2013

Providing Equal Investment Opportunity via Securities Exchange act Section 13(F) Note

Ryan M. Carpenter

CONNECTICUT LAW REVIEW

VOLUME 46 DECEMBER 2013 NUMBER 2

Note

PROVIDING EQUAL INVESTMENT OPPORTUNITY VIA SECURITIES EXCHANGE ACT SECTION 13(F)

RYAN M. CARPENTER

In 1975, Congress amended the Securities Exchange Act of 1934, incorporating section 13(f) on Periodic Reporting requirements of institutional investment managers. The law mandates that institutional investors file a holdings report, known as Form 13F, with the Securities and Exchange Commission for public distribution. The law provides filers with confidential treatment when in the public interest.

This Note argues that the SEC has not implemented section 13(f) in a way that achieves Congress's professed goal of providing more egalitarian access to information about the financial and security markets, both by neglecting to effectively administer the program and failing to promulgate a meaningful standard for exemption. It also argues that this failure is detrimental to the efficiency of the securities markets. It makes the case that the SEC should more deliberately balance the competitive interest of institutional investment managers with the public interest in transparent and efficient markets when administering the regulation.

By harmonizing section 13(f) with existing securities regulation doctrine, this Note ultimately arrives at suggestions for improvement, namely that the law be deployed as a mechanism for sharing gains with the market and that confidential treatment be granted only when necessary to avoid inflicting losses on an institution, as opposed to protecting future potential gain. This Note also makes corollary suggestions that modernize the administration of the law and provide for more rigorous enforcement policies.

NOTE CONTENTS

PROVIDING EQUAL INVESTMENT OPPORTUNITY VIA SECURITIES EXCHANGE ACT SECTION 13(F)

RYAN M. CARPENTER*

> *But the most common and durable source of factions, has been the various and unequal distribution of property. Those who hold, and those who are without property, have ever formed distinct interests in society. . . . The regulation of these various and interfering interests forms the principal task of modern Legislation . . . .*[1]
>
> —James Madison, The Federalist No. 10

> *The distribution of wealth and income, and the hierarchies of authority, must be consistent with both the liberties of equal citizenship and equality of opportunity.*[2]
>
> —John Rawls, A Theory of Justice

I. INTRODUCTION

Suppose that Cate is an investment adviser who, in the process of managing her clients' accounts, diligently follows all of the companies in which she invests. She takes in relevant financial media daily, reads analyst reports, and is sure to review all of their regulatory filings. She uses this information to adjust her strategies accordingly. Let us assume that many of Cate's client accounts have long been invested in the stock of Monolith, Inc., an industrial conglomerate with a revered CEO, and she prizes the investment as a core holding because of its track record of steady returns, its long-term approach to growth, and its policies of open disclosure to its shareholders. As a result of Monolith's successful track record in its own operations and in partnering with other companies, experts and market media tend to dwell on its every move.

---

* University of Connecticut School of Law, J.D. Candidate 2014; Princeton University, A.B. 2005. I would like to express sincere gratitude to James Kwak for his thoughtful guidance. Thanks also to Kip Hall for challenging me to take up this subject at the outset. Casey Smith, Cassandra Beckman Widay, Jeffrey Wisner, and the rest of the *Connecticut Law Review* staff provided valuable editorial assistance for which I am grateful. As always, affectionate appreciation is due to my wife, Lauren, for her enduring love and support. This is dedicated to Cadence—may your life be rich with opportunity.

[1] THE FEDERALIST NO. 10, at 59 (James Madison) (Jacob E. Cooke ed., 1961).

[2] JOHN RAWLS, A THEORY OF JUSTICE 61 (1971).

Suppose now that Monolith makes a sizeable purchase of stock issued by a troubled corporation, First Icarian Bank ("FIB"), for its own portfolio. After making a series of bad investments in the asset-backed securities market, FIB is cash-strapped and its share price has declined accordingly. The market assumes that there is a decent chance that it will file for bankruptcy. Monolith's CEO believes that FIB is actually a turnaround story about to happen, but does not want to telegraph his company's investments to the market. At times in the past, Monolith's eventual acquisition of a company could be traced back to a large purchase of common stock. The CEO does not want others buying up FIB stock, thereby forcing its market price back up and ruining what he sees as a prospective opportunity for heady gain.

The quarter is closing soon, however, and his company must file Form 13F with the U.S. Securities and Exchange Commission (SEC or the "Commission"), which would publicly disclose this information. Happily for Monolith, it can apply for a temporary exemption from reporting its FIB holdings on Form 13F. In the meantime and—if approved—for a set period afterwards, Monolith does not have to tell anybody, potentially including its shareholders, that it has made the investment. Monolith receives the SEC's permission to withhold information of its investment in FIB stock from the public for twelve months from the date of purchase.

Cate, like many other active investors, has done her own independent research on FIB, which has also been followed closely by the financial press. She has concluded that the stock is a poor investment and that it amounts to nothing more than a reckless and speculative gamble. Suppose that Jack, a longtime FIB shareholder, comes to the same conclusion and, fearing that the shares might soon be completely worthless, sells his stock in the open market for a deep loss. Because Monolith received confidential treatment regarding its Form 13F requirement, neither Cate nor Jack knew about its investment. If FIB collapses in six months, inflicting financial losses upon Monolith, Inc., Cate will suffer a corresponding decline in the value of the shares in her accounts. She had no opportunity to avoid this loss. If FIB survives and its share price rebounds, then Jack will have cut and run without understanding all material aspects of the company's outlook.

Section 13(f) of the Securities Exchange Act of 1934[3] requires companies that manage investment funds to file Form 13F with the SEC on a quarterly basis.[4] The filing is required from companies that exercise investment discretion over accounts holding certain securities that have an aggregate fair market value of at least $100 million on the last trading day

---

[3] 15 U.S.C. § 78m(f) (2012).

[4] *Id.*

of any month of the preceding calendar year.[5] Congress enacted section 13(f) in 1975 to increase the public availability of information regarding the purchase, sale, and holding of securities by institutional investors.[6]

The text and legislative history of the statute make clear Congress's intent that information collected under section 13(f) be disseminated to the public as promptly as possible.[7] At the same time, it conceded that sometimes "disclosure of certain types of information could have harmful effects, not only on a filing investment manager, but also on the investors whose assets are under its management."[8] To strike a balance between these competing interests, section 13(f)(3) authorizes the Commission to "delay or prevent the public disclosure" of information "as it determines to be necessary or appropriate in the public interest" or for the protection of investors.[9] Part II of this Note will provide an overview of section 13(f) reporting requirements, the confidential treatment exception process, and its policy concerns. It will also introduce the core of the argument: the section 13(f) confidential treatment reporting exemption should aim to allow money managers to avoid losses in limited and extraordinary situations wherein demanding compliance with regulatory reporting requirements would, in itself, cause losses. It should otherwise require disclosure, even when that would result in sharing some gains derived from privately funded research with the public.

In order to fully understand the function of the disclosure requirement and the exemption, this Note will then examine and appraise the practical mechanics and underlying theory behind the regulation itself. This is to uncover the ways in which section 13(f) reporting and its accompanying confidential treatment exception present problems. First of all, there are a number of practical shortcomings associated with application and administration of the exemption that have received unfavorable political and media attention. The lack of effective administrative processes and, perhaps more importantly, the failure of the SEC to use the information gathered by the report in a meaningful way cancel out much of the effect that section 13(f) was intended to have on financial markets. Instead, investment managers are left with yet another compliance cost without a corresponding market benefit. These concerns will be examined in Part III.

Secondly, there are well-supported theoretical problems with section

---

[5] *Id.*

[6] Filing and Reporting Requirements Relating to Institutional Investment Managers, Exchange Act Release No. 34-14852, 43 Fed. Reg. 26,700, 26,701 (June 22, 1978).

[7] S. REP. NO. 94-75, at 87 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 265.

[8] Section 13(f) Confidential Treatment Requests, SEC Guidance Letter, 1998 WL 35318911, at *2 (June 17, 1998) [hereinafter 1998 Guidance Letter].

[9] 15 U.S.C. § 78m(f)(3).

13(f) confidential treatment. The vagueness of the controlling "public interest" standard, particularly in its oft-avowed purpose of "protecting investors," is easily misdirected and ultimately unsound as a policy justification. The public interest would be more expeditiously served if the Commission were to focus on rules that furthered ex ante informational equity that advanced market efficiency and liquidity. In Part IV, this Note will take a look at the public interest in informational equity through the lens of the smaller investor and consider also the countervailing interest of institutional asset managers who invest heavily in research and strategy.

The best tack, I argue, is to find the middle ground: economic principles and policy considerations demand that we preserve the fruits of engaging successfully in informational competition for those who spend their resources seeking them, but not in perpetuity. Section 13(f) is the device by which institutional investors are eventually required to cede what residual advantage remains in the information they have gathered for the benefit of market efficiency and fairness over the long term, but only after they have acted on it. In this way, not only does the regulation strive to provide economic efficiency, but it also acts to align the law with public interest and the legislative intent of section 13(f).

With these practical and theoretical concerns in mind, we will move to Part V, where I seek to integrate section 13(f) and its confidential treatment provision into the existing body of securities regulation doctrine as a coherent whole. While section 13(f) is an underdeveloped and unsung provision within the canon of securities laws, it is clear that it nonetheless offers something distinct and important to the body of regulation. This perspective on the regulation should color our understanding of the confidential treatment allowance and underscore that it should only be available in limited circumstances when not providing it would impose a dilemma forcing the investment manager to choose between similarly undesirable options: (a) not transact against the firm's better judgment or (b) risk subsequent loss as a result of disclosure.[10] Such economically non-neutral regulations are to be discouraged to the extent that they would inform an investment managers' decision-making on matters that should be dictated predominantly by economic substance. At the same time, liberally permitting disclosure exemptions for unsubstantiated or insufficient reasons might have the converse effect of allowing the investment manager to gain by unjust enrichment.

[10] This is, perhaps, most likely to occur in situations where the investment manager has established a large position in some security and decides that she wants to liquidate the asset. If news of her liquidation leaks into the market, through regulatory disclosure or otherwise, it may cause other investors to run on the stock, forcing her to sustain losses before she is able to exit the position. Because this is likely to have deterrent effects on investment in small or distressed companies that would otherwise present worthwhile opportunities, the availability of the exemption here is sensible.

II. A REVIEW OF EXCHANGE ACT SECTION 13(F)

A. *Section 13(f) Strikes a Balance Between Institutional Investors' Competitive Interests and the Public Interest in Transparent Markets*

In 1968, Congress became concerned with the effects that transactions by large-scale institutional investment management companies were having on the stock market.[11] Its concern was rooted in a sudden increase in trading volume in American securities markets, which the paper-driven market infrastructure could not bear, resulting in sharp declines in stock prices and a financial industry crisis.[12] In response, Congress passed the Securities Investor Protection Act of 1970 "to provide greater protection for customers of registered brokers and dealers and members of national securities exchanges."[13] Additionally, both houses embarked upon the first exhaustive independent congressional examinations of the securities market since the studies completed in the early 1930s, which had resulted in the Securities Act of 1933, the Securities Exchange Act of 1934, and the formation of the SEC.[14]

As a result of the examination reports, Congress ordered the SEC to study and investigate such transactions on a continuing basis "in order to determine the effect of those activities upon the maintenance of fair and orderly securities markets, the stability of those markets, and the interests of issuers of securities and of the public."[15] Citing "gaps in information about the purchase, sale and holdings of securities by major classes of institutional investors," the SEC recommended that Congress empower it with the capacity to require institutional investment managers to report and disclose their holdings and transactions on a regular and ongoing basis.[16] Concurrently, the President's Commission on Financial Structure and Regulation in 1971, as well as the Senate Subcommittee on Securities in 1973, similarly recommended improved disclosure by institutional investors.[17]

In response, Congress adopted section 13(f) of the Securities Exchange

---

[11] Filing and Reporting Requirements Relating to Institutional Investment Managers, 43 Fed. Reg. at 26,701.

[12] Philip A. Loomis, Jr., Comm'r, Sec. & Exch. Comm'n, The Securities Acts Amendments of 1975, Self-Regulation and the National Market System, Address Before the Joint Securities Conference (Nov. 18, 1975), *available at* http://www.sec.gov/news/speech/1975/111875loomis.pdf.

[13] Pub. L. No. 91-598, 84 Stat. 1636, 1636.

[14] Loomis, *supra* note 12, at 3.

[15] Filing and Reporting Requirements Relating to Institutional Investment Managers, 43 Fed. Reg. at 26,701.

[16] *Id.* (internal quotation marks omitted).

[17] *Id.*

Act of 1934 as part of the Securities Acts Amendments of 1975.[18] The law added to the pre-existing body of section 13, the unambiguous purpose of which is "[t]o substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry."[19] The reporting system called for by section 13(f) was "intended to create in the Commission a central repository of historical and current data about the investment activities of institutional investment managers," and thereby advance two separate congressional objectives.[20]

First, the disclosures would vastly increase the amount of market data available, allowing for the effective study of how large investment management companies affect the equity market and consideration of the public policy implication of these effects.[21] Secondly, in making the Commission responsible for gathering, processing, and disseminating this data, a uniform reporting standard and centralized database would be possible.[22] The legislative history for section 13(f) indicates that Congress intended for the immediate and orderly dissemination of information about institutional investment managers' holdings and transactions to the general public because it would "stimulate a higher degree of confidence among all investors in the integrity of our securities markets."[23] It was concerned with utilizing the methods of public dissemination that would be most useful "to investors, issuers, and other institutional investment managers."[24] Congress also directed the Commission to use the information, in consultation with other regulatory agencies, to fulfill regulatory responsibilities in a way that achieved uniform, nonduplicative reporting by investment managers, in turn minimizing the cost and burden associated with regulatory compliance.[25]

---

[18] Pub. L. No. 94-29, 89 Stat. 97; *see also* 17 C.F.R. § 240.13f-1 (1979) (implementing section 13(f) requirements as Rule 13f-1); 17 C.F.R. § 249.325 (adopting Form 13F and issuing instructions for completing the form).

[19] Spilker v. Shayne Labs., Inc., 520 F.2d 523, 525 (9th Cir. 1975) (quoting SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963)) (internal quotation marks omitted).

[20] Filing and Reporting Requirements Relating to Institutional Investment Managers, 43 Fed. Reg. at 26,701.

[21] *Id.*

[22] S. REP. NO. 94-75, at 87 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 265.

[23] *Id.* at 82; *see also* Div. of Inv. Mgmt., *Frequently Asked Questions About Form 13F*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/divisions/investment/13ffaq.htm (last modified Oct. 10, 2013) [hereinafter *FAQ About Form 13F*] ("Congress passed Section 13(f) of the Securities Exchange Act in 1975 in order to increase the public availability of information regarding the securities holdings of institutional investors. Congress believed that this institutional disclosure program would increase investor confidence in the integrity of the United States securities markets." (citation omitted)).

[24] Filing and Reporting Requirements Relating to Institutional Investment Managers, 43 Fed. Reg. at 26,704.

[25] *Id.* at 26,701.

On June 15, 1978, the SEC rolled out Rule 13f-1[26] in Exchange Act Release No. 34-14852, implementing the disclosure program mandated by section 13(f), effective July 31, 1978.[27] Mechanically, Rule 13f-1 works by requiring that every institutional investment manager that exercises investment discretion with respect to accounts holding equity securities of a class described in section 13(d)(1) of the Exchange Act that have an aggregate fair market value of at least $100 million 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, but in no event shall such reports be filed for periods longer than one year or shorter than one quarter."[28] The filing document is known as Form 13F.[29]

Institutional investment managers are required to file a Form 13F for each calendar quarter, no later than forty-five days after its close.[30] The report must include, as of the last day of the reporting period, "the name of the issuer and the title, class, CUSIP number, number of shares or principal amount, and aggregate fair market value or cost or amortized cost of each other security" with respect to which the institutional investment manager exercises investment discretion.[31] The securities that must be reported generally include exchange-traded or NASDAQ-quoted stocks, shares of exchange-traded funds (ETFs), equity options and warrants, shares of closed-end investment companies, and certain convertible debt securities.[32] This list of includable securities intentionally neglects a range of popular financial instruments.[33] For example, investment managers neither have to report positions in bonds, debentures, or shares issued by open-end investment (i.e., mutual fund) companies,[34] nor report or net out any short sale positions in includable security types.[35]

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 contains, however, a yet-to-be implemented provision amending section 13(f) to require certain disclosures of short positions by

---

[26] 17 C.F.R. § 240.13f-1 (1979).

[27] Filing and Reporting Requirements Relating to Institutional Investment Managers, 43 Fed. Reg. at 26,705.

[28] 15 U.S.C. § 78m(f)(1) (2012).

[29] 17 C.F.R. § 249.325 (2012).

[30] *FAQ About Form 13F*, *supra* note 23.

[31] 17 C.F.R. § 240.13f-1(A).

[32] *FAQ About Form 13F*, *supra* note 23.

[33] *Id.*

[34] *Id.*

[35] *Id.*; *see also Official List of Section 13(f) Securities Users*, U.S. SEC. & EXCHANGE COMMISSION (June 18, 2013), http://www.sec.gov/divisions/investment/13flists.htm (publishing a file for each calendar quarter containing the list of securities reportable under section 13(f) to assist with the preparation of reports).

institutional investment managers.[36] This amendment, section 929X, mandates the disclosure of short sale positions to the SEC, which will make such information available to the public, as with other section 13(f) data.[37] There is some disagreement among industry participants and interest groups, at the time of this writing, as to whether the SEC would be publicizing the short sale data in an aggregated format or on a firm-specific basis.[38]

The Commission intended, in establishing the types of holdings that were material for the purpose of this disclosure in 1978, to limit the reportable stock positions to those that have the potential to impact U.S. financial markets.[39] Moreover, the SEC expressly acknowledged that it had reflected on the influence that the rule might have on competition: it concluded that disclosure would not significantly burden competition and, additionally, "that any possible resulting competitive burden will be outweighed by, and is necessary and appropriate to achieve, the benefits of this information to investors."[40]

The Commission acknowledged those benefits again, about half a year later, when it revised the rule to require quarterly reporting rather than merely annual reports.[41] Market participants had stated that more frequent reporting would be invaluable to trading desks, facilitate increased market liquidity, and allow for competitive "comparison shopping" of investment managers.[42] Based on this input, the SEC concluded that quarterly filings would be in the public interest and, furthermore, the "continuous flow of information" demanded by the increased reporting rate would also be useful for formulating policy.[43]

What would go wrong without section 13(f)? Congress appears to have been concerned with the aggregation of information by those market participants who have the means to purchase such an advantage. That is, market participants with superior resources can deploy them to build up

---

[36] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929X, 124 Stat. 1376, 1870–71 (2010).

[37] *Id.*

[38] *See, e.g.*, Letter from Richard H. Baker, President & Chief Exec. Officer, Managed Funds Ass'n, to James A. Brigagliano, Deputy Dir., Div. of Trading & Markets, U.S. Sec. & Exch. Comm'n (Feb. 7, 2011), *available at* http://www.managedfunds.org/wp-content/uploads/2011/06/2.7.11-MFA.Letter.on_.Short_.Sale_.Disclosures.under_.Section.929X.of_.Dodd_.Frank_.pdf.

[39] *See* Filing and Reporting Requirements Relating to Institutional Investment Managers, Exchange Act Release No. 34-14852, 43 Fed. Reg. 26,700, 26,703 (June 22, 1978) (announcing that the establishment of a de minimis exemption and the decision not to exempt foreign holders of U.S. stocks are both decisions controlled by a concern for isolating the report to holdings that may impact the market).

[40] *Id.* at 26,705.

[41] Filing and Reporting Requirements Relating to Institutional Investment Managers, Exchange Act Release No. 34-15461, 1979 WL 173407, at *2 (Jan. 5, 1979).

[42] *Id.*

[43] *Id.*

substantial market advantages by essentially creating non-public information and trading on it until it is, one way or another, fully incorporated into the security's price. This result undercuts confidence in public markets because such privatized informational advantages will result in concealing transactional opportunities that the public would otherwise be able to participate in or, worse yet, would be on the losing side of until the news is made public. Once the news is announced, the average investor is likely to be aggravated and discouraged by the systematic disadvantages that deprived her of an opportunity or caused her losses. As President Ford remarked upon signing the Securities Acts Amendments of 1975 into law: "Public confidence is a vital ingredient if our capital markets are to continue to attract a wide variety of investors. Though large institutions have become increasingly active as owners and traders of securities, individuals still represent the backbone of the American capital system."[44] Even now, when institutions execute the vast majority of daily stock exchange transactions, the market's inherently open and public nature demands that regulators remain committed to a framework of rules and systematic safeguards that preserve the interest of public participants generally and avoid the privatization of all advantage.

Concern for individual investors is economically understandable. Rational investors would be deterred from participating in markets that too strongly favor an elite group of large money managers and thereby deprive them of the opportunity to partake in positive investment outcomes, forcing them to invest their money with the money managers that hold the informational advantages and pay the fees required to do so. Moreover, in the context of public companies, a failure to report specific equity holdings to the investing public results in misleading shareholders—if investors do not know what assets and liabilities underlie a security, they will not be able to make an informed assessment of the issuing company's financial health and accurately price it.[45]

Some might argue that if such disclosures were not required by the public company reporting requirements, Congress must have decided that they were unimportant or best left confidential. It seems more likely, though, that Congress meant to supplement the cursory securities holding disclosures included in the consolidated financial statements with the more

[44] President Gerald R. Ford, Statement on Signing the Securities Acts Amendments of 1975 (June 5, 1975), *available at* http://www.presidency.ucsb.edu/ws/?pid=4970.

[45] While public companies are bound to report financial results as part of the annual (10-K) and quarterly (10-Q) filings required by the Exchange Act, such reports do not require a comprehensive statement of securities held by the reporting entity. 15 U.S.C. § 78m(a)–(c) (2012). Oftentimes, the reporter will list several of its largest security holdings and then clump the rest together in a single line item marked "Other." *See, e.g.*, Berkshire Hathaway Corp., Annual Report (Form 10-K), at 74 (Dec. 31, 2010) (listing equity holdings in four corporations valued at approximately $34 billion followed by a single line for "other" equities worth over $26 billion).

granular Form 13F for those companies that meet the Rule 13f-1 qualifications and for which such holdings would be a material aspect of their financial health. While disclosure of information is likely to level the playing field and provide the fruits of institutional investor research to individual investors for little to no real cost, the end-of-quarter-plus-forty-five-days reporting period should allow an institutional investor enough time to begin implementing a new investment strategy and, if its thesis is correct, to profit from it. It may not have sufficient time to maximize those profits, but the lost excess return is a cost of operating in efficient markets.

The legislative background and the administrative implementation of section 13(f) indicate that, while it expressly stands for rather broad free market principles like efficiency and fairness, Congress and the SEC implicitly meant for the regulation to grant expansive access to institutional investor information on controlled terms that would strike a balance between the institutions' desire to keep such information confidential for competitive reasons and the public interest in keeping regulators and individual investors abreast of the forces that are driving the markets—thereby preventing investment management oligopoly and deception of investors.

B. *Confidential Treatment of Section 13(f) Information Allows Investors to Avoid Incurring Investment Losses in Connection with Reporting*

Exemptions from section 13(f) reporting requirements are available from the SEC under subsection 2.[46] Confidential treatment under this provision was to be permitted in situations where the Commission determines it "necessary or appropriate in the public interest or for the protection of investors."[47] Congress made the exemption available because it recognized that some instances of disclosure might not be in the public interest, in that revealing the information could visit "harmful effects" upon an investment manager and the investors whose assets are under the firm's control.[48]

In order to succeed in obtaining a confidential treatment exemption, institutional investors must submit a request for confidential treatment ("CT Request") identifying the specific information that they would like to refrain from disclosing as well as the Freedom of Information Act (FOIA) provisions upon which the request is based, and including a statement and analysis of the grounds for the applicability of such provisions.[49] If the filing firm's request is granted, such firm will receive confidential

---

[46] 15 U.S.C. § 78m(f)(2).
[47] *Id.* § 78m(f)(3).
[48] 1998 Guidance Letter, *supra* note 8, at *2.
[49] 17 C.F.R. § 240.24b-2 (2012).

treatment with respect to the specified positions for a period of three, six, nine, or twelve months measured from the filing date.[50] CT Requests that do not provide sufficient basis for the request or provide only conclusory or generalized information are to be denied.[51]

In 1998, the SEC provided an explanation of the requirements for CT Request filers in a guidance letter, particularly in order to explain that such "requests can be granted only under certain limited circumstances."[52] The letter explains that the Exchange Act and the applicable FOIA provisions require that confidential treatment only be made available in instances where the investment manager establishes "that confidential treatment is in the public interest."[53] Congress acknowledged two categories of securities information that would be in the public interest to not disclose in Form 13F filings:

> (1) information that would identify securities held by the account of a natural person or certain estates or trusts; and (2) information that would reveal an investment manager's program of acquisition or disposition that is ongoing both at the end of a reporting period *and* at the time that the investment manager's Form 13F is filed.[54]

Section 13(f)'s legislative history reveals that the second scenario was of concern because Congress believed that "generally it is in the public interest to grant confidential treatment to an ongoing investment strategy of an investment manager [when] [d]isclosure of such strategy would impede competition and could cause increased volatility in the market place."[55] The SEC has supplemented the categories of information eligible for confidential treatment under its statutory authority with two additional types of information: (1) open risk arbitrage positions; and (2) investment strategies that utilize block positioning.[56]

---

[50] *FAQ About Form 13F*, *supra* note 23.

[51] 1998 Guidance Letter, *supra* note 8, at *2.

[52] *Id.* at *1.

[53] *Id.*

[54] *Id.* at *2.

[55] S. REP. NO. 94-75, at 87 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 265.

[56] 1998 Guidance Letter, *supra* note 8, at *2. "[T]he term 'risk arbitrage' refers to the risking of capital in connection with a proposed merger, acquisition, tender offer, or similar transaction involving recapitalization . . . . The term applies only to transactions effected after the public announcement of the deal and before completion or termination of the deal." Requests for Confidential Treatment Filed by Institutional Investment Managers, Exchange Act Release No. 34-21539, 49 Fed. Reg. 48,318, 48,319 (Dec. 12, 1984). Rule 3b-8(c) of the Exchange Act defines block positioning as buying "a block of stock with a current market value of $200,000 or more in a single transaction, or in several transactions at approximately the same time, from a single source" with reasonable certainty that such transactions could not be completed with another party on similar or better terms and selling the block stock "as rapidly as possible commensurate with the circumstances." 17 C.F.R. § 240.3b-8(c) (2012). Oftentimes, this type of transaction is done directly between large institutional buyers and sellers

The SEC's 1998 guidance letter outlined five general requirements for a successful confidential treatment request under the common "program of acquisition or disposition" exception.[57] In October 2013, the SEC's Division of Investment Management released additional guidance to describe further information that it identified as "particularly helpful in reaching an informed decision on whether delaying or preventing public disclosure is necessary or appropriate in the public interest and for the protection of investors or to maintain fair and orderly markets."[58] The 2013 guidance update describes specific information that is helpful in successfully supporting each of the general requirements outlined in the 1998 guidance letter.[59] The releases do not ascribe any levels of priority or relative weighting to the many factors considered.

Taken together, the two guidance releases provide a general sense of the information that the Commission would like to review in connection with a CT Request for reason of an ongoing acquisition or disposition program. First, the applicant investment manager must show that its company or fund is following a specific program by detailing measures taken during the most recent quarter toward effectuating the program and information regarding the program's goal.[60] The description of the program "should be specific to each Reportable Security covered" by the request, and discuss its timing, level of progress, and "ultimate goal" in terms of percentage of each issuer's total outstanding securities.[61]

Second, the applicant must show that the program is "ongoing both at the end of the quarter and at the time of the filing."[62] This should include evidence of recent purchases or sales in the securities subject to the CT Request and, if applicable, why a program should be considered "ongoing during any periods when no transactions occurred."[63]

Third, the applicant must present evidence that disclosure of the securities positions in question would reveal the manager's investment strategy by showing "how the purchases or sales of particular securities that took place during the quarter relate to the manager's overall

---

outside of the auspices of a national securities exchange so as to minimize the effects of the trade on the market price. *Block Trade*, INVESTOPEDIA, http://www.investopedia.com/terms/b/blocktrade.asp (last visited Nov. 20, 2013).

[57] 1998 Guidance Letter, *supra* note 8, at *3–4.

[58] DIV. OF INV. MGMT., U.S. SEC. & EXCH. COMM'N, GUIDANCE UPDATE NO. 2013-08: FORM 13F CONFIDENTIAL TREATMENT REQUESTS BASED ON A CLAIM OF ONGOING ACQUISITION/DISPOSITION PROGRAM 2 (2013) [hereinafter 2013 GUIDANCE UPDATE], *available at* http://www.sec.gov/divisions/investment/guidance/im-guidance-update-filing-requirements-for-certain-electronic-communications.pdf.

[59] *Id.* at 3–4.

[60] 1998 Guidance Letter, *supra* note 8, at *3.

[61] 2013 GUIDANCE UPDATE, *supra* note 58, at 3.

[62] 1998 Guidance Letter, *supra* note 8, at *4.

[63] 2013 GUIDANCE UPDATE, *supra* note 58, at 3–4.

investment strategy" and how the public would be able to discern the thrust of the strategy from those transactions.[64] In order to support a claim that disclosure would reveal a broader investment program, the request must consider what information is already deemed to be public, why compliance with the regulation would reveal the program given the "historical snapshot" nature of Form 13F, and "how the public would discern from Form 13F data the Institutional Manager's intent" to transact in specific reportable securities in the future.[65]

Fourth, the applicant must analyze how the disclosure would affect the underlying securities holdings in order to demonstrate that the failure to receive the "confidential treatment would present a likelihood of substantial harm to the manager's competitive position."[66] This section of the CT Request should detail the likelihood that and manner in which the filer's "competitive position" in a security would be substantially harmed by providing "a description and comparison of any prior instances of market reaction to the Institutional Manager's public disclosure of its position in an issuer."[67]

Lastly, the request must specify the period of time for which confidential treatment is requested.[68] This is to include an explanation of the "projected timeframe" for achieving the "ultimate objective," whether there are other related regulatory disclosures that might impact the timeframe for confidential treatment, and "any other factors that may be relevant."[69]

It is apparent from these guidelines that the SEC wants a lot of information from CT Request filers. It is not clear, though, that it is evaluating the information in a methodical way. More puzzling still, the Commission has yet to specifically express its rationale as to how granting CT Requests regarding a plan of acquisition or disposition can be in the public interest, advance the general "protection of investors," or further the administration of fair and orderly markets.

What would go wrong without the availability of a confidential treatment exemption for Form 13F? Large investors would likely point out that mass disclosure of their positions generally disincentivizes them from doing market research and investing in companies at all. If they cannot earn excess returns by uncovering, through honest means, financially relevant information not yet incorporated into the value of a company's securities, then they will stop doing it altogether. Considering that large

---

[64] 1998 Guidance Letter, *supra* note 8, at *4.
[65] 2013 GUIDANCE UPDATE, *supra* note 58, at 3.
[66] 1998 Guidance Letter, *supra* note 8, at *4.
[67] 2013 GUIDANCE UPDATE, *supra* note 58, at 4.
[68] 1998 Guidance Letter, *supra* note 8, at *3.
[69] 2013 GUIDANCE UPDATE, *supra* note 58, at 4.

investors play an important role in assessing the true value of corporate enterprises and, accordingly, the securities that they issue, it would be generally unwise to enforce laws that completely strip the reward out of the work they do and the risks they take.

For a number of institutional investors who have long track records of success and broad followings in the financial media, large transactions in the stock of companies are highly scrutinized and, often, blindly copied by large numbers of bandwagon jumpers. If the investor's following is large and voracious, and especially when it includes other institutional managers,[70] this following can cost her the fruits of her research. She may not be able to build a large position or liquidate an existing one before the herd of smaller copycats has rushed into or out of the stock, impacting the price adversely for her and potentially ruining the opportunity that she had uncovered. This scenario could result in increased volatility as well, because the investor would be incentivized to liquidate or build large positions more quickly than she normally would, rather than in a manner that would minimize impact on market values.

With these effects in mind, the SEC requires that the money manager affirmatively show that disclosure of the position on a Form 13F filing will damage the institution's "competitive position" by public dispersal of data regarding its recent trading patterns.[71] Considering applicable insider trading law, one might assume that the investment program in question is developed using publicly available information assembled by the investment manager, though the program itself cannot be public information and still meet the eligibility requirements for confidential treatment.[72]

While indications like this one help market participants understand what is not subsumed under the confidential treatment rule, the SEC has not provided a definition of what constitutes demonstrable harm to "competitive position" from disclosure.[73] One might deduce, then, that the

---

[70] Consider, for example, Warren Buffett, Carl Icahn, John Paulson, and George Soros. The Internet is replete with websites that use regulatory filings (including Forms 13F) to aggregate and report upon the investment movements of stock market heavyweights, track their performance, and report on their findings to the public, sometimes for a fee. *E.g.*, GURUFOCUS, http://www.gurufocus.com/ (last visited Nov. 20, 2013); STOCKPICKR, http://www.stockpickr.com/list/latestpro/ (last visited Nov. 20, 2013).

[71] 1998 Guidance Letter, *supra* note 8, at *4.

[72] *Id.*

[73] It is worthwhile to note that Congress has not emphasized competition as a core consideration of the Securities Acts, but rather as a peripheral concern:

> [T]he Commission's responsibility [is] to balance the perceived anti-competitive effects of the regulatory policy or decision at issue against the purposes of the Exchange Act that would be advanced thereby and the costs of doing so. Competition would not thereby become paramount to the great purposes of the Exchange Act, but the need for and effectiveness of regulatory actions in achieving

standard is an open-ended one for fund managers. The SEC has offered that it is within its discretion to provide an exemption if the applicant can successfully show that revealing its positions would amount to a discernible competitive harm.[74] The "demonstrable harm" standard is inadequate for the administration of CT Requests because it fails to consider the exemption as a counterpart of the reporting regulation from which it provides relief. While section 13(f)'s disclosure requirements were enacted in order to advance full disclosure and freely available information (because market efficiency is a derivative product of maximizing information flow), the exemption is a counterbalance that works to preserve incentives to competition for institutional investors.

Certainly, President Ford emphasized the value of promoting competition in the markets upon signing section 13(f) into law, stating that the 1975 amendments to the Securities Acts provided "new directives to the industry and its regulators to insure that competition is always a prime consideration in establishing or abolishing market rules."[75] He simultaneously pointed out, though, that the market must function with the highest degrees of financial capability, ethical behavior, efficiency, order, and accessibility.[76] For several of these enumerated goals, enhancing competitiveness is a means to the end. For others—namely ethical fortitude and accessibility—regulation must act to ensure that unbridled competition does not trample them underfoot.

In considering the confidential treatment exemption as a balancing device that prevents the forced inequitable disclosure of Form 13F information by investment managers, application of the exemption should be based on a determination of whether compliance with the reporting requirements would be the proximate cause of losses in extraordinary situations. In other words, we would be best served to think of it as a shield and not a sword: Confidential treatment should be granted in scenarios where it is necessary to protect an institutional investor's portfolio from regulation-imposed losses.

As discussed above, the quintessential case occurs when news of the investor's exit from a position might cause others in the market to sell their shares in that stock quickly and preemptively, causing a price drop and leaving the discloser with losses she would have otherwise been unlikely to incur.[77] It might also be used if disclosure makes the cost of an intended

---

> those purposes would have to be weighed against any detrimental impact on competition.

S. REP. NO. 94-75, at 13–14 (1975), *reprinted in* 1975 U.S.C.C.A.N. 179, 192.

[74] 1998 Guidance Letter, *supra* note 8, at *4.

[75] Ford, *supra* note 44.

[76] *Id.*

[77] *See supra* note 10 (detailing a possible situation in which this might occur).

merger or acquisition prohibitively high because of the size of the resulting net loss to the economy generally, which might benefit from the greater efficiencies achieved through industry consolidation and achieving economies of scale. It is not to be used, however, as a tool to maximize investment managers' profits at the expense of market transparency. This construction defies the law's twofold purpose of simultaneously advancing informational equity and fair competition.

III. LACK OF A MEANINGFUL CONFIDENTIAL TREATMENT STANDARD RESULTS IN PRACTICAL DEFICIENCIES IN THE APPLICATION AND ADMINISTRATION OF SECTION 13(F)

Section 13(f) reporting exemption protocol has recently been the subject of much scrutiny from the SEC's independent internal auditor and market observers alike.[78] The areas that have attracted the most criticism, by and large, could be remedied if the SEC adjusted its administration of the reporting requirements and the CT Request process to agree with Congressional intent, and embraced the balancing act between public transparency and protection from private harm.

In 2010, the SEC's Office of Inspector General (OIG) released a review of the 13(f) reporting requirements and audit findings as to the oversight of the 13(f) filing process.[79] The report contained twelve recommendations to the agency to strengthen its supervision of the statutory requirement and demanded written corrective action plans for each of the items.[80] The OIG reviewed the 13(f) oversight process in light of the statute's intent to "improve the body of publicly available factual data" regarding the activity of institutional investment managers and "thereby increase investor confidence in the integrity of the U.S. securities markets."[81] Moreover, the OIG sought to examine whether then-current policies and procedures complied with statutory requirements, including whether the review and processing of confidential treatment requests were adequate and appropriate.[82]

The review found significant shortcomings in the administration and supervision of 13(f) filings. First, the OIG found that the SEC conducted

---

[78] OFFICE OF INSPECTOR GEN., SEC. & EXCH. COMM'N, REP. NO. 480, REVIEW OF THE SEC'S SECTION 13(F) REPORTING REQUIREMENTS (2010) [hereinafter OIG REPORT]; *see also* Heidi N. Moore, *Warren Buffett: Even Oracles Have Their Secrets, and the SEC Lets Them*, AM. PUB. MEDIA: MARKETPLACE (Nov. 8, 2011), http://www.marketplace.org/topics/business/easy-street/warren-buffett-even-oracles-have-their-secrets-and-sec-lets-them; Andrew Ross Sorkin, *One Secret Buffett Gets to Keep*, N.Y. TIMES DEALBOOK (Nov. 14, 2011, 9:24 PM), http://dealbook.nytimes.com/2011/11/14/one-secret-buffett-gets-to-keep/.

[79] OIG REPORT, *supra* note 78.

[80] *Id.* at ii.

[81] *Id.* at iv.

[82] *Id.* at v.

no continuous or systematic review or analysis of Form 13F reports or the data found therein.[83] In fact, "no Commission division or office had been delegated the authority to review the Form 13F filings" and, as a result, no office considered such a review part of its ongoing responsibility.[84] Not surprisingly, this lack of monitoring rendered the data "less useful and reliable than Congress had intended."[85] The SEC's monitoring procedure for the filings was so inadequate that there have been at least twenty-two documented cases of third party observers from the public informing the agency about basic noncompliance by required reporters.[86] For example, the agency had been notified that certain filers had used the wrong form and that other required reporters had failed to submit Forms 13F altogether.[87]

This administrative failing is notable in part because Form 13F has been highlighted as a useful, but underutilized, tool for detecting fraudulent activity by institutional investment managers. For example, in the wake of Bernard Madoff's massive Ponzi scheme, through which he defrauded his investors of approximately $18 billion,[88] observers have pointed out that the Madoff firm's "slim 13F filing [was] a major red flag."[89] While its September 30, 2008 Form 13F showed an equity portfolio valued at approximately $237 million, Madoff's firm had reported total holdings of about $17 billion in other filings to the SEC a year earlier.[90] The forms should have also raised concerns in that the reported holdings were inconsistent with the strategies allegedly employed by the company.[91]

While Madoff's failure to comply truthfully with Form 13F filing requirements is an inherent hazard embedded in any self-reporting regulatory regime, closer inspection of filings that are supposed to be part of a useful centralized and standardized repository of information may well have played a meaningful role in uncovering the long-perpetrated fraud sooner, saving the victims millions of dollars in losses. The system of Form 13F administration, which has been deferential to investment companies at best and asleep at the wheel at worst, fails to affect the balance between competition and transparency that the regulation is designed to achieve.

---

[83] *Id.* at 6.
[84] *Id.* at 8.
[85] *Id.* at 9.
[86] *Id.* at 11–12.
[87] *Id.*
[88] *The Madoff Scam: Meet the Liquidator*, CBS NEWS: 60 MINUTES (June 20, 2010), http://www.cbsnews.com/stories/2009/09/24/60minutes/main5339719.shtml.
[89] ALT. INV. GRP., MADOFF SCANDAL: CASE, RED FLAGS, AND LESSONS LEARNED 5 (2009), *available at* http://altinv.com/news/view/8.
[90] *Id.*
[91] *Id.*

Related to this observation is the OIG's finding that Form 13F does not currently require "disclosure of all significant investment activities of institutional investment managers."[92] Specifically, the OIG found that the universe of reportable security types under section 13(f) had not been updated since the enactment of the statute in 1975, nor had the reporting threshold been increased to keep pace with inflation and the extraordinary growth of the investment management industry.[93] As a result, more modern and complex investment vehicles such as derivatives, mutual fund shares, and hedge positions are not reportable.[94]

Because the Dodd-Frank amendments to section 13(f) have not yet been implemented through an SEC rule, industry observers have persisted in complaining that short positions are not reportable, and that their omission misleads not only the public perception of an institutional investment manager's net positions, but also the market's general perceptions about the financial health of companies that offer public securities.[95] Moreover, the failure to increase the reporting threshold has resulted in an enormous uptick in the number of firms required to file and significantly increased the burden on the agency without increasing the efficacy of the reporting mechanism.[96] Neglecting to adjust the reporting requirements in order to conform to current stock market realities and simultaneously allowing the costs of administering the program to grow exponentially appear to contradict the congressional purpose to increase market transparency for traders and aggregate useful data for regulators. Providing piecemeal information about investment managers' portfolios,

---

[92] OIG REPORT, *supra* note 78, at 25.

[93] *Id.* at 25–26.

[94] *Id.* Ironically, when President Ford signed the Securities Acts Amendments of 1975 into law, including section 13(f), he declared that the law was part of vital efforts to continually improve the operation of the financial markets and to ensure that antiquated laws and regulations did not "unfairly interfere with the need for changes" as markets evolve. Ford, *supra* note 44.

[95] *See, e.g.*, Steven M. Davidoff, *Disclosure by Short-Sellers Would Improve Market Clarity*, N.Y. TIMES DEALBOOK (May 22, 2012, 5:39 PM), http://dealbook.nytimes.com/2012/05/22/disclosure-by-short-sellers-would-improve-market-clarity/ (describing how short position disclosures would have helped avoid a precipitous decline in Herbalife Limited's stock price after David Einhorn of Greenlight Capital emerged on one of the company's earnings conference calls and asked several critical questions because it would have prevented other investors from assuming that his line of questioning indicated that he was in possession of negative information about the company and had taken a short position when he had not); Meena Krishnamsetty, *SEC Should Shorten the 13F Reporting Period, Not 13D*, INSIDER MONKEY BLOG (Mar. 16, 2011, 4:25 PM), http://www.insidermonkey.com/blog/sec-should-shorten-the-13f-reporting-period-not-13d-2978/ (arguing that the short time periods that investment funds require to build large positions offers support for the notion that Form 13F should be required more frequently, on a shorter timeline, and include short-sale positions). *But see* Michael D. Kurzer, *Short-Sale Disclosures Would Force Investment Managers to Publicize Secret Sauce*, INVESTMENT NEWS (Sept. 22, 2013), http://www.investmentnews.com/article/20130922/REG/309229998 ("If the SEC adopts rules requiring public reporting of individual short-sale positions, an important component of fund managers' trading strategies would be made available to the public at large.").

[96] OIG REPORT, *supra* note 78, at 26–27.

rather than the complete picture, can also creates hazardous downside risk for publicly listed companies.[97] This, of course, makes it difficult to expect Form 13F to advance sound and efficient security pricing, the end goal of both transparency and effective regulation.

The OIG also reported two serious concerns with specific regard to the CT Request process. First, the auditor found that a majority of the confidential treatment requests that were selected for testing lacked supporting documentation or a proper audit trail.[98] The audit requested twenty-five files for review and the agency could not produce any files or provide any supporting documentation for twelve of the sample items and, for another two items, no file could be located but supporting documents were produced.[99] When the auditor requested twelve additional files in place of those that could not be produced, the agency could only provide support for four items.[100]

As a result, the OIG concluded that confidential treatment requests in many cases appeared to avoid processing, could have been lost or misplaced and the confidentiality of the data contained therein compromised, and that the Commission had been failing to comply with its record retention policies.[101] There is anecdotal evidence that the failure to substantiate confidential treatment requests is common. An experienced private practitioner in the field of securities regulation admitted that, in "years of submitting confidential treatment requests," he was never required to substantiate a single one.[102]

Additionally, the OIG found that certain filers for confidential treatment received de facto exemption from 13F disclosure even though their applications did not meet the criteria for confidential treatment under section 13(f).[103] Any passage of time between the CT Request filing and when the Commission issues a written response to the request results in postponed disclosure of investment holdings in accordance with section 13(f), essentially giving all or some of the investment manager's reportable securities positions de facto confidential treatment.[104] The audit found that, at times, cases of de facto exemption exceeded one year.[105] It is

---

[97] Davidoff, *supra* note 95.

[98] OIG REPORT, *supra* note 78, at 19.

[99] *Id.* at 20.

[100] *Id.*

[101] *Id.*

[102] Sorkin, *supra* note 78. The comment in Sorkin's article comes from Christopher J. Hewitt, a corporate partner at Tucker Ellis LLP and former partner at Jones Day LLP; his biographical webpage asserts expertise in the areas of securities law and SEC compliance, among others. *Christopher J. Hewitt*, TUCKER ELLIS LLP, http://www.tuckerellis.com/attorneys/christopher-hewitt (last visited Nov. 20, 2013).

[103] OIG REPORT, *supra* note 78, at 21.

[104] *Id.* at 23.

[105] *Id.* at 24.

worth noting that this exceeds the maximum time limit available for confidential treatment without refiling.[106] Moreover, the OIG found that when these long outstanding requests were reviewed, they did not meet the substantive criteria laid out by the Commission for confidential treatment, and the requests should have been denied.[107] Because the Commission never responded to the requests, the filers were able to utilize the Form 13F CT Requests to inappropriately and indefinitely skirt the regulatory requirement.

Financial media pundits have interpreted the results of this investigation as evidence that, while the SEC contends that it grants exemptions "for public interest reasons or the protection of investors," the rule is used to routinely exempt rich and powerful investors like Carl Icahn, Bill Ackman, and Warren Buffett.[108] While official statistics detailing confidential treatment request application numbers and approval rates are not available, there is evidence that a significant number of such large investors are seeking confidential treatment: a SEC spokesperson has confirmed that the agency receives about sixty confidential treatment requests per quarter.[109] These executives and money managers have been reported to garner a high rate of success in their applications for confidential treatment: one investigator found that Buffett's Berkshire Hathaway receives confidential treatment about half of the time that it seeks it.[110]

Speaking of publicly traded Berkshire Hathaway, Warren Buffet's conglomerate functions in many ways like a pooled investment fund, while at the same time it is subject to the disclosure-centric regime of federal securities laws. The disclosure requirements of the Securities Acts may not be appropriately designed for a company that operates a significant investment-based profit center outside of its otherwise primary industry but does not offer fund interests that are subject to the requirements of the Investment Company Act. It bears observing that the problem with reporting exemptions extends beyond Berkshire; the recent past is littered with examples of executives at publicly traded corporations operating primarily in industries like banking and retail that invested corporate funds

---

[106] *FAQ About Form 13F*, *supra* note 23.

[107] OIG REPORT, *supra* note 78, at 24.

[108] Sorkin, *supra* note 78.

[109] *Id*.

[110] Moore, *supra* note 78. Bear in mind that while a fifty percent yield on such requests may intuitively seem generous, there is no way for the public to know if this success rate is inappropriately high because of the confidential nature of the filings. Assuming that an in-house legal group or outside counsel that has filed many Forms 13F likely knows roughly "where the line is," it may be reasonable to assume that half of the applications optimistically overreach in hopes of lucking out or gaining temporary de facto confidential treatment due to administrative shortcomings. As noted above, there is no widely disseminated understanding of where "the line" actually is and what test, if any, the SEC employs in evaluating an application's viability.

in risky instruments and employed strategies not disclosed in detail to shareholders.[111]

Full disclosure of large deployments of capital and key profit-seeking strategies is at the heart of cultivating a culture of periodic disclosure among public corporations in the United States. Allowing executives to put corporate funds at risk without complying with mandatory disclosure rules in a timely manner defies the law's general emphasis on providing accurate and complete information to all market participants simultaneously. It also fosters a market culture that favors the informed insider over the ordinary participant. As pointed out above, Rule 13f-1 and Form 13F could prevent companies that operate like investment management companies, but outside the scope of the 1940 Act, from skirting important disclosures to shareholders about the extent and quality of their financial bets just because the annual and quarterly financial statements do not require that level of granularity.[112]

There are also logistical shortcomings. Even if a trade occurred a single day before the reporting period closed, the forty-five day grace period for filing is "an eternity" in the capital markets.[113] As argued in the prior section, the lag inherent in the section 13(f) reporting procedure allows the investor ample time to initiate position-building or liquidating measures, and any interpretation of section 13(f) that suggests that the investor needs more time to execute profitable strategies is questionable at best.[114] Section 13(f) already gives the investor at least forty-five days, and potentially *up to 135 days*, to accumulate the position.[115] He should not be

---

[111] *See, e.g.*, Jesse Eisinger, *In Scrutiny of JPMorgan Loss, Bigger Questions Left Unanswered*, N.Y. TIMES DEALBOOK (May 16, 2012, 12:15 PM), http://dealbook.nytimes.com/2012/05/16/in-scrutiny-of-jpmorgan-loss-bigger-questions-left-unanswered/ (detailing how JPMorgan Chase suffered massive losses with respect to the so-called "London Whale" investments in derivatives contracts not disclosed in its regulatory filings); Moore, *supra* note 78 (commenting on how the now-defunct MF Global brokerage firm, under CEO Jon Corzine, took massive risks with its treasury's funds, took on massive amounts of leverage, and ended up bankrupt); *Sears Sees Rise in Fourth Quarter Profits Despite Trading Losses*, CNBC.COM (Jan. 10, 2007), http://www.cnbc.com/id/16562581/Sears_Sees_Rise_in_Fourth_Quarter_Profits_Despite_Trading_Losses (reporting that Sears Holdings' CEO and former hedge fund manager Edward Lampert's risky derivative investments for the department store chain resulted in losses for shareholders). Whether companies that take massive bets in risky financial instruments should be required to disclose such facts in a detailed manner in their 10-K and 10-Q filings is a separate but important question. If Rule 13f-1 compliance was better enforced and Form 13F contents were made more comprehensive and valuable, such changes may not be necessary for the consolidated financial statement reports. The Form 13F would become an important supplement to the other financial reporting mandated for publicly traded companies.

[112] *See supra* Part II.A.

[113] Mebane Faber, *Bring in the Clones*, WEALTHMANAGEMENT.COM (Nov. 1, 2009), http://wealthmanagement.com/alternative-investments/bring-clones.

[114] *See supra* Part II.B.

[115] The 135-day maximum timeframe can be achieved if the investor were to initiate a new buying or selling strategy on the first day of the quarter. The position would not be reported for the length of

able to act secretly for as long as a strategy takes to fully implement. If he is not able to establish or liquidate his position before the disclosure requirements kick in, the regulation should, as a matter of policy, provide the public with an opportunity to benefit from knowing about the move before it is completed.

In addition to all the documented shortfalls in administering section 13(f)'s requirements, the statute appears to be somewhat toothless from an enforcement perspective. The agency has only brought one action against an investment firm for failing to properly disclose its investment positions.[116] Public questions about section 13(f) and its shadowy opt-out process have been repeatedly mooted.[117] This insinuates that the playing field, from the all-important informational perspective, appears to remain slanted toward a Wall Street inner circle.[118]

Sophisticated market regulators and observers should not be surprised that some long-unregulated private investment companies are hesitant to comply freely with section 13(f) requirements when an avenue to exemption exists.[119] Hedge funds and other private investment groups, concerned that their "proprietary" investment strategies comprise their competitive advantage in a flooded market of investment managers, pride themselves on being so-called black boxes and work to ensure these strategies remain elusive to their competitors and the general public.[120] Section 13(f) is designed to cut against that frame of mind, but the de facto exemption from reporting that can often result from merely filling out an unsubstantiated Form 13F CT Request and submitting it in a timely fashion undermines the effectiveness of the regulation. This contrasts starkly with Congress's intent to empower the Commission to secure investor trust and confidence by shedding light on an industry with a competitive stake in its own secrecy.

---

the quarter, which I assume to be 90 days, plus the 45-day grace period for compiling quarter-end reports.

[116] Quattro Global Capital, LLC, Exchange Act Release No. 56,252, Investment Advisers Act Release No. 2634, 2007 WL 2471810 (Aug. 15, 2007).

[117] Sorkin, *supra* note 78.

[118] *Id.*

[119] *See* Edward Pekarek, Note, *Hogging the Hedge? Bulldog's 13F Theory May Not Be So Lucky*, 12 FORDHAM J. CORP. & FIN. L. 1079, 1084 (2007) (detailing the legal claim by hedge fund manager Phillip Goldstein of Bulldog Investors that Form 13F disclosures are unconstitutional taking of trade secrets in violation of the Fifth Amendment).

[120] Moore, *supra* note 78. Interestingly, on the issue of property rights, the U.S. Court of Appeals for the District of Columbia Circuit held that mere disclosure to the SEC does not raise Fifth Amendment takings concerns even assuming that petitioner has a cognizable property interest in knowledge of its investment positions. Full Value Advisors, LLC v. SEC, 633 F.3d 1101, 1110 (D.C. Cir. 2011).

IV. ADVANCING MARKET EFFICIENCY BY WAY OF FORM 13F REPORTING

In response to media attention toward the apparent inequity involved with the administration of section 13(f), large investors have countered that the confidential treatment exemption is required to maintain their competitive advantage and to avoid disincentivizing investment research generally.[121] I will now turn to theoretical evidence that explains how liberally granting CT Requests can inflict more negative effects on the market generally than might be incurred by the manager who is forced to disclose her positions.

In contrast to traditionally subjective fairness-oriented approaches to policymaking, work by economic researchers supports the notion that policy decisions about the public interest in promoting adequate disclosure and increasing market efficiencies are less a matter of judgment and more often an empirical question.[122] This is partly the result of the minimalist regulatory approach of the securities regime, in the sense that the law does not grant authority to the government to positively assess the substance of an investment or its worthiness for purchase or sale, leaving the success of the instrument instead to judgment of its merits by the investing public, which is ostensibly better informed as a result of the required disclosures. Ultimately, the "dominating principle of securities regulation is that anyone willing to disclose the right things can sell or buy whatever he wants at whatever price the market will sustain."[123]

Nevertheless, as it is often inclined to do for its public policy-oriented decisions, the SEC justifies the availability of Form 13F exemption as simply for the "protection of investors."[124] This may be attributable in part to the lack of a sufficiently articulated statement of goals in the legislative history associated with this section of the Securities Acts Amendments of 1975. Permitting selective section 13(f) filing exemptions is the equivalent of making lower quality financial reporting acceptable under a regulatory regime that typically angles to meet its goals by demanding high quality, accurate statements of financial condition. The result is a redaction of information that increases information asymmetry among market participants. This Part suggests that equitable accounting policy provides a foundational model for illuminating exactly what degree of disclosure is actually in the public interest and whether and when exemption from

---

[121] Sorkin, *supra* note 78 (reporting on an interview with Warren Buffett, wherein Mr. Buffett "said that he did not believe that public investors should always be allowed to piggyback on investment ideas made by professional investors, especially before they are finished buying").

[122] ANNE M. THOMPSON, SEC CONFIDENTIAL TREATMENT ORDERS: BALANCING COMPETING REGULATORY OBJECTIVES 9 (2010).

[123] Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 670 (1984).

[124] *FAQ About Form 13F*, *supra* note 23.

disclosure requirements is acceptable.

In order to make an informed policy decision, one must first determine the goals of the legislation in question. It has been widely stated and repeatedly reaffirmed that the purpose of the federal securities laws is to promote market fairness through disclosure of complete and accurate information about securities and the markets on which they are traded.[125] It is important, though, to understand *why* this policy is in the public interest in order to properly apply it. While the vague platitude "protecting investors" seems to have become something of a rallying cry for the SEC, it is inadequate as a policy standard. Achieving general fairness or defending purportedly small and defenseless individual investors from fraud and exploitation by insiders should not be the perceived hallmark of just financial markets.[126] Such a concept is too closely aligned with ex post notions of distributive justice that call for equality of outcomes, which cancels out rewards for risk-taking and ultimately creates disincentives to investment instead of ex ante equality of opportunity, which, by contrast, incentivizes information discovery and investment.[127] In this sense, large investors arguing in favor of broad availability of the exemption are right. The exercise of implementing the exemption should be informed, however, by a narrower understanding of "opportunity" than many large investors might insist upon.

As discussed, the legislative history and regulatory releases for section 13(f) also mention the counterbalancing interest in not requiring "harmful" disclosure of information.[128] But the existence of information asymmetry is the major reason for systematic ex ante risk-adjusted return differentials across investors; such asymmetries are expected to benefit large-scale investors who have increased access to information characterized by increasing returns to scale.[129] Proponents of allowing disclosure exemptions for competitive reasons—often the large institutions that benefit most from information asymmetry—argue that policies which deprive them of their informational advantages are anti-competitive because they disincentivize them from working for superior investment strategies in the first place.[130]

Economic theory and empirical evidence support the idea, however, that inequity in capital markets due to information asymmetry results in

[125] JAMES D. COX ET AL., SECURITIES REGULATION 1 (6th ed. 2009).

[126] Baruch Lev, *Toward a Theory of Equitable and Efficient Accounting Policy*, 63 ACCT. REV. 1, 6 (1988).

[127] *Id.* at 4.

[128] 1998 Guidance Letter, *supra* note 8, at *2.

[129] Lev, *supra* note 126, at 4–6.

[130] 1998 Guidance Letter, *supra* note 8, at *2; *see also* Sorkin, *supra* note 78 (quoting Warren Buffett that allowing the public to free-ride on the investment ideas of "professional investors" is "unfair").

negative social consequences, including higher transaction costs, thinner markets, lower liquidity, and, in general, decreased gains from trade.[131] Underpinning this theory is the idea that free market participants, no matter how small, are not "defenseless" or inherently exploitable by large-scale managers and insiders because they have a number of options available to them, including adoption of a broadly diversified and passive portfolio strategy, recourse to legal and contractual methods of preventing insiders from transacting in the securities of their own firms altogether, and withdrawal from the market.[132] Thus, while effective, these self-defense tactics each introduce inefficiencies and costs into the market, borne by all participants. Disclosure was designed, at the outset at least, to mitigate these adverse effects and, in turn, to promote public welfare.[133]

This does not necessarily imply that securities regulators should adopt a policy requiring that *all* relevant information be publicly disclosed. Rather, information disclosure rules should be limited to ensure that the transfer of information from the informed to the uninformed via regulatory disclosures will be efficient—that is, the decrease in information asymmetry by way of the transfer should result in an expanded investor base and increased liquidity which, in turn, will lead to a broad increase in opportunities for trade and risk-sharing, spurring diffuse increases to welfare for most investors while minimizing the negative effects on the reporting investors.[134] On the other hand, it is not unimaginable that aggressive disclosure rules might result in pure welfare redistribution, in which some investors benefit materially at the expense of others. Such information redistribution is permissible in only the most dire of circumstances: if and only if a refusal to impose information disclosure requirements would compromise market function entirely such that the aggregated general harm to all exceeds the isolated harm to the disclosers.[135] Thus, when the Commission is implementing the congressional mandate to allow disclosure exemption in cases that might result in "harmful" effects, just how the agency perceives and measures such harm is of central importance.

---

[131] Lev, *supra* note 126, at 9.

[132] *Id.* at 6–7.

[133] Easterbrook & Fischel, *supra* note 123, at 670. Easterbrook and Fischel note that relying exclusively on this description of federal securities regulation is too simple in the modern age and that the regime persists now because it also—or perhaps instead—has found support from interest groups representing securities issuers who utilize it to protect their own interests at the expense of investors. *Id.* at 670–71.

[134] Lev, *supra* note 126, at 10. The idea is analogous to the Pareto efficiency principle. An allocation of goods, either input or output goods, is Pareto efficient if one cannot find a reallocation of those goods such that one can produce more of something (utility or output) without producing less of something else. Bruce C. Greenwald & Joseph E. Stiglitz, *Externalities in Economies with Imperfect Information and Incomplete Markets*, 101 Q.J. ECON. 229, 230, 234 (1986).

[135] Lev, *supra* note 126, at 10.

Professor Baruch Lev of New York University Stern School of Business has pointed out that recognizing "evenhandedness" in implementation of perfectly efficient information redistribution "is obviously impossible to achieve in most situations."[136] With that reality in mind, he argues that the ex ante equity objective seems to provide a standard that specifies the public interest: "*The interests of the less informed investors should, in general, be favored over those of the more informed investors*."[137] Employing Lev's rule here shows us that the balancing paradigm, qualified with a bias toward the less informed (and therefore in favor of disclosure) and a higher bar in terms of substantiating "harm," can provide the SEC with clearer, more operational "public interest" guideposts than currently exist under the "protecting investors" and "preserving competition" rhetoric often invoked in discussions of section 13(f). Use of this standard will, in general, continue to demand a fact-driven analysis of the broad consequences of disclosure exemption and resulting information asymmetries.

More importantly though, the standard shifts the SEC's evaluation of an application in such a way that the agency must think more critically about the harm incurred by the information-sharer in relation to the gains enjoyed by the information gainers. Arguments that information sharing undercuts competition are categorically untrue under this rubric, and should not result in successful application for exemption. Claims that disclosure results in loss of opportunity would similarly be insufficient to meet statutory or common law understandings of harm.[138] The applicant should instead be demonstrating real and tangible harm as a result of disclosure—making the case that the firm's situation is one in which information disclosure is tantamount to devaluing the institution's investment book and, as a result, passing those losses on to the investors in their funds or accounts or, in the alternative, to their shareholders. Because the exemption's plain and narrow meaning allows for an end-around in situations where disclosure would harm investors, this is a plausible and commonsense application. Allowing it to exist for the purpose of maximizing gain for the institutions who might stand to reap the most upside from being out in front of their own transactions—or, correspondingly, for one pool of fortunate investors over all of the others—

---

[136] *Id.* at 13.

[137] *Id.*

[138] *See* 15 U.S.C. § 77k(e) (2012) (setting the amount recoverable for securities fraud as the actual losses, calculated as the value at the time of purchase less the value at the time of the suit or the value at which the shareholder disposed of the stock, either before or after the initiation of suit, except for any amount of the loss for which the issuer can prove was caused by something other than the misstatement); Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 343–44 (2005) (finding that private securities fraud actions are similar to common law deceit and misrepresentation tort actions and worthy of the same standard for determining the extent of damages).

strikes a dissonant chord against the theme of fair and efficient markets.

V. SECTION 13(F) AND AN INTEGRATED SECURITIES LAW DOCTRINE

Functionally, federal securities regulations generally demand disclosure as a means of maintaining fair dealing in the marketplace, facilitating capital formation, and protecting against fraud.[139] The theoretical basis for this is rooted in the fact that investment securities are not like cars or homes: the prospective buyer cannot effectively self-inspect the asset or hire a trained eye somewhat cheaply to tell him if something is wrong with it before he plunks down a large sum of money. It is nearly impossible for the average investor to reliably and independently arrange for an inspection of the condition of a company. Requisite accounting and analytical proficiency aside, the resources consumed in such an exercise alone would easily make the upfront costs so high that the investment would become nonsensical for all but the wealthiest investors.

In designing the law, Congress made the decision to place much of this cost on the issuer, who is generally more willing and able to bear it as a cost of accessing capital markets. As part of this effort, section 13 of the Exchange Act provided "mechanisms for mandatory disclosure requirements" for the benefit of publicly traded markets.[140] This effort was not solely driven by the choice to make large amounts of high quality information available to investors for their benefit and protection, but also "by the belief that enhanced disclosures . . . would allow sound investing to triumph over manipulation and speculation."[141]

In angling to make manipulation less feasible and speculation less prevalent, the resulting regime of mandatory disclosure reduces fraud, which allows for allocative efficiency and maximizes the net benefit to society.[142] A host of important regulations do this work. One might reasonably suggest that the annual and quarterly financial reporting requirements of public companies under the Exchange Act,[143] the internal controls and independent audit standards mandated by the Sarbanes-Oxley Act,[144] and the sweeping fraud protections imposed by section 11 of the Securities Act[145] and section 10(b) of the Exchange Act[146] all do enough to

---

[139] *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCHANGE COMMISSION (June 10, 2013), http://www.sec.gov/about/whatwedo.shtml.

[140] COX ET AL., *supra* note 125, at 548.

[141] *Id.*

[142] Easterbrook & Fischel, *supra* note 123, at 673.

[143] 15 U.S.C. §§ 78m, 78o(d).

[144] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 103, 404, 116 Stat. 745, 755–57, 789.

[145] 15 U.S.C. § 77k.

[146] *Id.* § 78j.

provide market transparency and efficiency, and that section 13(f) provisions have not received attention because their work is repetitive of these other filings and therefore unnecessary. Put differently, one might ask what unique protection the section 13(f) reporting requirements provide.

The answer is that the statute does not do something altogether different than the other regulatory requirements. Section 13(f) is supposed to prevent manipulation and control speculation, as well as inhibit fraud and unjust enrichment by investment managers, while the other disclosure requirements are intended to prevent manipulation and fraud by security issuers. We can use the doctrine that has developed in the more robust area of security issuance and periodic filing enforcement to define the contours of section 13(f) requirements for institutional managers and how they should be enforced.

A. *Preventing Market Manipulation*

It is well documented that Congress was motivated to protect investors against manipulation of securities markets when it enacted the Exchange Act: "There cannot be honest markets without honest publicity. Manipulation and dishonest practices of the market place thrive upon mystery and secrecy."[147] The SEC has suggested that market manipulation is epitomized by boiler room-style "pump-and-dump" schemes, which entail hard-sell tactics in connection with the sale of a company's stock "through false and misleading statements to the marketplace."[148] "Often the promoters will claim to have 'inside' information about an impending development" or some foolproof alchemy that will allow them to convert market data into accurate predictors of future market prices.[149]

In reality, these promoters have often purchased penny shares on the market before initiating their selling efforts, and they stand to gain by selling these shares after they have created a frothy, false market in the security, causing the subsequent investors to suffer losses.[150] Market manipulation is not confined to pump-and-dump schemes. It extends equally to all practices "intended to mislead investors by artificially affecting market activity" including "wash sales, matched orders, [and] rigged price[s]."[151] In sum, "[i]t connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially

---

[147] H.R. REP. NO. 1383, at 11 (1934).

[148] *"Pump-and-Dumps" and Market Manipulations*, U.S. SEC. & EXCHANGE COMMISSION (Mar. 12, 2013), http://www.sec.gov/answers/pumpdump.htm.

[149] *Id.*

[150] *Id.*

[151] Santa Fe Indus. v. Green, 430 U.S. 462, 476 (1977).

affecting the price of securities."[152] The Supreme Court has declared that there is "[n]o doubt [that] Congress meant to prohibit the full range of ingenious devices that might be used to manipulate securities prices."[153]

Defining "artificial effects" on the market as those that have no basis in the economic substance of the security in question, one could make the case that permitting exemption from section 13(f) and therefore allowing selective disclosure of securities positions is meant to control current market prices for a stock by minimizing copycat investing and preventing artificially suppressed or bolstered valuations. The fact that certain investors are buying or selling a stock is not usually, in itself, material to the stock's intrinsic worth.[154] Large investors claim that disclosure artificially adjusts market pricing in this way as a basis for arguing that the exemption from section 13(f) should be available to them.[155]

It seems more likely that exemptions allow institutional investors to artificially keep the information they have gained from being incorporated into the market price. In reality, all of the investment decisions made by these institutions should be of equal value in an efficient market. By arguing that certain buy-and-sell decisions are more worthy of confidential treatment, the managers are usually admitting that those investments are in securities that present an informational arbitrage opportunity. It is not that the market follows them blindly, as many suggest. In reality, the market could see that a prominent investor has taken a position in that security and deduce that he knows something that has not been broadly disseminated. Given section 13(f) disclosure requirements, hiding a position from the marketplace is a form of price manipulation.

Not only does selective disclosure prevent natural market forces from maintaining efficient pricing mechanisms, whether rationally related to the valuation of the issuer or not, but it raises valid concerns about equitable treatment. By making special exceptions available for large investors in certain circumstances, the securities regulation regime risks playing favorites and disadvantaging everyone else in the process. As one large institutional investor said in criticizing confidential treatment, "If I'm going to pull down my pants in public I want everyone to pull down their

---

[152] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

[153] *Santa Fe Indus.*, 430 U.S. at 477.

[154] *See* IVO WELCH, CORPORATE FINANCE 4, 28 (2d ed. 2011) (explaining that a security is a financial claim against a company that is generally sold to investors and the value of such investment is determined principally by calculating the net present value of the future cash flows to which that investment entitles its owner). Some informed investors make a living from exploiting what they perceive as "noise" trading. This phenomenon consists of market participants who trade for idiosyncratic reasons—that is, reasons unrelated to the present value of the security's cash flows. *Id.* at 291.

[155] Sorkin, *supra* note 78 ("[B]illionaire investors . . . essentially argue that the simple disclosure of an investment would cause the price to rise so much as to scuttle their strategy.").

pants, too."[156] This colorfully illustrates the point that Form 13F confidential treatment exemptions should be approached with a skeptical eye. Once the choice is made to operate a public securities market in an open and transparent manner, it becomes difficult to equitably implement selective provisions for confidentiality.

B. *Deterring Speculation: Protection for Fund Investors*

Speculation happens when investors chase excess investment returns by buying up high-risk, high-return assets that do not have the fundamental economic substance needed to support their market price and are more likely to suffer deep losses.[157] While not inherently a problem, speculation tends to compromise investor interests and markets generally when accompanied by large amounts of borrowing and regulatory schemes that favor Wall Street firms and their ilk at the expense of individual investors.[158] It also increases the likelihood of bubbles, which can result in traumatic financial market crashes and rippling macroeconomic effects.[159]

Within the context of investment management companies and the funds under their purview, opacity encourages speculation. The market for pooled investment products is saturated—there are over fourteen thousand publicly available investment funds representing over $13 trillion in assets.[160] Over forty-five percent of U.S. households own such funds.[161] Assuming most investors are rational, they would prefer to invest in securities and funds that offer more reward, that is, where they expect high rates of return.[162] Of course, the only empirical evidence at one's disposal for seeking high rates of return is the record of historical returns garnered by a particular fund or manager.

It is difficult, however, to glean from this information whether the success is a result of skill, superior access to information, or just dumb luck.[163] As a result, average fund investors are more likely to place their money into funds that have done well on the assumption that those funds are more likely to continue to outperform. Funds that underperform, on the

---

156 *Id.* (quoting Larry N. Feinberg, founder of Oracle Partners).

157 Jesse Eisinger, *Efforts to Revive the Economy Lead to Worries of a Bubble*, N.Y. TIMES DEALBOOK (Apr. 17, 2013, 12:00 PM), http://dealbook.nytimes.com/2013/04/17/efforts-to-revive-the-economy-lead-to-worries-of-a-bubble/.

158 SIMON JOHNSON & JAMES KWAK, 13 BANKERS: THE WALL STREET TAKEOVER AND THE NEXT FINANCIAL MELTDOWN 30–31 (2011).

159 *Id.*

160 INV. CO. INST., 2012 ANNUAL REPORT TO MEMBERS, at ii (2012), *available at* http://www.ici.org/pdf/12_ici_annual.pdf.

161 *Id.*

162 WELCH, *supra* note 154, at 186.

163 *Id.* at 305.

other hand, tend to disappear quietly.[164] This phenomenon, called survivorship bias, means that investment fund opportunities available at any given time typically look like they have been able to consistently earn excess returns,[165] when efficient market theory says that they cannot unless they consistently take on outsized risk.[166]

This all creates incentives for investment managers to shoot for the moon and, correspondingly, take on too much risk. The countervailing check against this competitive impulse is transparency. If a rational investor sees that a given fund has strongly outperformed the market and then can see that it is because the manager has leveraged the fund—by buying or selling securities with borrowed money or investing in companies with unsustainably high debt ratios—he might decide that the investment is a poor one in the context of his overall portfolio. Section 13(f) disclosure requirements prevent investment managers from hiding risk on their holdings reports for the benefit of investors in the same way that quarterly and annual disclosure requirements allow stock investors to understand the particulars of risk and reward that face a corporate entity.[167] To allow exception in the context of one and not the other is a contradiction that is hard to justify.

C. *Fraud-on-the-Market*

Section 10(b) of the Exchange Act[168] and Rule 10b-5[169] are the

---

[164] *Id.* at 306.

[165] *Id.* at 306–07.

[166] *See id.* at 184–85 (explaining the efficient frontier as "the lowest-risk, highest-reward set of portfolios" that can be obtained given a universe of available investments with discrete risk-reward characteristics and that anything outside the frontier, where one might find higher reward portfolios at relatively low risk, is "not obtainable") This model ignores leveraged buying of the most efficient portfolios in combination with risk-free assets, which would equate to assumption of outsized risk relative to the efficient frontier, but could theoretically result in otherwise unattainable reward.

[167] Note that section 13(f), as currently implemented, only partially addresses this problem. To be truly effective, it would have to expand the universe of reportable holdings and strategies. *See infra* Part VI.A (discussing the need to modernize the standards for section 13(f) reporting).

[168] 15 U.S.C. § 78j(b) (2012). Section 10(b) of the Securities Exchange Act of 1934 makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." *Id.*

[169] 17 C.F.R. § 240.10b-5 (2012). Rule 10b-5, promulgated under the authority of section 10(b) of the Exchange Act, states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any

principal tools for promoting the informational integrity of securities transactions.[170] Despite their sweeping language and legislative rhetoric, the law and its implementing rule have long been interpreted mainly as antifraud provisions.[171] To state a cause of action under Rule 10b-5, "a plaintiff must plead that in connection with the purchase or sale of securities, the defendant, acting with scienter, made a false material representation or omitted to disclose material information, and that plaintiff's reliance on defendant's action caused [plaintiff] injury."[172] According to Rule 405 of the Securities Act, "*material*, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."[173] The Supreme Court has interpreted the materiality threshold to contemplate a showing of "substantial likelihood that, under all the circumstances," the misrepresentation would be of "actual significance in the deliberations of a reasonable shareholder."[174] Or, in other words, there must be a substantial likelihood that revelation of the truth "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[175]

The fraud-by-overt-deception-only view of Rule 10b-5 gave way with the watershed decision in *Basic Inc. v. Levinson*,[176] which acknowledged that plaintiffs are able to take advantage of the "fraud-on-the-market" presumption of reliance.[177] This theory is premised on the idea that, in open and liquid markets, the value of a given security is determined by the totality of available information regarding the security's issuer and its business.[178] Misrepresentations, therefore, defraud those transacting in the security even if the market participants do not rely directly upon the

---

> act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id.

[170] COX ET AL., *supra* note 125, at 659.

[171] *See, e.g.*, Dirks v. SEC, 463 U.S. 646, 666 n.27 (1983) ("[T]o constitute a violation of Rule 10b-5, there must be fraud."); Chiarella v. United States, 445 U.S. 222, 234−35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.").

[172] Time-Warner Inc. Sec. Litig., 9 F.3d 259, 264 (2d Cir. 1993) (alteration in original) (quoting Bloor v. Carro, Spanbock, Londin, Rodman & Fass, 754 F.2d 57, 61 (2d Cir. 1985)) (internal quotation marks omitted), *superseded by statute on other grounds*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.

[173] 17 C.F.R. § 230.405.

[174] TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976).

[175] *Id.*

[176] 485 U.S. 224 (1988).

[177] *Id.* at 247.

[178] *Id.* at 241.

misstatements or omissions.[179] This creates what is now a well-established "theoretical link" between Rule 10b-5 doctrine and the efficient markets theory: a cardinal goal of the federal securities fraud proscription is to prevent distortions in the market.[180]

While it may be improbable that courts would interpret lax section 13(f) standards or systematic abuses as violations of Rule 10b-5 itself, these problems raise the same kind of fraud-on-the-market issues as those in Rule 10b-5 jurisprudence. The analogy is helpful in informing even application of the statute by the SEC and the courts. The presumption that all relevant information in the market is incorporated into the stock price and that a market price not reflecting all information inherently misleads investors is directly applicable in the context of institutional investment managers acquiring or dispensing of a security. Often, the presence of large institutional investors in the stock of a corporation acts as an implicit backing of management, sometimes even in cases where the corporation's fundamental financial indicators and short-term business prospects are negative or limited. Whether a corporation can accumulate that type of financial support in the market is material information in evaluating its stability; because of their subordinated position in the capital structure, institutional investors with large equity stakes are more likely to ensure that the companies they invest in maintain or improve their management and avoid risks associated with excessive debt and financial distress.

Concealing the presence (or disappearance) of such an investor may artificially support or suppress a stock price. This is glaringly obvious in the context of exiting institutional support for a publicly traded stock. If top-holder institutional investors do not have to disclose that they have disposed of the stock until they have fully closed the position, the effects of the changed risk profile and weakened corporate financial health are borne entirely by remaining shareholders. Dominant investors can use the Form 13F exemption provision in this way to shift risk. Section 13(f) provisions allow for the investment manager to begin liquidating the position silently, but if she cannot complete the sales in a timely manner and the liquidation is material to the value of the underlying stock, she will be forced to share in at least part of any resulting losses.

D. *The Unjust Enrichment Principle: An Avenue to Civil Liability for Section 13(f) Malfeasance*

Professor James J. Park argues that the subsequent application of Rule

---

[179] *Id.* at 241–42.

[180] James J. Park, *Rule 10b-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345, 356 (2010).

10b-5 to insider trading matters reflects a jurisprudence that has become concerned with the prevention of unjust enrichment over a strict adherence to the limits of traditional fraud doctrine.[181] By way of illustration, Park points to the case of *United States v. O'Hagan*,[182] involving a law partner who worked on a potential tender offer for a client who was the acquirer in the deal.[183] O'Hagan, the lawyer, had no role in the negotiations with the target company but became aware of the deal and purchased call options and stock in the target company.[184] When the deal became public knowledge, O'Hagan profited substantially from the resulting rise in the stock price.[185] In addressing whether O'Hagan's misappropriation of the inside information violated Rule 10b-5, the Supreme Court upheld his conviction, holding that his liability is premised on the "fiduciary-turned-trader's deception of those who entrusted him with access to confidential information."[186]

In contrast to the classic theories of insider trading liability, which are premised on a violation of Rule 10b-5 via breach of fiduciary relationship,[187] the *O'Hagan* misappropriation theory rests on either—or both—an agency theory and a property rights theory.[188] The agency theory is based on the Court's finding of liability in breaching the relationship of trust between O'Hagan and his law firm, which was a non-party to the transaction.[189] In establishing the property rights theory, the Court observed that the "company's confidential information . . . qualifies as property to which the company has a right of exclusive use."[190] In acknowledging that this theoretical leap by the Court appears to prohibit a broader range of conduct than classical theories of securities fraud, Park concludes that the guiding rationale for prosecuting insider trading under Rule 10b-5 constitutes an expansion from the antifraud theory into the prevention of unjust enrichment by market participants.[191]

Park argues that there are three simple elements to the unjust enrichment principle: it "applies to (1) deceptive conduct, (2) coinciding with a securities transaction (3) that enriches some individual at the

---

[181] *Id.* at 369.
[182] 521 U.S. 642 (1997).
[183] *Id.* at 647.
[184] *Id.* at 647–48.
[185] *Id.* at 648.
[186] *Id.* at 652.
[187] *See, e.g.*, Chiarella v. United States, 445 U.S. 222, 228 (1980) (holding that liability for insider trading violations under section 10(b) is premised upon a duty to disclose arising from a fiduciary relationship between parties to the transaction).
[188] Park, *supra* note 180, at 370–73.
[189] *O'Hagan*, 521 U.S. at 652.
[190] *Id.* at 654.
[191] Park, *supra* note 180, at 374.

expense of others."[192] He displays how unjust enrichment functions as an expansive principle within the regulation of the securities market: it has effectively been used in enforcement actions relating to matters of qualitative materiality, broker-dealer misappropriation, mutual-fund market timing, and stock option backdating.[193] Similarly, the principle might be applied to the section 13(f) exemption in that the regulation can be used as a procedural loophole to protect investment strategies before they have been fully deployed. Selective disclosure via the use of the exception is in fact deceptive (although currently sanctioned) protection of securities transaction information.

The problem with the exemption, though, is that if it is misused, it has the capacity to enrich more informed investors at the expense of the less informed. A disclosure-based system of market oversight should be suspicious of a regulatory device that functions this way. If the regulation fails in this manner, though, the shortcomings are a product of administrative application, not the law itself. Legal biases toward those already in more advantageous positions are bad for markets because they discourage participation by everyone else, or otherwise encourage an "if you can't beat 'em, join 'em" mentality that makes the only rational choice for investors to invest their money with institutional managers with the informational advantages, resulting in more management fees for those chosen institutions. The result is an indirect sort of government-sponsored oligopoly in the financial management market. Ultimately, the unjust enrichment theory, side-by-side with the fraud-on-the-market presumption, suggests that improper use of Form 13F exemptions for anything except the prevention of imminent losses should be actionable. Rule 10b-5 doctrine provides a blueprint for policing such improprieties and, at its outer bounds, may provide for a viable avenue through which to enforce noncompliance or abuse of section 13(f).

If section 13(f) is going to be a meaningful part of the canon of securities regulation, it should be coherent with the overriding mission and policy of the doctrine. By framing the application of the law within the four corners of market manipulation prevention, speculation deterrence, uniform enforcement against fraud-on-the-market, and prohibitions on unjust enrichment, it becomes easier to identify the regulation's potential as a safeguard of fair dealing and obstruction for deceptive practices. Applying these concurrent considerations to section 13(f)'s administration and enforcement, it becomes apparent that its current state of administration falls short and is in need of an overhaul.

---

[192] *Id.* at 377.
[193] *Id.* at 377–85.

VI. THE WAY TO MORE RATIONAL AND HELPFUL FORM 13F DISCLOSURES

The central argument of this Note is that the SEC and federal courts should structure the implementation and enforcement of investment company disclosure rules, particularly those made in fulfillment of statutory responsibilities under section 13(f) of the Exchange Act, in a way that balances the competitive interest of investment managers in their strategic decisions with the public interest in transparent and efficient markets. Having explained a compelling reason for adopting such a policy, as well as a doctrinal foundation upon which it can rest, I will now suggest improvements to the practical administration of the section 13(f) requirements and exemption that will align enforcement of this law with the interests outlined above.

A. *Update Rule 13f-1 to Provide Comprehensive Reports*

It was emphasized at the time the Securities Acts Amendments of 1975 were passed that part of their purpose was to allow regulation to keep pace with growth and development in the financial industry.[194] Nearly forty years later, the rules dictating the management of this disclosure provision have not been substantially reviewed and are now woefully out of date. Considering the dramatic rise of private investment vehicles, including hedge funds, "long/short strategies" generally, and the increased complexity of widely available financial instruments, Dodd-Frank section 929X, which mandates the inclusion of all short positions on a monthly basis,[195] is a step in the right direction. The rules should also be amended to mandate disclosure of all the most common exchange-traded financial instruments. This should include options contracts and a calculation of investment leverage for the investment company and its products individually, where applicable. Details of this sort and specificity are what made the original section 13(f) disclosures valuable in light of market realities of that time. In addition, the minimum reporting threshold should be raised from $100 million in assets under management to a substantially higher level. This would reduce the number of reporting entities required and allow the SEC to focus on the firms that are more able to make a discernible impact on securities markets due to the size of their holdings. The new threshold should consider the leverage ratio so that it might still catch small, but highly leveraged funds that have a real potential to affect the market in public securities.

---

[194] *See* Ford, *supra* note 44 ("[W]e must be sure that laws and regulations written 30 or 40 years ago do not unfairly interfere with the need for changes in our modern-day markets.").

[195] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929X, 124 Stat. 1376, 1870–71 (2010).

In contemporary markets, with long-oriented stock investing constituting only a small piece of the overall investment management world and widely contained within the mutual fund and exchange traded fund industries, which are regulated by the Investment Company Act of 1940,[196] Form 13F contents are too incomplete to be of value. It makes little sense to enforce costly compliance with a regulation that provides such limited beneficial effects for the market as compared with its original design. Rather than publishing a list of reportable securities under section 13(f), the universe should be expanded vastly and to a degree that the SEC could publish a short list of security types that would remain non-reportable.

Third, timing must be adjusted, although it is arguably the most difficult issue to deal with cleanly. In order to provide investment managers enough time to capitalize, at least in part, on their research, near immediate disclosure is not a workable solution. The quarter-end-plus-forty-five-days timeframe is certainly long enough, but is altogether arbitrary. In February 2013, the New York Stock Exchange and others petitioned the SEC to change the guideline to quarter-end-plus-two-days.[197] While the petition makes the valid point that quarter-end-plus-forty-five-days renders the information stale in contemporary markets and worth little in the way of tracking an investment manager,[198] this timeframe is just as arbitrary and, in cases where transactions occur at the end of the quarter, could be too short.

A better model would be to require rolling "material change in holding" reports within a fifteen-business day reporting window. Modeled after the public company material event disclosure requirement commonly known as Form 8-K,[199] this flexible standard should provide fund investors and the investing public with information once it becomes material but would not burden the asset manager with filing positions that are of no consequence. Once asset managers have accumulated a certain dollar amount of a given holding, they would be required to add that holding to their report and file it within three weeks. The same amendment would be required if the holding fell below the dollar threshold. Subsequently, if the position grew or shrunk by a predetermined increment, the reporting requirement would be triggered and the fifteen-day reporting window

---

[196] 15 U.S.C. §§ 80a-1 to 80a-64 (2012).

[197] Whitney Kisling, *NYSE Asks SEC to Shorten 13F Filing Period to 2 Days from 45*, BLOOMBERG (Feb. 6, 2013), http://www.bloomberg.com/news/2013-02-06/nyse-asks-sec-to-shorten-13f-filing-period-to-2-days-from-45.html.

[198] Marie Cabural, *NYSE Files Petition to Shorten 13F Filing Deadline*, VALUEWALK (Feb. 7, 2013), http://www.valuewalk.com/2013/02/nyse-files-petition-to-shorten-13f-filing-deadline/.

[199] U.S. SEC. & EXCH. COMM'N, FORM 8-K: CURRENT REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 (2012), *available at* http://www.sec.gov/about/forms/form8-k.pdf.

would begin. For investment companies that have not crossed a trigger point with respect to any of their holdings in thirty business days, a periodic report would be due.

This system would have the effect of increasing disclosure frequency only when relevant, and would be continuous enough to be of real value to the investor community at large while providing the management company enough time to make meaningful headway on a program of acquisition or dispensation. At the time these measures were formulated, the SEC would have been concerned with the costs implied by such a potentially high rate of frequency,[200] but advances in technology have decreased the burden of a reporting requirement as simple as this.

If these changes were implemented and the results were tabulated in a more accessible format than the SEC's cumbersome online document retrieval service (i.e., EDGAR),[201] the information would be more readily usable, not only for investors and the market generally, but also for regulators concerned with systemic risk and dramatic shifts in capital allocation. It is reasonable to hope that these changes would enhance the SEC's policy development efforts and its investigatory work in fraud detection as well.

B. *Develop and Promulgate a Clear and Strict Standard of Review for Granting Confidential Treatment*

The standard for exemption, as reviewed in Part II.B, should be revised to require an affirmative showing of likely and substantial imminent harm to the asset manager's financial condition in order to obtain exemption from the reporting requirements. The 1998 guidance letter and 2013 guidance update on CT Requests left open the ways in which an institutional money manager can claim to be harmed by disclosure of the firm's positions, provided that the harm is "substantial" and demonstrable by historical evidence of "market reaction" to public disclosure by that investment manager.[202] Demonstrating that a "market reaction" could result in less favorable outcomes for the CT filer than would be likely if he were not required to disclose his positions is not a sufficient standard from the perspective of market efficiency and true fairness.

The SEC should promulgate more defined standards aimed at advancing the spirit of disclosure pervasive throughout U.S. securities law, which detail the *types* of harm that are preventable by way of confidential treatment and define "substantial" in clearer terms. These measures would

---

[200] Filing and Reporting Requirements Relating to Institutional Investment Managers, Exchange Act Release No. 34-14852, 43 Fed. Reg. 26,700, 26,701 (June 22, 1978).

[201] *Filings & Forms*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/edgar.shtml (last visited Nov. 21, 2013).

[202] 2013 GUIDANCE UPDATE, *supra* note 58, at 4; 1998 Guidance Letter, *supra* note 8, at *4.

help to limit the cases where confidential treatment is granted to those in which regulatory requirements, and not the underlying market dynamics attached to transparency in general, would be the principal source of the loss. This requires separating the "purely regulatory" from those effects that are grounded in economic substance. The burden of making the distinction should be on the CT requester. This would help to make the cases where confidential treatment is available less ambiguous, which, in turn, would increase competitive interests by ensuring that some institutions do not receive preferential regulatory treatment over others and making it less likely that an institution would successfully be able to obtain confidential treatment principally for the benefit of its own investment returns.

Moreover, exemptions should not be granted for set periods of time up to one year, but rather for shorter increments that can be renewed upon subsequent application to the SEC. Providing for prolonged and impenetrable immunity from disclosure does not allow the disclosure requirements to react to changing market conditions and investor status. Lastly, once exemption periods lapse, the SEC should publish the applications for exemption, redacted for otherwise privileged or confidential material, so as to build public understanding of how the decisional standard for exemption is made. This would allow for ongoing and transparent precedent-building that would both further the interest of certainty among applicants and do much to advance perceptions of fair play among other smaller market participants and observers.

C. *Enforce Civil Liability for Abuse of Confidential Treatment*

As discussed, there has only been one action against an investment management firm for alleged section 13(f) malfeasance.[203] The action was related to the failure to file over a period of more than three years and resulted in a cease and desist order and a civil penalty of $100,000.[204] Quattro, the hedge fund manager subject to the fine, had assets under management of approximately $900 million.[205] Outside of this slap on the wrist, the unqualified lack of reported enforcement actions for failure to properly file or for abusing the exemption process illuminates the diminished extent to which the SEC polices Form 13F filings. While there is no doubt that the Commission has authority to prosecute for failing to file or for willful material misstatements and omissions,[206] the exemption process has never been the subject of SEC enforcement.

---

[203] Quattro Global Capital, LLC, Exchange Act Release No. 56,252, Investment Advisers Act Release No. 2634, 2007 WL 2471810 (Aug. 15, 2007).

[204] *Id.* at *1, *3–4.

[205] *Id.* at *1.

[206] 17 C.F.R. § 240.10b-5 (2012).

Because any strategic use of the exemption provision to selectively disclose holdings is potentially manipulative of markets and takes advantage of information imbalance to the detriment of the public and for the benefit of enriching the manager, civil liability should arise in cases where exemption is granted and it later comes to light that it was not warranted. The SEC could easily conduct a contextual examination of applications during the on-site examinations of investment managers already conducted by its Office of Compliance Inspections and Examinations ("OCIE") division.[207] The SEC should be expressly authorized to take civil action against those institutional investors for the amount they were enriched as a result of wrongfully withholding information from the market, plus interest.

VII. CONCLUSION

When the federal government set out to regulate the public market in securities, it took it upon itself to provide all market participants with a better opportunity to protect themselves from fraud and loss and, conversely, to identify the prospect of gain. It chose to do this by requiring the disclosure of certain information not otherwise readily available to all investors. In the 1970s, the scope of relevant information deemed necessary to secure an equalized opportunity was expanded to include the holdings of institutional investment firms, because it was decided that transparency and fairness ultimately trumped the interests of pure competition. Section 13(f) was born as a result, but has been long neglected.

Fully realized, the statute could make large strides toward protecting investors by accelerating the point at which the informational interests of the less informed investors are favored over those of the more informed. This information sharing would still allow investment managers the opportunity to act on their advantages, but not in perpetuity or until they have maximized their profits. Instead, there would come a point when they must cede what might prove to be a meaningful residual opportunity to the public. This would spur broader economic efficiency in financial markets and, more importantly, would better equalize opportunity for gain across all groups of participants, without regard to the status quo distribution of resources.

At the same time, reporting exemptions act as a steam valve, ensuring that the regulatory regime does not unduly disincentivize important institutional investment research. It remains, however, that section 13(f) CT Requests should be granted only in limited and extraordinary situations

[207] *National Exam Program*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/offices/ocie.shtml (last modified Aug. 19, 2013).

where demanding compliance with the reporting requirements would, in itself, cause losses. Otherwise, information should be deemed reportable and the filing requirement should be enforced accordingly.

The improvements to section 13(f) administration suggested in this Note would bring us dramatically closer to realizing the broader goals of securities regulation including, most notably, a fair and transparent public market in securities. Because the changes would allow comprehensive access to institutional investor holdings data on controlled terms and in a way that strikes a balance between the institutional investors' interest in concealing their strategic positioning and the public interest in efficient and accessible markets, a revamped section 13(f) could provide the public with a real opportunity to more readily understand the forces animating the pricing of public securities without undermining the benefits of conducting proprietary research in the first place. Then, finally, it would be feasible to avoid the privatization of informational advantage in public markets and better provide fair opportunity consistent with the purpose of securities regulation and just society alike.