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The SEC Amends Beneficial Ownership Reporting Rules

Authors: Jeffrey Nadler, Giulia Caselli Maldonado and Patricia L. Olasker

On October 10, 2023, the Securities and Exchange Commission (SEC) adopted final amendments to the rules that govern beneficial ownership reporting and provided guidance on the application of those rules. The SEC also articulates two overarching themes which arguably reveal a new SEC perspective on shareholder activism.

Sections 13(d) and 13(g) of the *Securities Exchange Act* of 1934 (the Exchange Act), together with Regulation 13D-G, require any person (and any "group" of persons) who beneficially own more than five percent of a class of voting equity securities to publicly report their beneficial ownership by filing a Schedule 13D or a (shorter) Schedule 13G, as applicable, depending on the type of holder and whether such holder owns securities with or without control intent. The rules apply to all classes of securities listed on a U.S. national securities exchange or otherwise registered under Section 12 of the Exchange Act, whether issued by domestic issuers or foreign private issuers (including Canadian issuers that rely on the multijurisdictional disclosure system).

The amendments accelerate the deadlines for filing initial and amended beneficial ownership reports on Schedules 13D and/or 13G, extend the "cut-off" time for filing such reports from 5:30 p.m. to 10:00 p.m. Eastern Time, clarify the Schedule 13D disclosure requirements with respect to derivative securities and require that Schedule 13D and 13G filings be made using a structured, machine-readable data language. The amendments will become effective 90 days after publication in the Federal Register.[1]

The SEC also provides guidance on the application of the existing rules to an investor's use of certain cash-settled derivative securities and on the application of Sections 13(d)(3) and 13(g)(3) of the Exchange Act on the formation of a group to certain common types of shareholder engagement and communication activities.

Two Key Themes

The SEC very clearly acknowledges the importance of shareholder activism and makes clear that the final amendments are not intended to discourage activism. The SEC accepts the argument made by the opponents of the proposed rule that a reduction in the pursuit of activism may reduce shareholder value creation and have related negative effects on operational efficiency, market efficiency, liquidity and capital formation. For that reason, the SEC notes that it was appropriate to temper the goal of timely disclosure of material information (through the mechanism of accelerating the filing of beneficial ownership reports) by the need to avoid imposing undue burdens on shareholders who seek to assert influence or control over public companies.

Secondly, the SEC acknowledges the debate around information asymmetries and agrees that not all information asymmetries warrant a regulatory response and that benefits may stem from the information asymmetry between an activist Schedule 13D filer and the market. The informational advantage gained by activists results, in general, from their own expenditures on research, or from their own efforts to pursue changes at the issuers in which they accumulate shareholdings, and these asymmetries do not warrant regulatory intervention. In other words, shareholders who sell on the market when an activist is buying are not entitled to regulatory protection against the information asymmetry that exists there. This fresh perspective reflects the views of commentators who pointed out that there is no policy reason why the selling shareholder should be entitled to share in the value of information created by the activist, and no justification for affording priority to shareholders who made the short term decision to sell over the majority of shareholders who retain their interest and the activist who catalyzes changes for the benefit of all shareholders.

The SEC focuses the concern more narrowly on information asymmetries that exist between "informed bystanders" and other less informed investors who sell their shares during the period after a 13D filing is triggered but before the filing is made. This, the SEC notes, can be perceived to be an unfair wealth transfer and worthy of intervention in the form of an accelerated filing deadline.

Shortened Filing Deadlines

The amended deadlines for filing initial and amended reports on Schedules 13D and 13G are as follows:

- Initial Schedule 13D filing: The amended deadline is **five business days**[2] (instead of 10 days) after the date on which a person acquires beneficial ownership of more than five percent of a covered class of voting equity securities. In case of an ineligibility event, the amended deadline is **five business days** (instead of 10 days) after the event that causes a person to cease to be eligible to report on Schedule 13G in lieu of Schedule 13D.[3]
- Initial Schedule 13G Filing: The amended deadline for filings by "Qualified Institutional Investors"[4] and "Exempt Investors"[5] is within 45 days after the end of the **calendar quarter** (instead of the calendar year) in which beneficial ownership first exceeds five percent of a covered class.[6] For "Passive Investors,"[7] the amended deadline is **five business days** (instead of 10 days) after the date on which they acquire beneficial ownership of more than five percent of a covered class.
- Amendments to Schedule 13D Filing: The amended deadline for the filing is within **two business days** (instead of promptly) after there is a material change in the information previously reported.
- Amendments to Schedule 13G Filing: The amended deadline for the filing is 45 calendar days after the **calendar quarter** (instead of the calendar year) in which there is a **material** change[8] (instead of any change) in the information previously reported. For Qualified Institutional Investors and Exempt Investors, the amended deadline is **five business days** (instead of 10 days) after the end of the month in which beneficial ownership first exceeds ten percent of a covered class, and upon any deviation by more than five percent of the covered class. For Passive Investors, the amended deadline for the filing is within **two business days** (instead of promptly) after the date on which beneficial ownership exceeds ten percent of a covered class, and thereafter upon any deviation by more than five percent of the covered class.

SEC Guidance on Formation of a Group

The SEC abandoned most of its proposed substantive rule amendments on the formation of a group, including a proposed amendment to remove a reference to an "agreement" between two or more persons in Rule 13d-5(b)[9]. Instead, the SEC provides guidance in the final rule regarding the legal standard for determining whether a group is formed. Specifically, the SEC makes clear that "the determination as to whether two or more persons are acting as a group does not depend solely on the presence of an express agreement and that, depending on the particular facts and circumstances, concerted actions by two or more persons for the purpose of acquiring, holding or disposing of securities of an issuer are sufficient to constitute the formation of a group."

The SEC also provides guidance (in the form of questions and answers) on how the existing legal framework should be applied to certain common types of shareholder engagement activities. For example, according to SEC guidance:

- a group is not formed when two or more shareholders communicate with each other (or with the issuer's management), whether 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, regarding an issuer or its securities (including a discussion on a joint engagement strategy that is not control-related), without taking any other action;
- a communication 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) would not result in the shareholder and activist being deemed to form a group because such communications, alone and without more, are merely the exchange of views among shareholders about the issuer;

- an announcement or a communication by a shareholder of its intention to vote in favour of an unaffiliated activist investor's director nominees, without more, would not constitute coordination sufficient to find that the shareholder and the activist investor formed a group;
- a cash-settled derivative entered solely for commercial purposes between an investor and a financial institution and settled exclusively in cash would not be sufficient to find that a group exists between the investor and the financial institution, absent other indicia of group status, such as a voting agreement or other factors;
- on the other hand, a person with a substantial block of stock who intentionally communicates to another person non-public information about an upcoming Schedule 13D filing that such person is or will be required to make, with the purpose of causing the recipient of such non-public information to make purchases of securities of the same class of stock, and as a direct result of the communication the recipient subsequently purchases securities of that class based on this non-public information, such person may have formed a group with the recipient.[10]

Guidance on Cash-Settled Derivative Securities

The SEC did not adopt a proposed rule that would have treated a holder of a cash-settled derivative security, excluding a securities-based swap (SBS), as the beneficial owner of the equity securities of a covered class referenced by the cash-settled derivative security if such person held the cash-settled derivative security with the purpose or effect of changing or influencing the control of the issuer of the class of equity securities, or in connection with or as a participant in any transaction having that purpose or effect. Instead, the SEC provides guidance that the holder of a cash-settled derivative security may become a beneficial owner of the referenced equity securities of the covered class under the existing rules as follows:

- First, if such derivative security provides its holder, directly or indirectly, with exclusive or shared voting or investment power over the referenced equity securities of the covered class through a contractual term of the derivative security or otherwise.
- Second, if such derivative security is acquired with the purpose or effect of divesting its holder of beneficial ownership of the referenced equity securities of the 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).
- Third, if the person either (1) has a right to acquire beneficial ownership of the equity security within 60 days or (2) obtains 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.

This guidance is similar to guidance the SEC previously provided in 2011 regarding the beneficial ownership determination of holders of SBS,[11] with the result that SBS and other cash-settled derivative securities are now treated identically in this respect.

To eliminate any ambiguity, the SEC also amended Item 6 of Schedule 13D to expressly state that the use of derivative securities, including cash-settled SBS and other derivatives not originating with the issuer settled exclusively in cash, which use the issuer's securities as a reference security are included among the types of contracts, arrangements, understandings and relationships which must be disclosed in a Schedule 13D.

Implications for Canada

Prompted by the SEC's initial release of proposed amendments to the beneficial ownership reporting rules and by the 2021 decision of the Alberta Securities Commission (ASC) in *Re Bison Acquisition Corp*, 2021 ABASC 188 (*Bison*), the Canadian Securities Administrators have stated their intention to review Canada's beneficial ownership reporting regime to consider the appropriate scope of disclosure requirements concerning equity derivatives.[12] This review will likely include the consideration of the circumstances in which a holder of a cash-settled derivative should be deemed a beneficial owner of the reference security.

The decision of the ASC in *Bison* looked at the use of cash-settled derivatives through an even wider lens, to consider whether the use of cash-settled derivatives by a hostile bidder, was abusive and unfair to shareholders of the target where the bidder had at the time the swaps were entered into a potential take-over intention or at least a general awareness that the target was generally the subject of take-over interest. The ASC found that although the bidder was not legally required to disclose its swaps position, it was able to acquire shares at prices that did not reflect the effect disclosure of its intentions would have had on the market price of the target's shares, and this was detrimental to the target shareholders who sold into the market at that "suppressed" price. In other words, the ASC was heavily influenced by the presence of the very type of information asymmetry now so plainly rejected by the SEC as being worthy of regulatory intervention. Although the *Bison* decision concerned a hostile bid, the analysis is translatable to the proxy contest environment. It remains to be seen whether the SEC's two overarching themes, discussed above, will inform the debate in Canada on the appropriate regulatory treatment of cash-settled equity derivatives.

[1] Compliance with the revised Schedule 13G filing deadlines will be required beginning on September 30, 2024. Compliance with the structured data requirement for Schedules 13D and 13G will be required beginning on December 18, 2024.

[2] The SEC is increasingly and consistently using "business days" rather than "days" in the newly adopted rules.

[3] An ineligibility event occurs, for example, when a person is no longer able to certify that their beneficial ownership is not for the purpose of, or with the effect of, changing or influencing the control of the issuer or in connection with any transaction that would have such purpose or effect, or if certain institutional investors acquire or hold beneficial ownership outside of the ordinary course of business. Similarly, an ineligibility event occurs if a person beneficially owns 20 percent or more of a covered class. Ineligibility will also be triggered if a Qualified Institutional Investor (defined below) either no longer qualifies as such or ceases to beneficially own the equity securities in the ordinary course of business.

[4] The term "Qualified Institutional Investor" refers to the institutional investors qualified to report on Schedule 13G, in lieu of Schedule 13D and in reliance upon Rule 13d-1(b), which include a broker or dealer registered under Section 15 of the Exchange Act, a bank as defined in Section 3(a)(6) of the Exchange Act, an insurance company as defined in Section 3(a)(19) of the Exchange Act, an investment company registered under Section 8 of the Investment Company Act of 1940, a person registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940, a parent holding company or control person (if certain conditions are met), an employee benefit plan or pension fund that is subject to the provisions of the Employee Retirement Income Security Act of 1974, a savings association as defined in Section 3(b) of the Federal Deposit Insurance Act, a church plan that is excluded from the definition of an investment company under Section 3(c)(14) of the Investment Company Act of 1940, non-U.S. institutions that are the functional equivalent of any of the institutions listed in Rules 13d-1(b)(1)(ii)(A) through (I), so long as the non-U.S. institution is subject to a regulatory scheme that is substantially comparable to the regulatory scheme applicable to the equivalent U.S. institution and related holding companies and groups.

[5] The term "Exempt Investor" refers to persons holding beneficial ownership of more than five percent of a covered class, but who have not made an acquisition of beneficial ownership subject to Section 13(d).

[6] However, as noted below, Qualified Institutional Investors and Exempt Investors, will be required to file a Schedule 13G (or an amendment thereto) within five business days (instead of 10 days) after the end of the month in which beneficial ownership first exceeds 10% of a covered class, and upon any deviation by more than five percent of the covered class.

[7] The term "Passive Investors" refers to beneficial owners of more than five percent but less than 20% of a covered class who can certify under Item 10 of Schedule 13G that the subject securities were not acquired and are not 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.

[8] Under the amended rule, an amended report is required if there is a material change to the information previously reported. The SEC clarifies that the applicable materiality standard is in Rule 12b-2, which states that the term "material," when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered.

[9] In the proposed rule, the SEC sought to eliminate "any potential [for Rule 13d-5(b)] to be misconstrued as the definition of a group and consequently used as a basis to narrow the application of [the statutory standard in] Sections 13(d)(3) and 13(g)(3) [of the Exchange Act]." Explaining its decision to abandon its proposal in the final rule, the SEC acknowledged that Rule 13d-5(b) was never intended to serve as a substitute for the statutory standard in Sections 13(d)(3) and 13(g)(3) for determining when a group is formed. The SEC also acknowledged commenters' objections to the proposed amendment on the basis that it could result in a group being formed absent some evidence of agreement, arrangement, understanding or concerted action, which was not the SEC's intent.

[10] The SEC explains that "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).

[11] See *Beneficial Ownership Reporting Requirements and Security-Based Swaps*, Release No. 34-64628 (June 8, 2011) [76 FR 34579 (June 14, 2011)].

[12] 2022-2025 CSA Business Plan available at https://www.securities-administrators.ca/wp-content/uploads/2022/10/2022_2025CSA_BusinessPlan.pdf

Key Contacts: Jeffrey Nadler and Patricia L. Olasker