CONVERGENCE

OPTIMAL PERFORMANCE

SEC Proposed Changes to Schedule 13F
Increasing the Reporting Threshold from $100mm to $3.5bn
A Step Forward or Backward?

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We continue to support the SEC's mission to protect investors, maintain fair, orderly, and efficient markets and facilitate capital formation. In fact, we applaud the significant enhancements the agency made to Form ADV back in October 2017. The additional disclosures they added and the many enhancements and clarifications to the form’s questions provided additional transparency and simplicity to the prior form. This improved the insights of small and large investors who often refer to Form ADV to help them make more informed adviser selection decisions.

We do not believe that the current proposal to raise the 13F reporting threshold to $3.5bn is consistent with the SEC's mission. In fact, it represents a significant step backward. Less transparency and less data are never good for small and large investors. And 13F data is important.

We cite the following reasons for urging the SEC to materially reduce the proposed $3.5bn threshold for the following reasons:

1. It will severely limit future academic research on markets, specifically in the areas of pricing, liquidity, operating and compliance risk and adviser behaviors in bull and bear markets. It will eliminate the transparency needed to study filing behaviors across a statistically relevant number of filers which yields valuable insights into the compliance culture of advisers. In fact, it will eliminate the SEC’s ability to produce and evaluate signals that can suggest stress in an adviser’s business. These stresses often lead to adviser wrongdoing. In fact, we estimate that slightly less than 600 filers will meet the threshold.

2. It will severely limit public companies' ability to know more about their shareholders.

3. It will materially reduce an investor's ability to reconcile investment positions reported to them in the quarterly performance reports and investment summaries given to them by their advisers against positions reported in their 13F filings.

4. Many advisers work together informally to buy shares in companies they seek to influence. Investors need the ability to analyze positions across 13F filers of all sizes to identify this form of investment "smurfing." These advisers have access to company management that small investors do not.

5. While the SEC's intent is to relieve advisers of unneeded cost burdens, the cost justification for the rule change is highly questionable and actually encourages advisers to spend even less on the internal processes, controls, and technology that they need to run their business in an orderly and well controlled manner. Advisers who invest properly in infrastructure have little to no problem producing and delivering 13F data and filings. In fact, in our studies of 13F filing accuracy, we clearly see differences between those advisers who do and do not invest in the appropriate infrastructure. The actual cost to produce 13F data and deliver the quarterly filings is only burdensome to advisers who fail to pay for the infrastructure needed to reduce and streamline these processes. Trade order management systems have existed for decades and there are plenty of service providers to leverage for this service. In fact, as more compliance costs are shifted to the fund's limited partners, the adviser is not really paying these costs in many cases. Therefore, the 13F burdens cited are simply exaggerated. .

6. Raising the reporting threshold to such a high number will rob individual investors of their ability to avoid over-owned stocks, what is referred to as crowded trades. Many contrarian investors use 13F data to manage investment risk. This rule change greatly reduces individual investors ability to reduce this risk.

7. In the event of a significant correction, the number of reporting advisers would decline.

About Convergence

Convergence is a research firm that studies the regulatory filings of SEC registered advisers. Our founders were senior leaders in the asset management industry and our research provides our clients with insights into various business risks that registered advisers face in carrying out their advisory services. We study the businesses of the 18,000 exempt and non-exempt SEC filing advisers by examining Form ADV, Form D and Schedule 13F and developing business profiles from the data we create from them.

Our asset management clients use our data-driven insights to improve the efficiency and effectiveness of their control environments and our retail and institutional investor clients use our insights to identify and manage operational risk. We are fortunate to serve many of the largest and most prominent firms in the industry.