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# Proposed Changes to Beneficial Ownership Reporting Rules and Impact to Stakeholders

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# Discussion Topics

- Proposed changes that would shorten multiple filing deadlines for Schedules 13D and 13G
- Proposed amendments to the definition of beneficial ownership to include certain cash-settled derivatives, other than security-based swaps
- Proposed method for calculating reference securities underlying cash-settled derivatives
- Proposed amendments that would clarify the disclosure requirements with respect to derivative securities
- The relationship of these proposed amendments to the SEC's proposed Rule 10B-1, which would require public reporting of, among other things, certain large positions in security-based swaps
- Proposed amendments to clarify when persons are deemed to "act as" a group under Sections 13(d)(3) and (g)(3) of the Exchange Act and exemptions
- The effect of the proposed amendments to the beneficial ownership definition on Section 16 filing requirements
- The effect on activist interest and strategies and ongoing private transactions

# Overview

- The Securities Exchange Act of 1934 (“Exchange Act”), Section 13(d), was originally enacted to address the increasing use of cash tender offers in corporate takeovers and requires investors who request more than 5 percent of a covered class of equity securities to report their holdings. Section 13(g) permits short-form disclosure by certain passive or early investors that hold or obtain significant positions in the voting stock of public companies.
- February 10, 2022: Securities and Exchange Commission (“SEC”) proposed amendments to Schedules 13D and 13G relating to beneficial ownership reports (“Proposed Amendments”).
- Proposed Amendments intended to modernize the rules that govern reporting on Schedules 13D and G by:
  - Making information available to the public in a more timely manner,
  - Deeming holders of certain cash-settled derivative securities to be beneficial owners of the reference equity securities, and
  - Clarifying the disclosure requirements in respect of derivative securities.

# Basic Requirements

- Sections 13(d) and 13(g) require investors who acquire beneficial ownership, or who beneficially own, more than 5 percent of a covered class of equity securities to publicly report their beneficial ownership
- Schedule 13D is the default reporting form and must be filed within 10 days after the acquisition
- Schedule 13G is for institutional investors, passive investors and for certain pre-IPO holders and generally must be filed with 45 days after the end of the calendar year, or within 10 days in the case of passive investors
- The current deadlines have not been amended since the 1970s

# The Proposing Release

- The proposing release (“Proposing Release”) acknowledges the chilling effect that the shortening of the initial Schedule 13D filing deadline may have on an investor’s ability and incentive to effect changes at companies, which changes may be beneficial to all shareholders.
  - The Proposing Release cites academic studies regarding the economic analysis and notes that “there are several reasons to expect that this effect, including its impact on corporate control, would be limited.” However, not much detail is provided
  - Little economic analysis is provided with respect to the changes related to derivatives

# Prior Updates to Schedules 13D & 13G

- Dodd Frank Act (2010)
  - Provided SEC with authority to adopt rules to shorten the 10-day filing period
  - Amended Section 13(d)(1) by providing the SEC with authority to require beneficial ownership reporting of security-based swaps
- Brokaw Act (proposed; not enacted)
  - Introduced in 2016 by US Senators Tammy Baldwin and Jeff Merkley
  - Would have amended Sections 13(d) and 13(g) to shorten the Schedule 13D reporting period to four days
  - Would have modified the definition of “beneficial ownership” by
    - Making it broader and including pecuniary and indirect pecuniary interests, and
    - Setting a methodology for calculating beneficial ownership in the context of derivative instruments



# Filing Deadlines, Amendments and Formats

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- The proposed changes to the deadlines differ depending on the type of investor
  - Passive Investors are subject to shorter deadlines than Qualifying Institutional Investors (“QIIs”) and Exempt Investors
- QIIs are eligible to file a 13G pursuant to Rule 13d-1(b) and are permitted to file an initial report on 13G within 45 days of year-end
- Passive Investors are eligible to file a 13G pursuant to Rule 13d-1(c) within 10 days of acquisition
- Exempt Investors are eligible to file a Schedule 13G pursuant to Rule 13d-1(d) as are investors who acquired their greater than 5 percent stake pre-IPO within 45 days of year-end



# Filing Deadlines, Amendments and Formats *(cont'd)*

- Proposed changes:
  - **Rule 13d-1(a)** – an investor that exceeds 5 percent of a covered class of equity security (generally, a “covered class” means a voting class of equity securities registered under Section 12 of the Exchange Act) would need to file within five days instead of 10 days
  - **Rules 13d-1(e), (f), and (g)** – an investor who forfeits eligibility to report on Schedule 13G instead of 13D would need to file a Schedule 13D within five days after the event causing ineligibility instead of 10 days
  - **Rule 13d-2(a)** – amendments to Schedule 13D for material changes would need to be filed within one business day after the occurrence of the material change (currently “promptly”)
  - **Rules 13(d)-1(b) and (d)** – the initial Schedule 13G filing deadline for QIIs and Exempt Investors would be within five business days after the month in which beneficial ownership first exceeds 5 percent of a covered class instead of within 45 days after calendar year-end
  - **Rule 13d-1(c)** – Passive Investors would need to file a Schedule 13G within five days of exceeding 5 percent of a covered class instead of 10 days

# Filing Deadlines, Amendments and Formats *(cont'd)*

- **Rule 13d-2(b)** – amendments to Schedule 13G would need to be filed within five business days after the end of the month in which a reportable change occurs instead of 45 days after calendar year-end (but the Proposed Amendments raise the threshold for what constitutes a reportable change from “any change” to a “material change”)
- **Rule 13d-2(c)** – QIIs would need to amend a Schedule 13G within five days of exceeding 10 percent of a covered class instead of 10 days after the month in which such change occurred
  - New five-day deadline would apply for any additional deviation of more than 5 percent of a covered class (deadlines would apply to such percentage changes at any time during the month)
- **Rule 13d-2(d)** – Passive Investors would need to amend a Schedule 13G one business day after exceeding 10 percent of a covered class instead of “promptly” after the ownership change
  - The new one business day deadline would apply for any additional deviation of more than 5 percent of a covered class
- Extending “cut-off” time for filing Schedules 13D and 13G and any amendments from 5:30 p.m. ET to 10:00 p.m. ET on a business day
- Schedules 13D and 13G will need to be filed using a structured, machine-readable data language (*i.e.*, filed with XML-based language for ease of investor access)

# Filing Deadlines, Amendments and Formats (cont'd)

Issue	Current Schedule 13D	Proposed New Schedule 13D	Current Schedule 13G	Proposed New Schedule 13G
<b>Initial Filing Deadline</b>	Within 10 days after acquiring beneficial ownership of more than 5 percent or losing eligibility to file on Schedule 13G. Rules 13d-1(a), (e), (f) and (g).	Within 5 days after acquiring beneficial ownership of more than 5 percent or losing eligibility to file on Schedule 13G. Rules 13d-1(a), (e), (f) and (g).	<u>QIIs &amp; Exempt Investors</u> : 45 days after calendar year-end in which beneficial ownership exceeds 5 percent. Rules 13d-1(b) and (d). <u>Passive Investors</u> : Within 10 days after acquiring beneficial ownership of more than 5 percent. Rule 13d-1(c).	<u>QIIs &amp; Exempt Investors</u> : 5 business days after month-end in which beneficial ownership exceeds 5 percent. Rules 13d-1(b) and (d). <u>Passive Investors</u> : Within 5 days after acquiring beneficial ownership of more than five percent. Rule 13d-1(c).
<b>Amendment-Triggering Event</b>	Material change in the facts set forth in the previous Schedule 13D. Rule 13d-2(a).	No amendment proposed – material change in the facts set forth in the previous Schedule 13D). Rule 13d-2(a).	<u>All Schedule 13G Filers</u> : Any change in the information previously reported on Schedule 13G. Rule 13d-2(b). <u>QIIs &amp; Passive Investors</u> : Upon exceeding 10 percent beneficial ownership or a 5 percent increase or decrease in beneficial ownership. Rules 13d-2(c) and (d).	<u>All Schedule 13G Filers</u> : Material change in the information previously reported on Schedule 13G. Rule 13d-2(b). <u>QIIs &amp; Passive Investors</u> : No amendment proposed – upon exceeding 10 percent beneficial ownership or a 5 percent increase or decrease in beneficial ownership. Rules 13d-2(c) and (d).
<b>Amendment Filing Deadline</b>	Promptly after the triggering event. Rule 13d-2(a).	Within one business day after the triggering event. Rule 13d-2(a).	<u>All Schedule 13G Filers</u> : 45 days after calendar year-end in which any change occurred. Rule 13d-2(b). <u>QIIs</u> : 10 days after month-end in which beneficial ownership exceeded 10 percent or there was, as of the month-end, a 5 percent increase or decrease in beneficial ownership. Rule 13d-2(c). <u>Passive Investors</u> : Promptly after exceeding 10 percent beneficial ownership or a 5 percent increase or decrease in beneficial ownership. Rule 13d-2(d).	<u>All Schedule 13G Filers</u> : 5 business days after month-end in which a material change occurred. Rule 13d-2(b). <u>QIIs</u> : 5 days after exceeding 10 percent beneficial ownership or a 5 percent increase or decrease in beneficial ownership. Rule 13d-2(c). <u>Passive Investors</u> : 1 business day after exceeding 10 percent beneficial ownership or a 5 percent increase or decrease in beneficial ownership. Rule 13d-2(d).
<b>Filing “Cut-Off” Time</b>	5:30 p.m. ET. Rule 13(a)(2) of Regulation S-T.	10:00 p.m. ET. Rule 13(a)(4) of Regulation S-T.	<u>All Schedule 13G Filers</u> : 5:30 p.m. ET. Rule 13(a)(2) of Regulation S-T.	<u>All Schedule 13G Filers</u> : 10:00 p.m. ET. Rule 13(a)(4) of Regulation S-T.



# Cash-Settled Derivatives

# Change Beneficial Ownership Status of Holders of Certain Cash-Settled Derivatives

- Currently, under Rule 13d-3, holders of derivatives that are settled “in kind” or that otherwise convey a right to acquire a covered class are considered “beneficial owners” of the covered class
- A holder of a derivative that provides nothing more than economic exposure to the reference security has generally not been considered a beneficial owner of the reference security
- Proposed Rule 13d-3(e) would deem certain holders of cash-settled “derivatives” to have beneficial ownership of the reference equity securities, causing the derivatives position to be counted toward the reporting thresholds of Section 13(d)
- Definition of “derivative security” is definition used for Section 16 purposes, which is very broad
  - Rule 16a-1(c) – a “derivative security” generally means any option, warrant, convertible security, stock appreciation right, or similar right, with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an “equity security.”
- Derivative securities with a floating exercise price excluded from definition of derivative security

# Change Beneficial Ownership Status of Holders of Certain Cash-Settled Derivatives *(cont'd)*

- Proposed Rule 13d-3(e)(1) would provide that a holder of a cash-settled derivative security, other than a security-based swap, will be “deemed” the beneficial owner of the reference equity securities if the derivative is held:
  - With the purpose or effect of changing or influencing the control of the issuer of the reference securities, or
  - In connection with or as a participant in any transaction having such purpose or effect
- Disclosure of large positions in security-based swaps would be addressed under a proposal issued in December 2021 relating to a new Rule 10B-1

# Calculation of Underlying Reference Securities

- The number of equity securities that a holder of a cash-settled derivative will be deemed to beneficially own will be the larger of:
  - The product of (x) the number of securities by reference to which the amount payable under the derivative security is determined multiplied by (y) the delta of the derivative security, and
  - The result of (x) dividing the notional amount of the derivative security by the most recent closing market price of the reference equity security, and then (y) multiplying such quotient by the delta of the derivative security
    - This calculation must be performed on a daily basis based on each day's closing price
  - If a derivative security has a variable delta, then, under either calculation, the delta must be calculated daily
- For purposes of these calculations, only long positions should be counted, and short positions, whether direct or synthetic, should not be netted or otherwise taken into account

# Disclosure Requirements Under Item 6 of Schedule 13D

- Item 6 of Schedule 13D requires beneficial owners to describe any contracts, arrangements, understandings or relationships (legal or otherwise) among the persons named in Item 2 of Schedule 13D and between such persons and any person with respect to any securities of the issuer
- Cash-settled derivatives are not expressly included among the examples of contracts subject to Item 6
- Proposed revisions to Item 6 would expressly include derivative instruments, including cash-settled, security-based swaps and other derivatives settled exclusively in cash, which use the issuer's securities as a reference security






# Acting as a Group Under Rule 13d-5

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- Currently, the term “group” is not defined
  - The level of coordinated activity by two or more persons that would render them a “group,” and, thus, subject them to regulation as a “person,” has been a factual question
  - Many courts have determined that an agreement among group members to act together is a prerequisite to a finding that there is a “group”
- SEC proposed to amend Rule 13d-5 to clarify that forming a group does not require an agreement
  - A person who shares information about such person’s upcoming Schedule 13D filing, to the extent that this information is not yet public and is communicated with the purpose of causing others to make purchases, and a person who subsequently purchases the issuer’s securities based on this information would be deemed to have formed a group within the meaning of Section 13(d)(3)
  - A group will be deemed to have acquired beneficial ownership of the securities of any market participant with whom the large blockholder communicates material information regarding the impending filing obligation



# Exemptions From the Application of Sections 13(d) and 13(g)

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- Two or more persons will not be deemed to have acquired beneficial ownership of, or otherwise beneficially own, an issuer's equity securities as a group solely because of their concerted actions related to an issuer or the issuer's equity securities, including engagement with one another, provided:
  - Communications among or between such persons are not undertaken with the purpose or 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
  - Such persons, when taking such concerted actions, are not directly or indirectly obligated to take such actions

# Exemptions From the Application of Sections 13(d) and 13(g) *(cont'd)*

- Two or more persons (including financial institutions acting as derivatives counterparties) will not be deemed to have formed a group solely by virtue of their entrance into an agreement governing the terms of a derivative security. Exemption is only available:
  - If entered into in the ordinary course of business, and
  - If the agreement is a bona fide purchase and sale agreement not entered into 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.



# Impact on Section 16

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- The proposed amendments to Rules 13d-3, 13d-5 and 13d-6 would impact an analysis under Rule 16a-1(a)(1) as to whether a person is a 10-percent holder
  - By potentially expanding the definition of “beneficial owner,” the proposed rules may result in increasing the number of persons subject to Section 16 filing requirements



# Comment Period





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- Comments are due by the later of: 60 days following issuance (which is April 11, 2022), or 30 days following publication of the Proposing Release in the Federal Register



# Considerations for Shareholder Activism and M&A

# Shareholder Activism Limitations on Stake Building

- Proposed changes requiring initial 13D disclosure in 5 days could put additional pressure on ability of shareholder activists to establish meaningful stakes at acceptable value
  - 5% to 10% “sweet spot”
  - Buying beyond 5% would need to be done in shorter time, potentially resulting in higher per-share price
  - Stakebuilding concerns particularly impact activism for small- to mid-cap companies; less so for large-cap companies
- Inclusion of cash settled derivative securities in beneficial ownership calculations potentially eliminates an alternative for shareholder activists to increase returns

# Shareholder Activist Wolfpack Activities

- Proposed changes relating to shareholders acting as a “group” could impact activists forming and taking action in “wolfpacks”
  - Changes clarify that agreement to act is not necessary; whether or not a group exists is dependent upon facts and circumstances
  - A person that shares information regarding an imminent 13D filing with the intent for others to acquire the issuer’s securities, and a person that purchases the issuer’s securities based on such information, have formed a group (tipper/tippee)
  - New proposed exemption permitting shareholder communications and concerted actions would not apply to wolfpacks
  - Proposed changes may also increase risk for wolfpack becoming subject to Section 16

# M&A Considerations

- **Hostile Deals**: Given corporate defensive mechanisms currently available and systemic circuit breakers (such as HSR), proposed changes likely will not have a significant effect on hostile deal practice
- **13e-3 Going Private Transactions**: If a 13D filer is an affiliate of a registrant and the affiliate decides to engage in a 13e-3 going private transaction with the registrant, such intention will need to be disclosed in one business day (instead of “promptly”)
- **Poison Pills**: As state courts grapple with the permissibility of anti-wolfpack provisions and definitions of “beneficial ownership” that are used in shareholder rights plans (“poison pills”), they often refer to the federal securities laws for comparison. It is unclear at this point how much of an influence the proposed changes will have on state courts’ views of poison pill provisions
- **Appraisal Rights**: Proposed changes mean that appraisal arbitrage hedge funds will have a shorter window to accumulate stakes before disclosing their positions and alerting the market to their intent to exercise appraisal rights

# Supplemental Materials & Additional Resources

Read:

- [Legal Update: SEC Proposes Amendments to Schedules 13D and 13G](#)
- [Proposing Release: Modernization of Beneficial Ownership Reporting](#)
- [Press Release](#)



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