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Watch Your Derivatives: The Role 13Fs Play in Detecting Shareholder Activism

By David Farkas, Georgeson

SEC Form 13F public filings can help companies understand whether the threat of a proxy fight is imminent and, crucially, take steps to defend themselves.

13F filings, as they're known, reveal the share position of institutional investors or funds and help companies understand whether a specific investor is beginning to accumulate a larger portion of shares inside their firms. This is a requirement for investors with more than $100 million in equity assets under management.

However, investors do not need to disclose this information until 45 days after the quarter end. For example, if an investor acquired a 4.9% equity position in a company during the first half of January, it only needs to file a 13F with the SEC by May 15.

As a result, a significant gap exists between the point an investor builds up a position in a company and the time such share position information is available.

This time frame poses challenges and risks for public companies seeking to understand their shareholder composition in order to preempt potential activism and shareholder opposition during their annual meetings.

One of the key risks involves shareholder activists employing various methods to build positions in investments "behind the scenes." While some shareholder activists may acquire a "straight equity" position in which their increased position is public, seasoned activists often use derivatives to grow their positions because such instruments don't require immediate disclosure under 13F filings.

Broker-dealers, who often hold derivative investments on behalf of their clients, such as hedge funds or other activist investors, are also required to file 13F.

Derivatives include swaps, over-the-counter options or forward contracts, with an investment bank typically serving as the counterparty in the agreement. This strategy allows the investor to gain economic exposure to the desired investment without directly holding the underlying security.

Derivatives therefore allow activists to avoid direct identification through 13F filings. Such a structure reveals only the counterparty, usually a broker-dealer, and keeps the activist investor's name out of the public realm.

An activist can therefore discreetly increase its position in a company for an extended period by remaining anonymous via a counterparty, without

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Table 1	9/30/2021		12/31/2021		3/31/2022	
	Position	Position Change	Position	Position Change	Position	Position Change
Activist	0	—	100	100	11,365,531	**11,365,431**
Nomura	3,089,970	3,079,369	19,201,410	16,111,440	7,671,614	**(11,529,796)**

the company's or the public's knowledge. This type of activist strategy can put a company at a disadvantage because there's no early warning signal via a 13F filing that a shareholder is holding a large block of voting shares or potential shares.

Public 13F filings *can* however help determine potential activism, even when the true identity of the activist is obscured by a counterparty. However, such filings can typically help only after the event.

For example, while numerous banks act as counterparties in derivative agreements, some are more prominent in the marketplace for doing so. Nomura, for instance, occasionally serves as a counterparty. The fact that the firm is taking an increasing position in a company potentially indicates that an investor may be building an "economic exposure" to a security.

Table 1 above is an example of how a known activist investor gained economic exposure to a well-known retail company with Nomura as the counterparty.

In this example, based on 13F filings, Nomura acquired approximately 3.08 million shares of the retailer during the third quarter of 2021, adding another approximately 16.11 million shares in the second quarter.

During the first quarter of 2022, Nomura's exposure to the retailer notably decreased by nearly the exact number of shares by which the activist's position increased.

13F filings can therefore reveal the mechanics of these transactions but only typically in hindsight.

As previously mentioned, investors are not required to file a quarterly 13F with the SEC until 45 days after the calendar-end. In the case of the activist and Nomura's filings, the timeline of events was as follows:

July 1, 2021 – September 30, 2021:

- Nomura adds approximately 3.08 million shares of exposure to the company.

November 12, 2021:

- Activist files a Schedule 13D with the SEC stating that it holds approximately 12.73 million shares of economic exposure to the retailer.
- Activist later files an amended Form 13D with the SEC stating that Nomura is the counterparty to the derivative transaction.

November 15, 2021:

- Nomura files its September 30th 13F position with the SEC, stating publicly for the first time that it added approximately 3.08 million of the retailer's shares to its portfolio.

In this sequence, public data did not reveal the full magnitude of a potential activist position until the activist filed a 13D with the SEC. This

leaves a gap of nearly one-and-a-half months between the last day of the calendar quarter (September 30, 2021) and the date (November 12, 2021) when the activist disclosed its economic exposure to the retailer's shares through derivatives.

The real-time speed at which an investor can convert a derivative into equity means that companies need to have an actives stock surveillance strategy from which they can gain critical information quickly about potential activism ahead of 13F filings and, in doing so, receive effective and timely advice to protect themselves against such threats. Understanding the types of investors driving equity flows on a daily basis is crucial, especially when distinguishing between routine institutional purchases and those linked to derivative movements.

For example, an experienced shareholder intelligence analyst can identify potential exposure using real time share movements.

Such a strategy provides the "first line of defense" in a proxy fight and increases a firm's chance of victory. Identifying the exposure risk early can often help prevent a proxy fight by allowing the company time to assemble their advisors groups, strategize for potential scenarios or engage and deploy counter measures.

In an age when intelligence is at a premium, there are devices to help boards and management teams understand who their current shareholders are in advance of data going public.

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