

CLIENT ALERT

# SEC Proposes Amendments to Rules Governing Beneficial Ownership Reporting

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## AUTHORS

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On February 10, 2022, the Securities and Exchange Commission (the “SEC” or the “Commission”) voted 3-1 to propose changes to the beneficial ownership reporting requirements under the Securities Exchange Act of 1934 (the “Exchange Act”).<sup>1</sup> The proposed amendments would: (i) revise the current deadlines for Schedule 13D and Schedule 13G filings; (ii) amend Rule 13d-3 to deem holders of certain cash-settled derivative securities as beneficial owners of the reference covered class; (iii) clarify and affirm the operation of Schedule 13D as applied to two or more persons that form a group under the Exchange Act; and (iv) set forth the circumstances under which two or more persons may communicate and consult with one another and engage with an issuer without becoming subject to regulation as a group with respect to the issuer’s equity securities.<sup>2</sup>

### Filing Deadlines.

The proposed amendments would:

- reduce the filing deadline for the initial Schedule 13D to five calendar days (from 10) after the date on which a person acquires more than 5% of a covered class of equity securities;<sup>3</sup>

<sup>1</sup> See Modernization of Beneficial Ownership Reporting, Exchange Act Release No. 94211 (Feb.10, 2022) (the “Proposing Release”).

<sup>2</sup> *Id.* at p. 6.

<sup>3</sup> A “covered class” is generally defined as a voting class of equity securities registered under Section 12 of the Exchange Act. *Id.* at p. 7.

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- shorten the filing deadline for the initial Schedule 13D required to be filed by persons who forfeit their eligibility to report on Schedule 13G in lieu of Schedule 13D to five calendar days (from 10) after the event that causes the ineligibility;
- revise the filing deadline under Rule 13d-2(a) for amendments to Schedule 13D to one business day (instead of “promptly”) after the date on which a material change occurs;
- shorten the deadline for the initial Schedule 13G filing for “Qualified Institutional Investors” (referred to herein as “QIIs”) and Exempt Investors to within five business days after the last day of the month in which beneficial ownership first exceeds 5% of a covered class (previously the deadline was 45 days after the calendar year-end);<sup>4</sup>
- require Passive Investors to file an initial Schedule 13G within five calendar days (from 10) after acquiring beneficial ownership of more than 5% of a covered class;<sup>5</sup>
- revise the filing deadlines required for amendments to Schedule 13G in Rule 13d-2(b) to five business days after the end of the month in which a reportable change occurs (previously the deadline was 45 days after the calendar year-end);
- amend Rule 13d-2(c) to shorten the filing deadline for Schedule 13G amendments filed by QIIs and Exempt Investors to five calendar days after the respective filing threshold is met (from 10 calendar days after the end of the month in which the respective filing threshold is met);
- amend Rule 13d-2(d) to revise the filing deadline for Schedule 13G amendments filed by Passive Investors from a “promptly” standard to one business day after the respective filing threshold is met; and
- provide that an amendment obligation for Schedule 13G filers shall only arise upon the occurrence of a material change in the facts reported (the current threshold is any change, regardless of materiality).<sup>6</sup>

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<sup>4</sup> An “Exempt Investor” is a person holding beneficial ownership of more than 5% of a covered class at the end of the calendar year, but who has not made an acquisition of beneficial ownership subject to Section 13(d). *Id.* at p. 7.

<sup>5</sup> A “Passive Investor” is a beneficial owner of more than 5% but less than 20% of a covered class who can certify under 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. *Id.* at p. 8.

<sup>6</sup> *Id.* at pp. 6-9.

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Regulation S-T would be amended to permit Schedules 13D and 13G, and any amendments thereto, that are submitted on or before 10 p.m. (instead of 5:30 p.m.) Eastern Time on a given business day to be deemed to have been filed on that business day.<sup>7</sup>

Cash-Settled Derivatives. The Proposing Release would add new paragraph (e) to Rule 13d-3 to deem certain holders of cash-settled derivatives as beneficial owners of the covered class of equity securities. The application of proposed Rule 13d-3(e) would be limited to those persons who hold cash-settled derivatives with the purpose or effect of changing or influencing control of the issuer of the reference security. By contrast, security-based swaps would not be included among the derivative securities covered by proposed Rule 13d-3(e).<sup>8</sup>

Concerns have been raised by activist investors that new Rule 13d-3(e), when combined with the proposed reduction in the filing deadline for the initial Schedule 13D filing to five calendar days and the proposed changes set forth in the recent Security-Based Swap Release, will make it difficult in many circumstances for activist investors to accumulate a meaningful position in a company prior to public disclosure of the activist's position to the company and to other investors. In addition, concerns have also been raised by practitioners about the unintended ramifications of new Rule 13d-3(e) and the changes to Rule 13d-5 discussed below under "Groups" on stock option plans, other compensation arrangements, financing arrangements and poison pills.

Groups. The Proposing Release would amend Rule 13d-5 to (i) remove any potential implication that an express or implied agreement among group members is a necessary precondition to the formation of a group under Section 13(d)(3) or 13(g)(3) of the Exchange Act and (ii) affirm 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, then those persons are deemed to have formed a group within the meaning of Section 13(d)(3).<sup>9</sup>

Exemptions. In addition, the Proposing Release sets forth proposed amendments to Rule 13d-6. New Rule 13d-6(c) would set forth the circumstances under which two or more persons may communicate and consult with one another and

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<sup>7</sup> *Id.* at p. 9. However, the Proposing Release also provides that the temporary hardship exemption in Regulation S-T for unanticipated technical difficulties preventing the timely submission of an electronic filing would be unavailable to Schedule 13D and 13G filings, including any amendments thereto.

<sup>8</sup> *Id.* at p. 58. Security-based swaps are addressed in separate rules proposed by the Commission in December 2021. See Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Exchange Act Release No. 93784 (Dec. 15, 2021) (the "Security-Based Swap Release").

<sup>9</sup> *Id.* at p. 11.

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engage with an issuer without becoming subject to regulation as a group with respect to the equity securities of the issuer.<sup>10</sup>

This rule would provide that two or more persons will not be deemed to beneficially own an issuer's equity securities as a group solely because of their concerted actions related to such issuer or its equity securities (including engagement with one another or the issuer or acquiring, holding, voting or disposing of the issuer's equity securities); provided that (i) communications among such persons are not undertaken with the purpose or the 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 (ii) such persons, when taking such concerted actions, are not directly or indirectly obligated to take such actions, such as by a voting agreement or cooperation agreement.<sup>11</sup> Many practitioners expect this exemption to be very useful for institutional investors in connection with the shareholder proposal process.

New Rule 13d-6(d) would set forth the circumstances under which two or more persons may enter into an agreement governing a derivative security in the ordinary course of business without becoming subject to regulation as a group with respect to the derivative's reference equity securities.<sup>12</sup> This rule would provide that two or more persons will not be deemed to have formed a group under Section 13(d)(3) or 13(g)(3) solely by virtue of their entry into an agreement governing the terms of a derivative security, so long as (i) the agreement is a bona fide purchase and sale agreement entered into in the ordinary course of business, and (ii) the parties to the agreement do not enter into the agreement with the purpose or effect of changing or influencing control of the issuer, or in connection with or as a participant in any transaction having such purpose or effect.<sup>13</sup>

Schedule 13D. The Proposing Release would also amend Item 6 of Schedule 13D to remove any implication that a person is not required to disclose interests in all derivative securities that use the issuer's equity security as a reference security, including with respect to derivatives not originating with the issuer, such as cash-settled options not offered or sold by the issuer and security-based swaps.<sup>14</sup>

Structured Data. The Proposing Release requires that Schedules 13D and 13G be filed using a structured, machine-readable data language.<sup>15</sup>

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<sup>10</sup> *Id.* at p. 12.

<sup>11</sup> *Id.* at pp. 97-98.

<sup>12</sup> *Id.* at p. 12.

<sup>13</sup> *Id.* at p. 98.

<sup>14</sup> *Id.* at pp. 102-103.

<sup>15</sup> *Id.* at p. 104.

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Section 16. The proposed amendments to Rules 13d-3, 13d-5 and 13d-6 would directly impact the analysis under Rule 16a-1(a)(1) as to whether a person is a 10% holder.<sup>16</sup> Given the Commission's view that Rule 16a-1(a)(1) has the same purpose as Regulation 13D-G (i.e., to identify persons who can influence or control the issuer as the result of equity ownership), the Commission believes it is appropriate to continue to apply the standards of Regulation 13D-G, as proposed to be amended, to identify 10% holders subject to Section 16.<sup>17</sup> Accordingly, the Proposing Release does not propose any amendments to Rule 16a-1(a)(1).

Dissenting Statement. Commissioner Peirce issued a statement in dissent, stating that (i) the Proposing Release suggests that shortening the reporting window is appropriate given the technological advances since 1968 when Section 13(d) was enacted, but the current 10-day window does not appear to be based upon the limitations of 1960s technology, (ii) the Proposing Release summarily concludes that the proposed amendments will achieve the proper balancing of interests between timely dissemination of information and preserving an incentive structure for investors to seek to change control at underperforming companies, without providing any evidence in support of this position, (iii) there is no clear link provided in the Proposing Release between ownership of cash-settled derivatives and the potential to change control of the issuer, and (iv) the expansion of the definition of beneficial ownership to include cash-settled derivatives lacks sufficient justification given that these securities do not convey ownership or voting rights.<sup>18</sup> Commissioner Peirce also raised a concern that the proposed exemption for institutional investors engaged in concerted actions related to an issuer or its equity securities (as discussed above) may end up "swallowing the rule."<sup>19</sup>

Comments on the proposed amendments must be received by the later of April 11, 2022 or 30 days after the Proposing Release is published in the Federal Register. The proposed amendments, if adopted, would have a significant impact on a variety of investors, including hedge funds that utilize an activist strategy where building a sizeable position prior to public disclosure is critical. Willkie will closely monitor developments on the proposed amendments and will provide comments on the proposed amendments to the SEC during the comment period.

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<sup>16</sup> *Id.* at p. 109.

<sup>17</sup> *Id.* at p. 109.

<sup>18</sup> See Dissenting Statement on Proposed Modernization of Beneficial Ownership Reporting, Commissioner Hester M. Peirce (Feb. 10, 2022).

<sup>19</sup> *Id.* at p. 2.

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