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## SEC proposes modernization of beneficial ownership reporting rules under Exchange Act Section 13

The SEC recently published its long-awaited proposal to amend Regulation 13D-G under the Exchange Act to modernize the SEC's requirements for reporting beneficial ownership of securities. The SEC expects that the proposed amendments will improve transparency in reporting, reduce the information gap between filers and other investors, and enhance investors' ability to make more informed investment decisions.

SEC rules under Regulation 13D-G require beneficial owners of more than 5% of a class of voting equity securities registered under Exchange Act Section 12 to report their ownership on either a Schedule 13D or a Schedule 13G. Among the most noteworthy aspects of the SEC's proposal, the amended rules would accelerate the deadlines for initial and amended Schedule 13D and Schedule 13G filings. The proposed amendments would also deem holders of certain cash-settled derivative securities to be beneficial owners of the reference equity securities and would modify the operation of reporting requirements applicable to "groups" under Sections 13(d)(3) and 13(g)(3) of the Exchange Act.

The SEC's release (No. 33-11030) describing the proposed amendments can be viewed [here](#). The comment period will be open until April 11.

### Accelerated Schedule 13D and Schedule 13G filing deadlines

The SEC proposes to accelerate the filing deadlines for persons reporting on Schedule 13D or 13G, including the following filers eligible to report on the shorter form, Schedule 13G:

- *Qualified Institutional Investors (QIIs)*, which include registered brokers or dealers, banks, insurance companies, registered investment companies and investment advisers, ERISA employee benefit plans and pension funds, and other specified types of institutions that invest in securities in the normal course of their business;
- *Passive Investors*, which are beneficial owners of more than 5% but less than 20% of a covered class that can certify that they did not acquire and do not hold the issuer's securities 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 a purpose or effect; and
- *Exempt Investors*, which are beneficial owners of more than 5% of a covered class at the end of a calendar year, but which did not make an acquisition of beneficial ownership that is subject to Section 13(d) (for example, because the investor acquired beneficial ownership of the securities before the issuer registered the class under Exchange Act Section 12).

### Initial filing deadlines

- *Schedule 13D*: Rule 13d-1(a) currently requires a holder of covered securities to file an initial Schedule 13D within 10 calendar days after acquiring beneficial ownership of more than 5% of the covered class. Similarly, Rules 13d-1(e), (f), and (g) currently require investors who lose eligibility to use Schedule 13G to file a Schedule 13D within 10 calendar days after losing 13G eligibility. The SEC proposes to amend these rules to require a Schedule 13D to be filed within *five calendar days* after the initial acquisition of more than 5% or the loss of Schedule 13G eligibility.
- *Schedule 13G*:
  - *Qualified Institutional Investors* – Under current Rule 13d-1(b), QIIs that beneficially own more than 5% of a covered class at the end of a calendar year are obligated to file a Schedule 13G within 45 calendar days after the end of the calendar year. A QII beneficially owning more than 10% as of the last day of any month, however, is required to file the initial Schedule 13G within 10 calendar days after the end of that month. The SEC proposes to amend

- Rule 13d-1(b) to shorten the filing deadline for the initial Schedule 13G to *five business days after the end of the month* in which beneficial ownership exceeds 5%, as well as to delete the alternative filing deadline when beneficial ownership exceeds 10%.
- Passive Investors – Rule 13d-1(c) currently requires Passive Investors to file a Schedule 13G within 10 calendar days after acquiring beneficial ownership of more than 5% of a covered class. The SEC proposes to amend Rule 13d-1(c) to shorten the filing deadline to *five calendar days* for the initial Schedule 13G.
  - Exempt Investors – Rule 13d-1(d) currently requires Exempt Investors to file an initial Schedule 13G within 45 calendar days after the end of the calendar year in which beneficial ownership exceeds 5% of a covered class. The SEC proposes to amend Rule 13d-1(d) to shorten the filing deadline for the initial Schedule 13G to *five business days after the end of the month* in which beneficial ownership exceeds 5%.

#### Amendment filing deadlines

- *Schedule 13D*: Rule 13d-2(a) currently requires a person that has filed a Schedule 13D to amend it “promptly” after any material change occurs in the information set forth in the initial filing or in the most recent amendment. The rule does not prescribe the number of days within which the amendment must be filed to be considered “prompt.” The SEC proposes to amend Rule 13d-2(a) to delete the term “promptly” and instead to require that an amendment be filed within *one business day* after a material change.
- *Schedule 13G*:
  - All filers – Rule 13d-2(b) currently requires Schedule 13G filers to file an amendment within 45 calendar days after the end of each calendar year if there are any changes in the information reported in the previous filing. The SEC proposes to amend Rule 13d-2(b) to change this filing deadline to *five business days after the end of the month* in which the triggering change occurs.
  - QIIs – Rule 13d-2(c) currently requires QIIs to file (1) an amendment to a Schedule 13G within 10 calendar days after the end of the first month in which beneficial ownership exceeds 10% of a covered class and (2) additional amendments 10 calendar days after the end of any month in which they increase or decrease their beneficial ownership by more than 5% of the covered

class. The SEC proposes to amend Rule 13d-2(c) to change these filing deadlines to *five calendar days* after a QII’s beneficial ownership exceeds either of the thresholds.

- Passive Investors – Rule 13d-2(d) currently requires Passive Investors to (1) “promptly” file an amendment to their Schedule 13G upon acquiring beneficial ownership of more than 10% of a covered class and (2) file additional amendments “promptly” if they increase or decrease their beneficial ownership by more than 5% of the covered class. The SEC proposes to amend Rule 13d-2(d) to change these filing deadlines from “promptly” to *one business day* after the date on which an amendment obligation arises.

#### Schedule 13G amendment trigger

Rule 13d-2(b) currently requires a person that reports on Schedule 13G to file annual amendments if there is “any” change in the information set forth in the previous filing. In addition to changing the frequency of the amendment assessment from annually to monthly, as noted above, the SEC proposes to amend Rule 13d-2(b) to replace the term “any” with “material” as the standard for determining the type of change that will trigger an amendment obligation. Accordingly, under the amended rule, amendments to a Schedule 13G filing would be required if there is a “material change” to previously filed information. The materiality standard would align the Schedule 13G amendment trigger with the standard that already applies to Schedule 13D amendments.

The SEC does not propose to amend the rules governing Schedule 13D amendment triggers.

#### Schedule 13D and Schedule 13G filing “cut-off” time

The proposed amendments would extend the cut-off time on the filing date to afford beneficial owners additional time to prepare and submit their Schedule 13D and 13G filings under the accelerated filing timelines. The SEC proposes to amend Rule 13(a) of Regulation S-T to provide that Schedule 13D and 13G filings, including any amendments, submitted by direct transmission on or before *10:00 p.m. eastern time* (rather than the current cut-off time of *5:30 p.m. eastern time*) on a business day would be deemed filed on the same business day. This amendment would align the cut-off time for these filings with filings made under Section 16 of the Exchange Act.

## Beneficial ownership of certain cash-settled derivative securities

Under Section 13(d) and the current rules, holders of cash-settled derivatives generally are not considered to beneficially own the reference securities underlying the derivative position. The SEC proposes to amend Rule 13d-3 to provide that a holder of a cash-settled derivative security (other than a security-based swap) would be deemed the beneficial owner of equity securities in the covered class referenced by the derivative security if such person holds the derivative security 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 a purpose or effect. The proposed amendment is intended to increase transparency regarding the significant interests in an issuer's securities and the potential control intent of investors in cash-settled equity-based derivatives.

The proposed amendment may cause numerous additional investors to become subject to Regulation 13 D-G's reporting requirements. Further, as the SEC highlights in its proposing release, the amendments may have the effect of subjecting holders of cash-settled derivative securities to Section 16 reporting obligations and short-swing liability, as well as to Section 16's prohibition on short sales of securities, if their total beneficial ownership exceeds 10% of the covered class.

The SEC also proposes to amend Item 6 of Schedule 13D to clarify the disclosure requirements with respect to derivative securities held by the reporting person. The import of the amendment would be to remove any implication that the filer is not required to disclose interests in all derivative securities that use a covered class as a reference security.

## Group formation and new exemptions from group status

The SEC is proposing a series of amendments to Rule 13d-5 to clarify and expand the circumstances in which a reportable "group" may be formed.

Sections 13(d)(3) and 13(g)(3) of the Exchange Act currently deem a "group" to exist where two or more persons act together for the purpose of acquiring, holding, or selling an issuer's securities. If a group acquires beneficial ownership of more than 5% of a covered class, the group generally is required to report its ownership on Schedule 13D or, if it is eligible to do so, on Schedule 13G.

Rule 13d-5 expands on the statutory language concerning group formation to require an agreement

among the group members to "act together." The SEC proposes to amend Rule 13d-5 to eliminate the agreement requirement and thus to align the applicable text of the rule with the statutory language in order, as the SEC puts it, to "remove the potential implication that an express or implied agreement among group members is a necessary precondition to the formation of a group."

The SEC also proposes to amend Rule 13d-5 to provide that if, in advance of filing a Schedule 13D, a beneficial owner discloses to any other person the non-public information that such a filing will be made, and such other person acquires beneficial ownership of the same class of securities based on such information, those persons would be deemed to have formed a group.

The SEC also proposes two new exemptions from group status. The exemptions are intended to permit persons to communicate and consult with each other, jointly engage with issuers, and execute certain transactions without becoming subject to Section 13(d) or 13(g) as a group.

The first exemption, in proposed Rule 13d-6(c), would permit two or more persons to communicate with one another and engage with an issuer without becoming subject to group reporting requirements, if two conditions are met. First, the communications may not be undertaken with the purpose or effect of changing or influencing control of the issuer, and may not be made in connection with or as a participant in any transaction having such a purpose or effect. Second, such persons must independently determine to take the concerted actions and, accordingly, may not be directly or indirectly obligated to take such actions, such as pursuant to the terms of a cooperation or joint voting agreement.

The second exemption, in proposed Rule 13d-6(d), would permit two or more persons to enter into a purchase and sale agreement governing the terms of a derivative security with respect to a class of equity securities in the ordinary course of business without becoming subject to group reporting requirements, so long as they do not enter into the agreement with the purpose or effect of changing or influencing control of the issuer of the equity securities, or in connection with or as a participant in any transaction having such a purpose or effect.

## Structured data requirements for Schedule 13D and Schedule 13G filings

Filings on Schedules 13D and 13G are not currently submitted in a structured data language. The proposed amendments would require disclosures on Schedules 13D and 13G to use a structured, machine-readable data

language that is similar to formatting currently used for certain EDGAR filings, such as Section 16 reports. The structured data requirement is intended to facilitate the use and analysis of beneficial ownership disclosures in the filings and improve public dissemination of material information.

## Looking ahead

The current beneficial ownership reporting regime has long attracted criticism from some investors and issuers for a variety of perceived shortcomings, including unduly extended filing deadlines and the uncertain scope of the beneficial ownership concept. The SEC's rule proposal represents a substantial effort to address many of these issues.

The proposal to accelerate key reporting deadlines for Schedule 13D and 13G filings is in line with the emphasis on faster reporting that has characterized many of the SEC's disclosure reform initiatives. Other aspects of the proposal, including the expansion of beneficial ownership reporting to include certain positions in cash-settled derivatives, are sure to attract comments reflecting the contentious nature of regulation affecting the market for corporate control. Equally likely to raise concerns are the SEC's statements and proposed rule amendments relating to the formation of "groups" absent the existence of an agreement, in light of the history of the SEC and the courts deeming groups to exist outside of the potential for corporate control, based solely on common investment objectives.

As in any rulemaking, the final rules could differ in important respects from the SEC's proposal. Recognizing that its proposal may not be the last word, the SEC has solicited comments on a range of alternatives to modernizing the current reporting scheme.

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