The secrets big investors get to keep

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NEW YORK The U.S. Securities and Exchange Commission usually does not let investors keep many secrets. Except if you are a major player like Warren E. Buffett.

On Monday, Mr. Buffett disclosed that his company, Berkshire Hathaway, had bought a 5.5 percent stake in I.B.M., his first big investment in a technology company.

But Mr. Buffett did not build his $10 billion-plus stake in I.B.M. overnight. He started buying eight months ago, in March. You would not have known that if you had been studiously reading Berkshire Hathaway's filings of 13Fs, documents in which companies must disclose stock holdings. There was no mention of I.B.M. in Berkshire's quarterly filing in April, nor in August. Instead, if you were looking carefully, you might have found an odd footnote that said: "Confidential information has been omitted from the form 13F and filed separately with the commission."

Translation: Mr. Buffett received special permission from the S.E.C. to keep secret his investment in I.B.M. — and possibly keep secret stakes in other companies he is building positions in that we have yet to learn about.

Mr. Buffett's special treatment from the S.E.C. is not new. He has long taken advantage of an obscure rule to avoid disclosing his bets to the public before he is good and ready.

Mr. Buffett and other billionaire investors, like Carl C. Icahn, Bill Ackman and Nelson Peltz, essentially argue that the simple disclosure of an investment would cause the price to rise so much as to scuttle their strategy.

The rule says the S.E.C. "may prevent or delay public disclosure of form 13F information for public interest reasons or the protection of investors."

In this case, the rule is clearly meant to protect the investor — Mr. Buffett — not the public.

John Nester, a spokesman for the S.E.C., said the agency tried "to balance the benefits of transparency of how large managers invest with the need to temporarily protect the legitimate confidentiality interests of managers in limited circumstances."

Mr. Buffett, during an interview, asked me, "How would you feel if you had to announce every story idea you had?"

He said 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.

"There are only about three people I'd like to know what they are doing," he said. "But I don't feel entitled to know." He paused for a moment. "In fact, I think it would be unfair."

Still, at a time when investors are asking for more and more transparency, there is a sense that the playing field on Wall Street is tilted toward the wealthy. Under the Securities Exchange Act of 1934, all big institutional investors — now defined as managing more than $100 million — have to disclose their holdings every quarter. Investors who buy more than 5 percent of a public company typically must make a separate 13D filing when they accumulate the shares.

NATI HARNIK/AP

Warren E. Buffett started building his $10.7 billion stake in I.B.M. eight months ago.

One of the reasons for the rules is to prevent an investor from mounting a covert takeover effort; another is so that average investors know where big wheels are moving their money.

Over the decades, questions have been raised about the S.E.C.'s confidentiality rule, but they have been quickly mooted. Back in 1997, Larry N. Feinberg, the founder of Oracle Partners, memorably told BusinessWeek: "I do not think confidential filings are fair. If I'm going to pull down my pants in public I want everyone to pull down their pants, too."

Mr. Nester, of the S.E.C., said the agency received about 60 requests a year to keep investments confidential.

There are also questions about how well the S.E.C. polices such filings. It appears that only one major case has recently been brought against an investment firm, Quattro Global Capital, for not properly disclosing its investment positions.

In 2010, the inspector general's office in the S.E.C. found problems with the way the commission broadly treated confidentiality requests by companies and investors. In addition to asking to hide investment stakes, firms ask to exclude financial information from pending contracts and proposals.

"Over 90 percent of confidential treatment requests submitted were not subject to a thorough review and examination for compliance with all aspects of the confidential treatment request rules," the inspector general found, saying that "there is an increased risk that material information to investors may not be disclosed."

Christopher J. Hewitt, a partner at the law firm Jones Day, said that in his years of submitting confidential treatment requests, "I've never had to substantiate one."

Of course, Mr. Buffett and other big investors could avoid the secrecy by accumulating their holdings within the three-month period between S.E.C. filings, but Mr. Buffett said sometimes more time was needed to build a position.

The S.E.C.'s review of the requests does not address another potential disclosure problem: investors who use options and derivatives to mask their publicly disclosed positions. The S.E.C. requires only that investors disclose long positions, so the public does not necessarily know if a position is hedged or perhaps is being magnified through another instrument. And the disclosures themselves represent only a snapshot in time: an investor could sell shares a day before having to disclose a position and buy them back a day after the disclosure requirement.

The purpose of requiring investors and companies to disclose their investment positions is to keep the markets transparent. And any time the government is making the markets more opaque, it deserves more scrutiny.

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