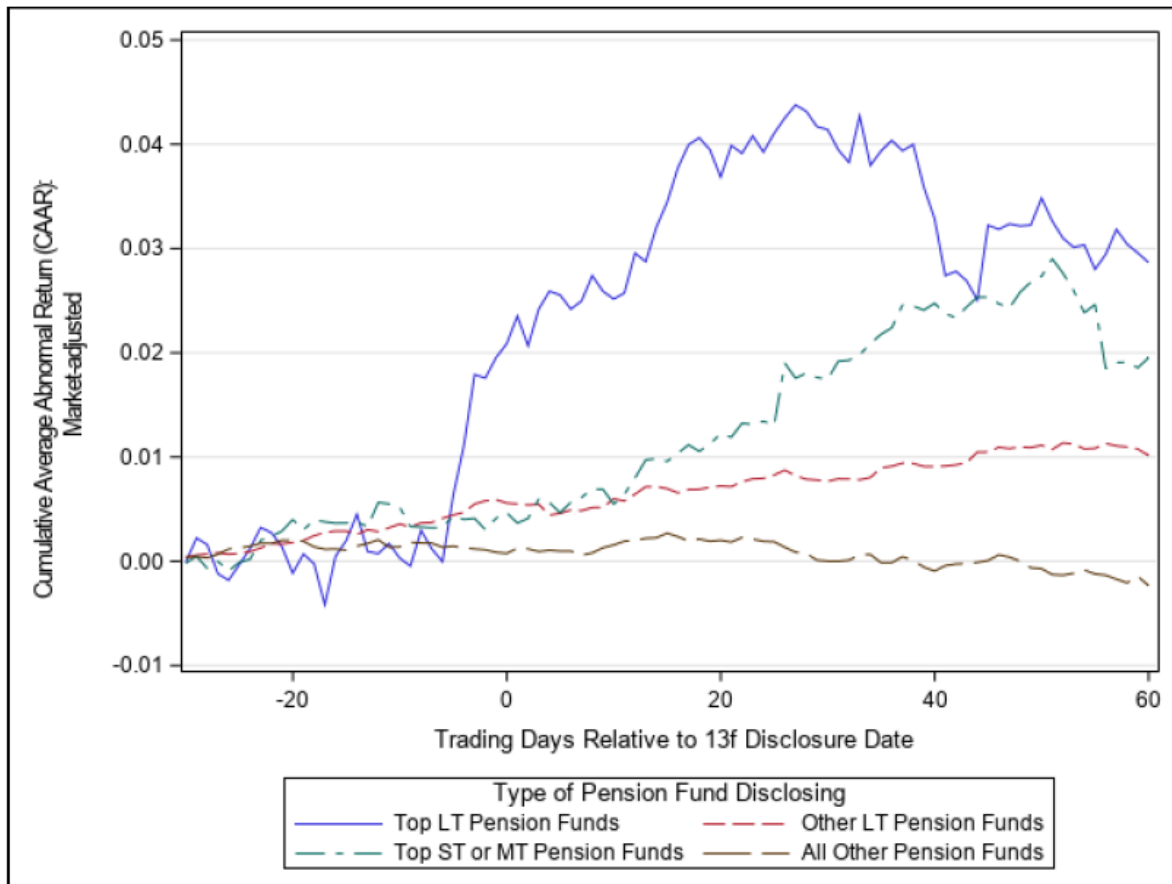
Lastly, I show in portfolio simulations that while short-term investors, to the extent that they face any copycatting, likely benefit from the positive market reactions caused by outside copycats, long-term investors do not benefit and can even be harmed. The reason for this is that the positive market reactions due to copycatting merely frontload returns, rather than increase returns permanently. Take Warren Buffett for example, who may have some special insight into a specific stock. A long-term investor like Buffett may not expect to benefit over the long-run from the positive market reactions caused by outside copycats, if he expects his special insight on the stock to be incorporated into the stock price over time anyways, regardless of copycatting. In other words, assuming that market reactions from copycatting merely correct an undervaluation, a long-term investor is likely to not benefit from such market reactions over the long run. I test and confirm these predictions in a sample of hedge funds and pension funds. Since copycats cause long-term stock investors to experience excess volatility in their returns without higher returns, my study finds that long-term stock investors' risk-adjusted returns are being harmed under the 13(f) rule. The chart below shows that copycatted stocks (those with high market reactions) do not outperform non-copycatted stocks for long-term hedge funds. However, high market reaction stocks do outperform for short-term and medium-term hedge funds. The following table below shows in portfolio simulations that copycatting activity negatively impacts targeted (i.e., copied) long-term investors' Sharpe ratios. The next chart shows that in my sample of long-term hedge funds, their Sharpe ratios are

especially harmed when they have larger assets (when they are building up positions more often and therefore more likely to be harmed by copycatting).
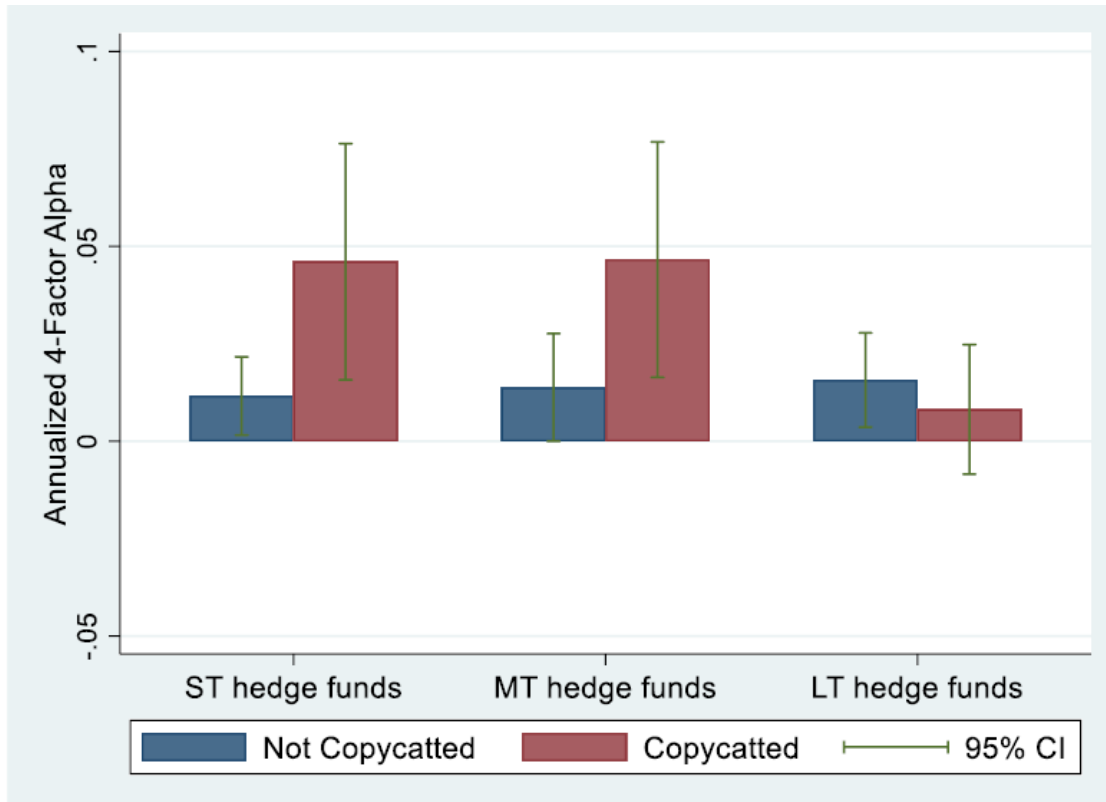
	Scenario: No Copycatting			Scenario: Copycatting				
Market Reaction Assumption	Annualized Return	Annualized Volatility	Sharpe Ratio	Annualized Return	Annualized Volatility	Sharpe Ratio	Absolute Decline in Sharpe Ratio	Percentage Decline in Sharpe Ratio
5%	14.2%	13.9%	1.02	13.6%	14.2%	0.96	(0.06)	-6%
10%	14.3%	13.9%	1.03	13.2%	14.6%	0.91	(0.12)	-12%
20%	14.4%	13.9%	1.04	12.5%	15.5%	0.81	(0.23)	-22%
20%: 25% Build	14.6%	13.7%	1.06	11.3%	14.7%	0.77	(0.29)	-27%
10%: 100% Build	14.3%	14.0%	1.02	14.3%	15.1%	0.95	(0.07)	-7%
20%: 100% Build	14.5%	14.0%	1.04	14.5%	16.6%	0.87	(0.17)	-16%

Notes: In my portfolio simulations, I assume that this investor has a 4-year horizon replacing 10 of its 40 stocks each year. I assume that each new purchase is copycatted generating a market reaction, and that the stock price in the scenario of copycatting converges to the stock price in the scenario of no copycatting within one year. Sharpe ratio is defined as annualized returns / annualized volatility.
Source: Author's calculations using data from CRSP
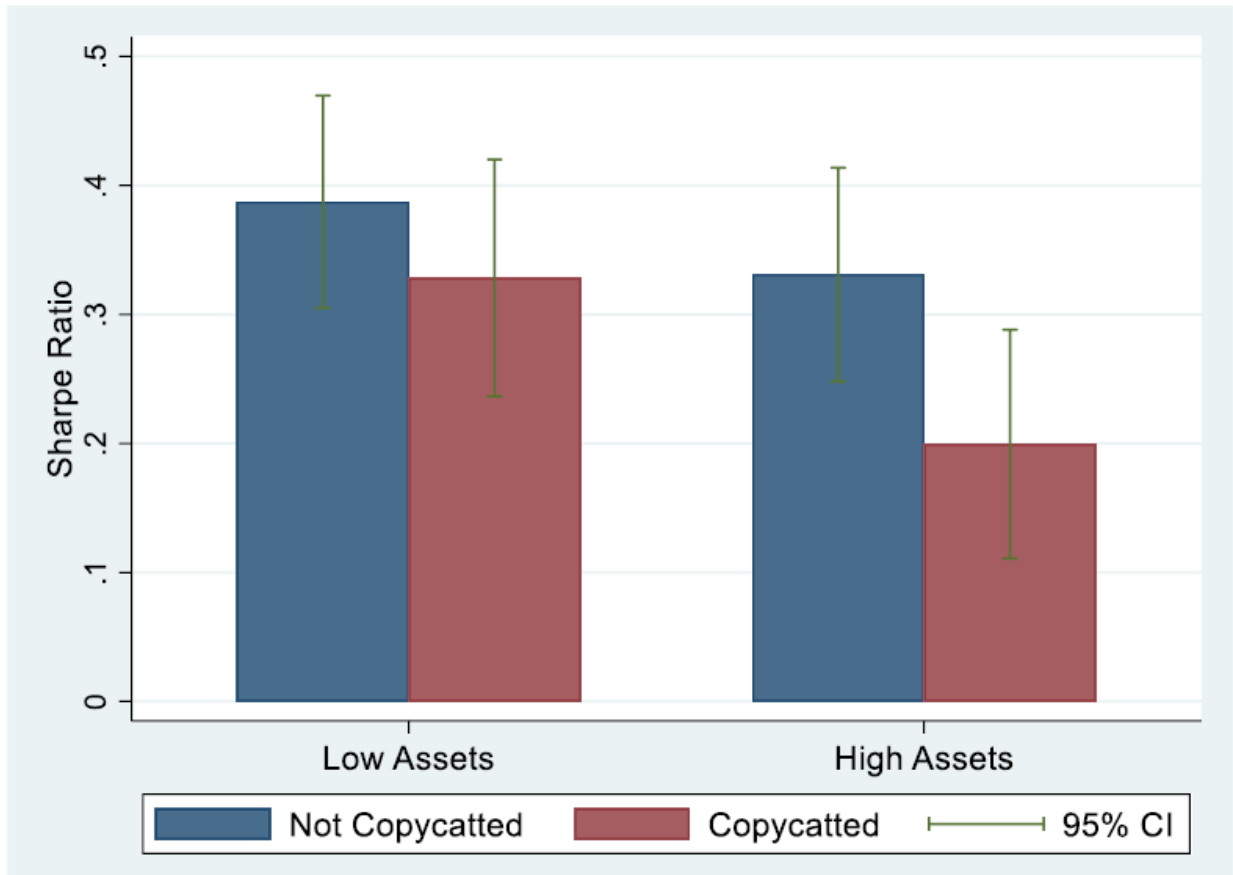
My study helps inform the government on the costs of investment disclosure as it contemplates whether to "fill in the gaps" of disclosure. I show that when investment disclosure is required, this results in excess volatility in the stock holdings of top-performing long-term stock investors without benefitting their portfolio returns over time, and even sometimes harming portfolio returns over time as they grow larger in assets. So, my dissertation suggests that long-term stock investment (and therefore innovation, which requires a long-term investing horizon) in the economy is being disincentivized in favor of short-term trading under the 13(f) rule.

Due to these significant public disclosure costs, while at the same time considering the government's desire to monitor institutional activity in financial markets, I recommend that the government eliminate the 13(f) rule and create a new rule that requires large investors like institutions (and even individuals with significant assets) to disclose *complete* portfolio holdings *privately* to regulators. This would have the benefit of removing public disclosure costs while at the same time allowing those in the government with confidential access to monitor investment activity across asset classes and financial instruments and to look for excessive trading especially in time of stress.

Here is the link to my dissertation if you would like to read further. Thank you!

Sincerely,
David Kwon