

SEC Proposes Amendments to Beneficial Ownership Reporting Requirements

March 21, 2022

On February 10, 2022, the Securities and Exchange Commission (the “SEC”) proposed amendments to certain rules and regulations under the Exchange Act of 1934, as amended (the “Exchange Act”), that govern beneficial ownership reporting (the “Proposed Amendments”).¹ The SEC provided that updating these reporting requirements for modern advances in the securities market will reduce information asymmetries and promote transparency and address the timeliness of key filings. Specifically, the Proposed Amendments are aimed at, among other things: (i) shortening deadlines regarding filing of Schedule 13D and Schedule 13G; (ii) clarify how certain derivatives acquired with control intent are treated with respect to beneficial ownership reporting; and (iii) clarify when a “group” is formed for purposes of beneficial ownership reporting.

Proposed Amendments to Deadlines for Beneficial Ownership Reports

The SEC noted that technological advances both in the SEC’s filing system on EDGAR as well as the use of modern information technology in today’s financial markets have led for calls to reassess the requirements around beneficial ownership reporting. The SEC reasoned that the current deadlines raise concerns that material information is not disseminated to the public sufficiently quickly for today’s financial markets, and the delay in reporting this material information contributes to harmful information asymmetries for investors broadly.

Current Framework

Sections 13(d) and 13(g) of the Exchange Act require an investor who acquires or has beneficial ownership of more than 5% of a class of an issuer’s securities to report such ownership on Schedule 13D or Schedule 13G. These schedules share a common base; however, Schedule 13G is the short-form alternative to Schedule 13D. Under the current rules, investors that file on Schedule 13D must report an acquisition of beneficial ownership of more than five percent of a class of securities of a publicly traded company (including a publicly traded investment company) no later than 10 calendar days after such acquisition (or after losing eligibility to file on Schedule 13G). For investors who are permitted to file on Schedule 13G,² the filing requirement may vary. Qualified institutional investors and exempt investors must file within forty-five days after the calendar-year in which such investor’s beneficial ownership exceeds five percent; whereas passive investors must file within ten days after acquiring beneficial ownership of more than five percent.

Beneficial owners are also currently required to file amendments throughout the course of the year. Specifically, Schedule 13D filers must file an amendment if there is a material change in the facts that were set forth in the previously filed Schedule 13D, which includes acquisitions or dispositions of the securities of a class of one percent. Such amendment is required to be filed “promptly” after such change (which practitioners generally view as two business days). For all Schedule 13G filers, an amendment must be filed for any change in the information previously reported on Schedule 13G within forty-five days after the calendar year-end in which the change occurred. Additionally, qualified institutional investors and passive investors must also file an amendment upon exceeding 10% of beneficial ownership or a 5% increase or decrease in beneficial ownership (10 calendar days after month-end for qualified institutional buyers and promptly for passive investors).

Proposed Framework

The Proposed Amendments accelerate the filing requirements for beneficial ownership reporting. First, the Proposed Amendments shorten the initial filing deadline for Schedule 13D investors to five calendar days. For qualified

institutional investors and exempt investors, the Proposed Amendments require Schedule 13G be filed within five business days after the month-end in which beneficial ownership exceeds five percent. For passive investors, the Proposed Amendments require Schedule 13G be filed within five calendar days after acquiring beneficial ownership of more than five percent.

The Proposed Amendments also address the requirements associated with filing amendments to Schedule 13D and Schedule 13G. For Schedule 13D investors, the Proposed Amendments do not alter the triggering event of an amendment (*i.e.*, it remains a material change in the facts). However, the timing requirement would change to require filing within one business day after the triggering event. For Schedule 13G investors, the Proposed Amendments alter the amendment triggering event from “any change” to a “material change”. The timing of filing the amendment pursuant to a material change would be accelerated to five business days after the month-end in which the material change occurs. Additionally, for qualified institutional investors and passive investors who exceed ten percent ownership, or a beneficial ownership increase or decrease of 5%, the filing deadline would change to five calendar days after such event for qualified institutional investors and one business day for passive investors.

Proposed Amendments for the Treatment of Certain Derivative Securities

The Proposed Amendments would also amend the rules associated with certain cash-settled derivative securities to deem holders of such derivatives to be the beneficial owners of the referenced security. The SEC noted that neither the Exchange Act nor Regulation 13D-G defines the term “beneficial ownership”. The SEC adopted Rule 13d-3 to provide standards for determining whether a person is a beneficial owner subject to Section 13(d) of the Exchange Act. Under the current Rule 13d-3, only those derivatives that would be settled “in-kind” or otherwise convey a right to acquire the covered security within sixty days trigger beneficial ownership. Derivatives that entitle the holder to nothing more than economic exposure historically have not been considered sufficient to constitute beneficial ownership.

Commentators have raised concerns that the current rules fail to explicitly address circumstances in which an investor in a cash-settled derivative may influence or control an issuer by pressuring a counterparty to make certain decisions regarding the voting and disposition of a substantial block of shares of an issuer. The use of cash-settled derivatives in the change of control context may also contribute to a shift in corporate control. While holders of cash-settled derivatives lack the express legal power to direct voting or disposition of a security, such holders may possess economic power that can be used to produce their desired outcomes and impact the price of the reference security.

The Proposed Amendments are designed to make information about large positions of cash-settled derivative securities and the related reference securities publicly available. The Proposed Amendments expand the definition of beneficial ownership to include that the holder of a cash-settled derivative (other than security-based swaps) is deemed the beneficial owner of the referenced equity security if such person holds the derivative with the purpose or effect of changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having such purpose or effect. This rule change is aimed at publicly identifying an investor who intends to influence or control the issuer publicly available sooner than the current regulatory regime. The Proposed Amendments also provide a formula for calculating the number of equity securities that a holder of a cash-settled derivative will be deemed to beneficially own.

Proposed Amendments Relating to Formation of a “Group” for Beneficial Ownership Reporting

The Proposed Amendments also intend to provide clarity for when investors act as a group with respect to beneficial ownership reporting. Sections 13(d)(3) and 13(g)(3) of the Exchange act provide that “[w]hen two or more persons act as a . . . group for the purpose of acquiring, holding, or disposing of securities of an issuer, such syndicate or group shall be deemed a ‘person’”. Neither provision defines the term “group” and is currently a question of fact that has been inconsistently applied.

The Proposed Amendments would amend Rule 13d-5 to track the statutory text of Sections 13(d)(3) and 13(g)(3) and specify that two or more persons who “act as” a group for purposes of acquiring, holding or disposing securities are

treated as a “group.” The SEC’s stated intent is to remove the potential implication that an express or implied agreement among group members is necessary to the formation of a group.

The Proposed Amendments also would promulgate new Rule 13d-6(c) to set forth circumstances under which two or more persons may communicate, consult with one another, and engage with an issuer without being deemed a “group”. It would also set forth circumstances under which two or more persons may enter into an agreement with regards to a derivative security in the ordinary course of business without being deemed a “group” with respect to such derivative agreement’s referenced equity security. The release states that the exemptions are designed to provide certainty and ensure that the Proposed Amendments will not have a chilling effect on shareholder communications or engagement.

Structured Data Requirements for Schedules 13D and 13G

The SEC also is requiring all information disclosed on Schedule 13D and Schedule 13G be filed using a structured, machine-readable data language.

Comment Period

Comments should be received prior to April 11, 2022. The Proposed Amendments are likely to draw significant comment from industry participants due to their breadth and scope.

For More Information

If you would like further information concerning the matters discussed in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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- 1 Specifically, the SEC proposes to amend Rule 13d-1, Rule 13d-2, Rule 13d-3, Rule 13d-5, Rule 13d-6, and Rule 13d-101 (Item 6 to Schedule 13D) under the Exchange Act, as well as Rules 13 and 201 under Regulation S-T.
 - 2 Specifically, an investor must be a “qualified institutional investor” (generally includes a specified institutional investor (such as a bank, broker-dealer or investment company) who acquired its stock in the ordinary course of business and not with the purpose or effect of controlling the issuer), a “passive investor” (generally includes a person who has not acquired the securities with the intent of influencing the control of the issuer, is not a qualified institutional investor, and does not directly or indirectly hold more than 20% of such securities), or an “exempt investor” (generally includes an investor who acquired its interest prior to the company becoming publicly traded).

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