DO YOU KNOW WHO YOUR SHAREHOLDERS ARE?

IN THESE TIMES OF ECONOMIC AND MARKET UPHEAVAL, STOCK SURVEILLANCE IS MORE CRITICAL THAN EVER.

The first half of 2020 has brought on a wave of new risks in many areas for Corporate America. While it has been a relatively slower year for activist campaigns based on historical standards, current conditions of economic and stock market upheaval have increased the level of concern within small-cap to mega-cap companies globally. Amid these uncertain times, senior management and Boards of Directors are faced with a question that may be harder than ever to address – due to increased trading volumes and sharp price swings over the past several months - who currently owns our stock? **Activism** has generally remained slow in the US during the COVID-19 pandemic; however, many executives are pondering the likelihood of an activist accumulation and whether there is an opportunity for an activist to influence change. Some companies have already taken strategic steps as evidenced by the recent increase in poison pills as an anti-takeover mechanism. Since March 2020, at least 78 companies have announced the adoption of poison pills.[1] As activist trends continue to evolve, companies must consider new hedge funds and involvement from significant players like pension funds, private equity firms, and influence from the passive index investors in the activism arena.

1. According to Factset data as of, August 19, 2020

In order to help assess these risks, there are some proactive steps companies can take as part of recommended best practice preparation. Generally, corporations should always consider having a thoughtful plan in place before the event of an activist attack, essentially avoiding a potential fire-drill scenario once a campaign is quickly launched.

Typically, corporations will assemble a dedicated team of advisors including legal counsel, public relations, investor relations, proxy solicitor for potential activism defense, strategic **stock surveillance**, and a financial advisor. Once the team is organized, a comprehensive plan is developed, including the evaluation of specific high-level risks and critical vulnerabilities that could serve as target points for an activist. Morrow Sodali has dedicated teams that handle activism defense and strategic stock surveillance and we believe there are benefits to having those services under one-roof if a company encounters activism.

In order to best address the important question of who are the current shareholders, the first critical step is engaging a stock surveillance firm to monitor trading activity, DTC settlement, broker activity, short interest, options and block trades. Hedge funds and activist investors have utilized more sophisticated derivatives, such as options and swaps via prime brokers, to establish positions. The real-time insight provided by a surveillance firm offers valuable information on recent buyers / sellers and serves as early detection for any unusual trading activity or large accumulations. Based on SEC filing requirements, investment advisors managing more than $100M in equity assets are required to file security holdings quarterly, however there is a significant lag time as that information only becomes publicly available 45 days after the end of the quarter. Stock surveillance sheds light on these blackout periods between the extended SEC required filing time periods.

It is worth noting that quant-trading has significantly increased over the past several years and these fast-money algorithms will generally account for a larger percentage of overall volume. In addition, new market players such as Robinhood and other automated investment platforms have played a larger role on behalf of retail investors which has been a meaningful factor when analyzing ownership profile trends. To be sure, the most important consideration in the current trading environment is to effectively weed-out the high frequency programs and other various sources as share prices fluctuate. The volatility these automated trading programs create provides a window of opportunity for activists to accumulate shares anonymously – this risk is one of the greatest stock ownership challenges that companies are faced with.

To conclude, consider the recent proposal by the SEC to update the Form 13F for institutional investment managers. This proposal would raise the reporting threshold to $3.5 billion from $100 million.[2] One study suggests for the most recent quarter, there would be a reduction in the number of funds that disclose holdings to the public from 5,283 to 549, which represents almost 90% of all filers which means $2.3 trillion in investment holdings would no longer be disclosed to the public.[3] The impact is clearly expected to reduce corporate visibility on the publicly available ownership data and further increase the need to consider the benefits of utilizing a stock surveillance firm to keep track of current ownership trends. This may help corporations with the challenges of managing potential risks and serve as an early warning system prior to any 13G or 13D filings that are required once the 5% ownership threshold is met.

2. SEC Proposes Amendments to Update Form 13F for Institutional Investment Managers; Amend Reporting Threshold to Reflect Today's Equities Markets, July 10, 2020
3. Whalewisdom email response to SEC Proposes to Reduce Equity Ownership Transparency, July 14, 2020