SEC TIGHTENS AND CLARIFIES CERTAIN ELEMENTS OF THE BENEFICIAL OWNERSHIP REPORTING REQUIREMENTS

Yesterday, the SEC adopted amendments to certain of its rules governing reporting of beneficial ownership of voting equity securities of US listed companies (the reporting rules do not apply to investments in foreign private issuers). These amendments were proposed in February 2022, and the public comment period was extended in April of this year.

The amendments generally shorten deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G, which incidentally generally date back to 1968. The SEC also expanded the timeframe within a given business day by which Schedules 13D and 13G must be filed with the SEC, and separately required that Schedule 13D and 13G filings be made using a structured, machine-readable data language.

In addition, the SEC addressed how, under the current rules, an investor's use of a cash-settled derivative security may result in beneficial ownership of the class of the reference equity security. And, rather than adopt proposed amendments to Rule 13d-5(b) intended to codify existing staff views, it provided guidance on the application of the current legal standard found in Section 13(d)(3) and 13(g)(3) of the 1934 Act (which addresses, from a facts and circumstances perspective, when a "group" has been formed, for reporting purposes) to certain common types of shareholder engagement activities. One other clarification was made to the Schedule 13G amendment requirement by modifying the trigger from "any change" to a "material change."

Background

1934 Act Sections 13(d) and 13(g), along with Regulation 13D-G, require an investor who beneficially owns more than 5% of a class of voting equity securities of domestic public companies to publicly file either a Schedule 13D or a Schedule 13G, as applicable, with the SEC. An investor with control intent files Schedule 13D, while so-called exempt investors and investors without a control intent, such as qualified institutional investors (QIIs) and passive investors, file Schedule 13G.

Shorter Deadlines

The following table sets forth the current rules, and the rules as amended.

	Current 13D Rules	New 13D Rules	Current 13G Rules	New 13G Rules
Initial Filing Deadlines	Within 10 days after acquiring beneficial ownership of more than 5% or losing eligibility to file on Schedule 13G. [Rules 13d-1(a), (e), (f), and (g)]	Within five business days after acquiring beneficial ownership of more than 5% or losing eligibility to file on Schedule 13G. [Rules 13d-1(a), (e), (f), and (g)]	***QIIs & Exempt Investors***: 45 days after calendar year-end in which beneficial ownership exceeds 5%. [Rules 13d-1(b) and (d)] ***QIIs***: 10 days after month-end in which beneficial ownership exceeds 10%. [Rule 13d1(b)] ***Passive Investors***: Within 10 days after acquiring beneficial	***QIIs & Exempt Investors***: 45 days after calendar quarter-end in which beneficial ownership exceeds 5%. [Rules 13d-1(b) and (d)] ***QIIs***: Five business days after month-end in which beneficial ownership exceeds 10%. [Rule 13d-1(b)]

			ownership of more than 5%. [Rule 13d-1(c)]	***Passive Investors***: Within five business days after acquiring beneficial ownership of more than 5%. [Rule 13d-1(c)]
Amendment Triggering Event	Material change in the facts set forth in the previous Schedule 13D, which is not limited to further acquisitions (deemed to be material at 1% or more), but also covers material changes to the narrative disclosure as well as material changes in the level of beneficial ownership triggered by involuntary changes. [Rule 13d-2(a)]	Same as current Schedule 13D: Material change in the facts set forth in the previous Schedule 13D. [Rule 13d-2(a)]	**All Schedule 13G Filers**: Any change in the information previously reported on Schedule 13G. [Rule 13d-2(b)] ***QIIs & Passive Investors***: Upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. [Rules 13d2(c) and (d)]	**All Schedule 13G Filers**: Material change in the information previously reported on Schedule 13G. [Rule 13d-2(b] ***QIIs & Passive Investors***: Same as current Schedule 13G: Upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. [Rules 13d2(c) and (d)]
Amendment Filing Deadline	Promptly after the triggering event. [Rule 13d-2(a)]	Within two business days after the triggering event. [Rule 13d-2(a)]	***All Schedule 13G Filers***: 45 days after calendar year-end in which any change occurred. [Rule 13d-2(b)] ***QIIs***: 10 days after month-end in which beneficial ownership exceeded 10% or there was, as of the month-end, a 5% increase or decrease in beneficial ownership. [Rule 13d2(c)] ***Passive Investors***: Promptly after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. [Rule 13d2(d)]	***All Schedule 13G Filers***: 45 days after calendar quarter-end in which a material change occurred. [Rule 13d-2(b)] ***QIIs***: Five business days after month-end in which beneficial ownership exceeds 10% or a 5% increase or decrease in beneficial ownership. [Rule 13d-2(c)] ***Passive Investors***: Two business days after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. [Rule 13d2(d)]
Filing Cut-off Time	5:30 p.m. ET. [Rule 13(a)(2) of Regulation S-T]	10 p.m. ET. [Rule 13(a)(4) of Regulation S-T]	***All Schedule 13G Filers***: 5:30 p.m. ET. [Rule 13(a)(2) of Regulation S-T]	***All Schedule 13G Filers***: 10 p.m. ET. [Rule 13(a)(4) of Regulation S-T]

Cash-settled derivative securities

Rather than adopt a proposed rule to treat certain holders of cash-settled derivative securities as beneficial owners of the reference covered class, the SEC opted instead to provide guidance for these securities along the lines of the guidance it provided for security-based swaps ("SBSs"):

- Under Rule 13d-3(a), to the extent a non-SBS cash-settled derivative security provides its holder, directly or indirectly, with exclusive or shared voting or investment power, within the meaning of that rule, over the reference covered class through a contractual term of the derivative security or otherwise, the holder of that derivative security may become a beneficial owner of the reference covered class.
- To the extent a non-SBS cash-settled derivative security is acquired with the purpose or effect of divesting its holder of beneficial ownership of the reference covered class or preventing the vesting of that beneficial ownership as part of a plan or scheme to evade the reporting requirements of Section 13(d) or 13(g), the derivative security may be viewed as a contract, arrangement, or device within the meaning of those terms as used in Rule 13d-3(b). The holder of such cash-settled derivative security, therefore, may be deemed a beneficial owner under Rule 13d-3(b).
- Under Rule 13d-3(d)(1), a person is deemed a beneficial owner of an equity security if it (i) has a right to acquire beneficial ownership of the equity security within 60 days or (ii) acquires the right to acquire beneficial ownership of the equity security with the purpose or effect of changing or influencing the control of the issuer of the security for which the right is exercisable, or in connection with or as a participant in any transaction having such purpose or effect, regardless of when the right is exercisable. Rule 13d-3(d)(1) applies regardless of the origin of the right to acquire the equity security and if such a right originates in a derivative security that is nominally "cash-settled" or from an understanding in connection with that derivative security, Rule 13d-3(d)(1) would apply.

Group status

The SEC had proposed to amend Rule 13d-5 to, among other things:

- revise Rule 13d-5(b)(1) to remove the potential implication that it sets forth the exclusive legal standard for group formation under Section 13(d)(3) or 13(g)(3);
- add new paragraph (b)(1)(ii) to specify that if a person, in advance of filing a Schedule 13D, discloses to any other person that such filing will be made and such other person acquires securities in the covered class for which the Schedule 13D will be filed, those persons will have formed a group within the meaning of Section 13(d)(3); and
- add new paragraph (b)(2)(i) to specify that when two or more persons "act as" a group under Section 13(g)(3) of the Act, the group will be deemed to have become the beneficial owner, for purposes of Section 13(g)(1) and (2), of the beneficial ownership held by its members.

Rather than adopt these amendments, the SEC instead issued guidance on the operation of existing Rule 13d-5(b) and Sections 13(d)(3) and 13(g)(3) that clarifies and affirms that,

among other matters, two or more persons who "act as" a group for purposes of acquiring, holding, or disposing securities may be treated as a group.

In addition, the SEC adopted certain amendments to Rule 13d-5 that it had proposed, namely:

- adding new paragraph (b)(1)(ii) to specify that a group subject to reporting obligations under Section 13(d) shall be deemed to acquire any additional equity securities acquired by a member of the group *after* the group's formation (rather than *after the date* the group was formed;
- adding new paragraph (b)(1)(iii) to carve out from paragraph (b)(1)(ii) any intragroup transfers of equity securities;
- adding new paragraph (b)(2)(i) to specify that a group regulated under Section 13(g) shall be deemed to acquire any additional equity securities acquired by a member of the group after the group's formation; and
- adding new paragraph (b)(2)(ii) to carve out from paragraph (b)(2)(i) any intra-group transfers of equity securities.

The SEC amended Rule 13d-101 to remove any implication that a person is not required to disclose interests in all derivative securities that use a covered class as a reference security and to eliminate any ambiguity regarding the scope of the disclosure obligations of Item 6 of Schedule 13D as to derivative securities, including with respect to any derivative not originating with, or offered or sold by, the issuer, such as a cash-settled option or SBS. As such, Item 6 should be read to cover derivative contracts, arrangements, understandings and relationships with respect to an issuer's securities, including cash-settled SBS and other derivatives that are settled exclusively in cash. The SEC eliminated the "including but not limited to" language in Item 6 that currently precedes the itemization of the instruments or arrangements covered to remove any implication that additional interests may need to be disclosed.

SEC guidance on group status

In light of concerns raised that the SEC's proposal to amend Rule 13d-5 could chill shareholder communications among other shareholders or impede shareholder engagement with issuers where those activities are undertaken without the purpose or effect of changing or influencing control of the issuer (and are not made in connection with or as a participant in any transaction having such purpose or effect), and notwithstanding its decision not to adopt those amendments, the SEC provided the following guidance, in a Q&A format:

Question: Is a group formed when two or more shareholders communicate with each other regarding an issuer or its securities (including discussions that relate to improvement of the long-term performance of the issuer, changes in issuer practices, submissions or solicitations in support of a non-binding shareholder proposal, a joint engagement strategy (that is not control related), or a "vote no" campaign against individual directors in uncontested elections) without taking any other actions?

Response: No. In the SEC's view, a discussion whether held in private, such as a meeting between two parties, or in a public forum, such as a conference that involves an independent and free exchange of ideas and views among shareholders, alone and without more, would

not be sufficient to satisfy the "act as a . . . group" standard in Sections 13(d)(3) and 13(g)(3). These provisions were intended to prevent circumvention of the disclosures required by Schedules 13D and 13G, not to complicate shareholders' ability to independently and freely express their views and ideas to one another. The policy objectives ordinarily served by Schedule 13D or Schedule 13G filings would not be advanced by requiring disclosure that reports this or similar types of shareholder communications. Thus, an exchange of views and any other type of dialogue in oral or written form not involving an intent to engage in concerted actions or other agreement with respect to the acquisition, holding, or disposition of securities, standing alone, would not constitute an "act" undertaken for the purpose of "holding" securities of the issuer under Section 13(d)(3) or 13(g)(3).

Question: Is a group formed when two or more shareholders engage in discussions with an issuer's management, without taking any other actions?

Response: No. For the same reasons described above, the SEC does not believe that two or more shareholders "act as a . . . group" for the purpose of "holding" a covered class within the meaning of those terms as they appear in Section 13(d)(3) or 13(g)(3) if they simply engage in a similar exchange of ideas and views, alone and without more, with an issuer's management.

Question: Is a group formed when shareholders jointly make recommendations to an issuer regarding the structure and composition of the issuer's board of directors where (i) no discussion of individual directors or board expansion occurs and (ii) no commitments are made, or agreements or understandings are reached, among the shareholders regarding the potential withholding of their votes to approve, or voting against, management's director candidates if the issuer does not take steps to implement the shareholders' recommended actions?

Response: No. Where recommendations are made in the context of a discussion that does not involve an attempt to convince the board to take specific actions through a change in the existing board membership or bind the board to take action, the SEC does not believe that the shareholders "act as a . . . group" for the purpose of "holding" securities of the covered class within the meaning of those terms as they appear in Sections 13(d)(3) or 13(g)(3). Rather, the SEC views this engagement as the type of independent and free exchange of ideas between shareholders and issuers' management that does not implicate the policy concerns addressed by Section 13(d) or Section 13(g).

Question: Is a group formed if shareholders jointly submit a non-binding shareholder proposal to an issuer pursuant to 1934 Act Rule 14a-8 for presentation at a meeting of shareholders?

Response: No. The Rule 14a-8 shareholder proposal submission process is simply another means through which shareholders can express their views to an issuer's management and board and other shareholders. For purposes of group formation, the SC does not believe shareholders engaging in a free and independent exchange of thoughts about a potential shareholder proposal, jointly submitting, or jointly presenting, a non-binding proposal to an issuer in accordance with Rule 14a-8 (or other means) should be treated differently from, for example, shareholders jointly meeting with an issuer's management without other indicia of group formation. Accordingly, where the proposal is non-binding, the SEC does not believe

that the shareholders "act as a . . . group" for the purpose of "holding" securities of the covered class within the meaning of those terms as they appear in Section 13(d)(3) or 13(g)(3). Assuming that the joint conduct has been limited to the creation, submission, and/or presentation of a non-binding proposal, those statutory provisions would not result in the shareholders being treated as a group, and the shareholders' beneficial ownership would not be aggregated for purposes of determining whether the 5% threshold under Section 13(d)(1) or 13(g)(1) had been crossed.

Question: Would a conversation, email, phone contact, or meetings between a shareholder and an activist investor that is seeking support for its proposals to an issuer's board or management, without more, such as consenting or committing to a course of action, constitute such coordination as would result in the shareholder and activist being deemed to form a group?

Response: No. Communications such as the types described, alone and without more, would not be sufficient to satisfy the "act as a . . . group" standard in Sections 13(d)(3) and 13(g)(3) as they are merely the exchange of views among shareholders about the issuer. This view is consistent with the SEC's previous statement that a shareholder who is a passive recipient of proxy soliciting activities, without more, would not be deemed a member of a group with persons conducting the solicitation. Activities that extend beyond these types of communications, which include joint or coordinated publication of soliciting materials with an activist investor might, however, be indicative of group formation, depending upon the facts and circumstances.

Question: Would an announcement or a communication by a shareholder of the shareholder's intention to vote in favor of an unaffiliated activist investor's director nominees, without more, constitute coordination sufficient to find that the shareholder and the activist investor formed a group?

Response: No. The SEC does not view a shareholder's independently determined act of exercising its voting rights, and any announcements or communications regarding its voting decision, without more, as indicia of group formation. This view is consistent with the SEC's general approach towards the exercise of the right of suffrage by a shareholder in other areas of the federal securities laws. Shareholders, whether institutional or otherwise, are thus not engaging in conduct at risk of being deemed to give rise to group formation as a result of simply independently announcing or advising others—including the issuer—how they intend to vote and the reasons why.

Question: If a beneficial owner of a substantial block of a covered class that is or will be required to file a Schedule 13D intentionally communicates to other market participants (including investors) that such a filing will be made (to the extent this information is not yet public) with the purpose of causing such persons to make purchases in the same covered class, and one or more of the other market participants make purchases in the same covered class as a direct result of that communication, would the block holder and any of those market participants that made purchases potentially become subject to regulation as a group?

Response: Yes. To the extent the information was shared by the blockholder with the purpose of causing others to make purchases in the same covered class and the purchases were made as a direct result of the blockholder's information, these activities raise the possibility that all

of these beneficial owners are "act[ing] as" a "group for the purpose of acquiring" securities of the covered class within the meaning of Section 13(d)(3). Such purchases may implicate the need for public disclosure underlying Section 13(d)(3) and these purchases could potentially be deemed as having been undertaken by a "group" for the purpose of "acquiring" securities as specified under Section 13(d)(3). Given that a Schedule 13D filing may affect the market for and the price of an issuer's securities, non-public information that a person will make a Schedule 13D filing in the near future can be material. By privately sharing this material information in advance of the public filing deadline, the blockholder may incentivize the market participants who received the information to acquire shares before the filing is made. Such arrangements also raise investor protection concerns regarding perceived unfairness and trust in markets. The final determination as to whether a group is formed between the blockholder and the other market participants will ultimately depend upon the facts and circumstances, including (i) whether the purpose of the blockholder's communication with the other market participants was to cause them to purchase the securities and (ii) whether the market participants' purchases were made as a direct result of the information shared by the blockholder.

Concluding Thoughts

The SEC amendments to the beneficial reporting requirements were motivated principally by the technological changes over the past 50 years that impact how quickly the market and individual investors receive information, including information about efforts to change or influence control of domestic public companies. The most significant impact of the new timing rules will be on activist investors that will have fewer days in which to build a stake above the 5% threshold before their purchases become public (five business days (rather than 10 calendar days) after crossing the threshold, and two business days (rather than promptly) after material changes by reason of additional purchases). The rules have also been tightened for investor purchases without "control intent."

These rules form part of a robust SEC rulemaking agenda updated last spring (*see also* SEC Tracker). The rule changes come a few months after the SEC (in May) amended requirements for its Form PF, which covers confidential reporting to the SEC by hedge fund advisers and private equity advisers, and only two months after the SEC (in August) adopted new rules requiring private fund advisers to provide investors with quarterly statements detailing information on performance, fees and expenses, to obtain annual audits and to obtain fairness opinions for adviser-led secondary transactions. In 2021, the SEC adopted its universal proxy card rules for director elections, seen as a providing at least a nominal benefit to activists seeking board seats.

We await, among others, final climate-related disclosure rules, rules restricting SPACs and rules for enhancing disclosures concerning short sales (called for by Section 929X of Dodd Frank).

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