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SEC Proposes Rule Amendments To Modernize Beneficial Ownership Reporting

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On February 10, 2022, the Securities and Exchange Commission (the “SEC”) proposed rule amendments (the “Proposed Amendments”) to modernize beneficial ownership reporting under Sections 13(d) and 13(g) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Under the proposed rules, the filing deadlines for Schedules 13D and 13G beneficial ownership reports would be accelerated; the application of Regulation 13D-G would be expanded to certain derivative securities; the circumstances under which two or more persons have formed a “group” subject to beneficial ownership reporting obligations would be expanded; and Schedules 13D and 13G would be required to be filed using a structured, machine-readable data language.

Comments on the Proposed Amendments may be submitted until the later of April 11, 2022 (*i.e.*, 60 days from publication on the website) and 30 days from publication in the Federal Register.

DEADLINES FOR SCHEDULES 13D AND 13G

Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G require an investor with beneficial ownership of more than 5% of a covered class¹ of equity securities (“Covered Securities”) to report such beneficial ownership on a publicly filed Schedule 13D or Schedule 13G.

The Proposed Amendments would shorten the deadline for filing an initial Schedule 13D from 10 to 5 days upon acquiring more than 5% ownership of Covered Securities (or losing eligibility to file the less burdensome Schedule 13G that is available only to certain types of investors). Amendments to Schedule 13D would need to be filed within one business day following any material change in the facts disclosed on the initial Schedule 13D (rather than “promptly” following such change).

The Proposed Amendments would also affect the filing deadlines for Schedule 13Gs and Schedule 13G amendments for certain filers (*i.e.*, qualified institutional investors (“QIIs”)² and exempt investors³). The Proposed Amendments would:

- Shorten the requirement for an initial Schedule 13G for QIIs and exempt investors from 45 days after year-end to 5 business days after the end of the month in which the investor acquires more than 5% of the Covered Securities;
- Shorten the initial filing deadline for filing a Schedule 13G for “passive investors”⁴ from 10 days to 5 days after acquiring more than 5% of the Covered Securities;

- Alter the annual amendment requirement for Schedule 13G, which currently requires Schedule 13G amendment filings 45 days after the year in which any change in the information reported in the previous filing occurred. The Proposed Amendments would modify this requirement, and require amendments five business days after the month in which a material change occurred;
- Shorten the deadline for QIIs to file Schedule 13G amendments. The current rules require QIIs to file Schedule 13G amendments to report crossing the 10% threshold of ownership in Covered Securities, with the amendment due 10 days after the end of the month the threshold is crossed, with additional amendments 10 days after the end of a month where ownership increases or decreases by more than 5% of the Covered Securities. The Proposed Amendments shorten these periods to five days after the occurrence of the relevant triggering event (whether crossing the 10% threshold or an increase or decrease of 5%); and
- Shorten the deadline for passive investors to file Schedule 13G amendments. The current rules require passive investors to file a Schedule 13G amendment “promptly” upon acquiring greater than 10% of the Covered Securities, with further amendments “promptly” upon increases or decreases of beneficial ownership by 5% of the Covered Securities. The Proposed Amendments specify these as requiring amendments one business day after the relevant event (whether crossing the 10% threshold or an increase or decrease of 5%).

APPLICATION TO CERTAIN DERIVATIVE SECURITIES

Currently, holders of derivative securities are not explicitly included in the definition of a “beneficial owner” in Rule 13d-3. The Proposed Amendments would add a new subsection (e) to Rule 13d-3 to include a holder of a cash-settled derivative security, other than a security-based swap, if the derivative is held “with the purpose or effect of changing or influencing the control of the issuer of such class of equity securities, or in connection with or as a participant in any transaction having such purpose or effect”.

Item 6 of Schedule 13D currently requires beneficial owners to “[d]escribe any contracts, arrangements, understandings or relationships” and includes a non-exclusive list of examples that does not expressly include derivatives. The Proposed Amendments would include a new provision to require disclosure of derivatives, including cash-settled security-based swaps and other derivatives settled exclusively in cash, that use the issuer’s securities as a reference security. Note that in the Proposed Amendments, security-based swaps based on the Covered Securities will not be counted for purposes of establishing “beneficial ownership” (unlike other cash-settled swaps), but if a Schedule 13D is required, security-based swaps would be required to be disclosed on Item 6.

“GROUP” DEFINITION

The Proposed Amendments would expand the definition of a “group” for beneficial ownership purposes by deleting the current reference to “an agreement” between two or more persons and would instead specify that two or more persons who “act as” a group for purposes of acquiring, holding or disposing securities would be treated as a “group”. As part of this definitional expansion, the SEC is proposing to amend Rule 13d-5 to expressly provide that a group will be formed by (1) a person who shares information about their upcoming Schedule 13D filing, to the extent that information is not yet public and is communicated with the purpose of causing others to make their own purchases, and (2) a person who subsequently purchases the issuer’s securities based on that information.

However, the Proposed Amendments would also provide exemptions permitting investors to “communicate and consult with each other, jointly engage issuers and execute certain transactions without being subject to regulation as a group”, including in situations where actions are taken by two or more persons (1) without the purpose or effect of changing or influencing the control of an issuer or (2) solely by virtue of entering into an agreement governing the terms of a derivative security.

EXTENSION OF FILING CUT-OFF TIMES

The Proposed Amendments would also extend the EDGAR filing “cut-off” times for Schedules 13D and 13G from 5:30 p.m. to 10:00 p.m. Eastern and would require Schedule 13D and 13G filings to use a structured, machine-readable data language for all information disclosed on such filings. This later filing time of 10:00 p.m. Eastern is currently only available for filings required pursuant to Section 16 (*i.e.*, Forms 3, 4 and 5).

ANALYSIS

Many of the Proposed Amendments have long been discussed in corporate governance circles. We expect the Proposed Amendments to generate a significant number of comments covering the grounds of this long-running debate, with supporting comments likely to come from corporate registrants and critical comments likely to come from activist investors (and each of their respective allies). Indeed, some registrants and their aligned parties may have hoped for even more comprehensive changes and greater transparency. In general, we believe the Proposed Amendments represent an important modernization of the beneficial ownership reporting system. The more timely filing requirements and treatment of cash-settled derivative securities will promote greater transparency in the market but without such short deadlines as may unduly prevent investors from accumulating positions entirely and will reduce some of the most significant information asymmetries between activists and their targets (and other investors) under the current rules.

There are some areas of the Proposed Amendments we believe are likely to attract particular comment. For example, the proposed rules related to the formation of a group apply principles-based (rather than bright-line) limits as to their application or the availability of the related safe harbors, and may draw criticism from the investor community. Another provision which may attract comment is the lack of a definition for “material change” for purposes of triggering a Schedule 13G amendment, not even incorporating the provision currently applicable to Schedule 13D amendments deeming as material a change in ownership of 1% of the class of Covered Securities. Given the use of Section 13 concepts in other areas of the law and contract drafting, we also expect commenters to highlight some of the potential far-reaching consequences of the Proposed Amendments.⁵

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¹ A “covered class” generally means, with limited exceptions, a voting class of equity securities registered under Section 12 of the Exchange Act. See Exchange Act Section 13(d)(1) and Rule 13d-1(i).

² A list of investors that are QIIs can be found in 17 CFR 240.13d-1(b)(1)(ii).

³ “Exempt investors” refers to persons holding beneficial ownership of more than 5% of a covered class at the end of the calendar year, but who have not made an acquisition of beneficial ownership subject to Section 13(d), such as pre-IPO investors or those who have not acquired more than 2% of a covered class within a 12-month period. See Rule 13d-1(d).

⁴ “Passive investors” refer to beneficial owners of more than 5% but less than 20% of Covered Securities who are able to certify pursuant to Item 10 of Schedule 13G that the subject securities were not acquired or held for the purpose or effect of changing or influencing the control of the issuer of such securities and were not acquired in connection with or as a participant in any transaction having such purpose or effect. See Rule 13d-1(c).

⁵ For example, the proposing release notes that the incorporation of cash-settled derivative securities into beneficial ownership may result in an expanded universe of investors subject to Section 16 filing obligations, since the 10% threshold for being subject to Section 16 filing obligations is defined with reference to the definition of “beneficial ownership” for purposes of Schedules 13D and 13G reporting. Additionally, a number of debt agreements and other instruments (including change of control severance plans and stockholder rights plans) frequently include rights that are triggered when a “group” acquires “beneficial ownership” of an issuer’s securities above a certain threshold and often define those terms by reference to Section 13 concepts. Finally, under the Change in Bank Control Act (“CIBCA”), persons are required to make a filing when “acting in concert” before acquiring 10% or more of a publicly traded banking organization’s stock. Because the bank regulators presume concerted action when joint Section 13 filings would be required, the Proposed Amendments could also affect CIBCA notice requirements.