SULLIVAN & CROMWELL LLP

S&C memo

October 16, 2023

SEC Adopts Rule Amendments to Beneficial Ownership Reporting

SEC Accelerates Filing Deadlines for Schedule 13D and 13G Filers

SUMMARY

On October 10, 2023, the U.S. Securities and Exchange Commission (the "SEC") voted to adopt certain amendments to Regulation 13D-G and Regulation S-T. These amendments:

- accelerate the filing deadline for Schedule 13D beneficial ownership reports from 10 days to five business days and mandate that amendments be filed within two business days after a material change;
- accelerate the filing deadline for Schedule 13G beneficial ownership reports by Qualified Institutional Investors from 45 days after year-end to 45 days after quarter-end (a change that will require Qualified Institutional Investors to create systems to monitor new reportable holdings at the end of each quarter);[1]
- accelerate the filing deadlines for other Schedule 13G filings and mandate specific deadlines for amendments for all Schedule 13G filings as specified in Appendix A; and
- require that Schedule 13D and 13G filings be made using a structured, machine-readable data language.[2]

In a significant change from the proposed rules, the SEC did not adopt amendments to:

- deem holders of cash-settled derivative securities to be beneficial owners of the underlying reference equity securities when the derivative securities are held with a control intent;
- provide that a person becomes a member of a group if such person acquires securities after simply being notified that another person intends to file a Schedule 13D (the so-called "wolf pack" or "tipper–tippee" proposal);
- define when two or more persons "act as" a group; or
- add safe harbors from group status for communications among institutional investors and ordinary course derivative transactions.

As a result, aside from changes in filing and amendment deadlines, the amendments to the rules were relatively minor. However, as further discussed below, the SEC provides guidance in the Release on the application of existing rules related to the areas listed above.

BACKGROUND

Sections 13(d) and 13(g) of the Securities Exchange Act of 1934 (the "Exchange Act"), together with Regulation 13D-G promulgated thereunder, require investors or groups who beneficially own more than 5% of a covered class of securities to publicly report their beneficial ownership on Schedule 13D (for active investors) or Schedule 13G (for Qualified Institutional Investors, Passive Investors and Exempt Investors).[1] This legal framework is intended to provide adequate disclosure of information to the marketplace with respect to the accumulation of covered equity securities by persons who may have the ability to change or influence control of a given company.

On February 10, 2022, the SEC proposed amendments to Regulation 13D-G and Regulation S-T discussed in our Memorandum to Clients, dated February 14, 2022. During the comment period, which ended on June 27, 2023, the SEC received more than 850 comments.[3]

OVERVIEW OF THE FINAL AMENDMENTS

Accelerated Schedule 13D and 13G Filing Deadlines

The SEC changed the filing and amendment deadlines under Regulation 13D-G in the manner summarized in Appendix A.

In light of the changes to the filing time frames, the SEC amended Regulation S-T to extend the deadline for Schedule 13D and 13G filings deemed to be filed on a given business day from 5:30 p.m. Eastern time to 10 p.m. Eastern Time. Further, the SEC is adding a definition of "business day" for purposes of Regulation 13D-G to mean any day, other than Saturday, Sunday, or a Federal holiday, from 12:00 a.m. Eastern Time to 11:59 p.m. Eastern Time.

Disclosure of Derivative Securities

The SEC amended Item 6 to Schedule 13D to "further clarify" that filers are required to disclose derivative securities (including call options, put options, and security-based swaps) that such person holds that use the issuer's equity security as a reference security. Current Item 6 to Schedule 13D has generally been interpreted to require such disclosure already, and thus, we do not view this change as substantive.

Structured Data Requirements for Schedules 13D and 13G

Consistent with the SEC's goal to make it easier for investors and markets to access, compile, and analyze information that is disclosed with the SEC, the amendments require that Schedules 13D and 13G (including quantitative disclosures, textual narratives, and identification checkboxes but excluding exhibits) be filed using a structured, machine-readable data language (*i.e.*, an XML-based language).

ADDITIONAL SEC GUIDANCE

Applicability of Rule 13d-3 to Cash-Settled Derivative Securities

As noted above, the SEC did not adopt amendments to deem holders of cash-settled derivative securities beneficial owners of the underlying reference equity securities where the derivative securities are held with a control intent. Rather, in the Release, the SEC discusses the circumstances in which such holders may be deemed to be beneficial owners of the underlying reference securities under the existing legal framework, and indicated that its guidance is similar to the guidance that it provided in 2011 regarding the applicability of Rule 13d-3 to security-based swaps. This reaffirms existing law on the treatment of cash-settled derivatives.[4]

Under this guidance, a derivative may provide beneficial ownership of the underlying securities if the derivative:

- confers voting or investment power over the underlying securities;
- is used with the purpose or effect of directing or preventing beneficial ownership as part of a plan or scheme to evade reporting requirements; or
- grants a right to acquire an equity security.

In summary, derivatives are covered by the 13D/G framework only when they have voting rights or "rights to acquire" or are used to purposefully evade the disclosure regime.

Of particular note is a lengthy discussion by the SEC of how activists may begin to use cash-settled derivatives to avoid the now five business day filing requirement. The Release states that "cash-settled swaps and related derivatives do not generally give rise to beneficial ownership . . . [and] therefore generally fall outside the scope of the primary purpose of the Schedule 13D filings and the Section 13(d) beneficial reporting system."

Group Interpretations

Group Formation

The SEC did not adopt amendments to clarify whether an express or implied agreement among group members is a necessary precondition to the formation of a group under Sections 13(d) and 13(g) of the Exchange Act. The SEC instead provides guidance on the application of the existing rules.

The SEC reiterates that the group determination "depends on an analysis of all the relevant facts and circumstances and not solely on the presence or absence of an express agreement, as two or more persons may take concerted action or agree internally."[5] The SEC then goes on to acknowledge that, "to determine that a group has been formed under Section 13(d)(3) or 13(g)(3), the evidence must show, at a minimum, *indicia*, such as an informal arrangement or coordination in furtherance, of a common purpose to acquire, hold, or dispose of securities of an issuer."[6] The SEC makes clear its view that "similar actions" by two or more persons alone is not conclusive in-and-of-itself that a group has been formed.

Shareholder Engagement

The Release also provides questions and gives guidance on the application of Sections 13(d) and 13(g) to certain common types of shareholder engagement activities. These questions and answers are included in Appendix B. For the most part, these interpretations are consistent with prior SEC guidance. They provide that shareholders do not become members of a group by, among other things:

- jointly submitting non-binding shareholder proposals;
- communicating regarding an issuer or its securities in relation to improvement of long-term performance, changes in issuer practices, solicitations in support of non-binding shareholder proposals or a joint engagement strategy (not control related) or a "vote no" campaign in an uncontested director election without taking other action;
- communicating with management without taking other action; and
- making joint recommendations to an issuer regarding the structure and composition of its board of directors so long as no discussion about individual directors or board expansion occurs and no commitments are made or understandings reached among the shareholders on director voting.

The SEC further indicates that emails and phone and other conversations between a shareholder and an activist investor seeking support for the activist investor's proposal would not, without more, create a group under Sections 13(d) and 13(g).[7] Likewise, the SEC indicates that a public announcement by a shareholder of its intention to vote in favor of an unaffiliated activist investor's director nominees, without more, would not form a group.

As discussed above, the SEC did not adopt the proposed rule that a person would become a member of a group if that person acquired securities after having been notified that another person intended to file a Schedule 13D. That provision was designed, in part, to address concerns about so-called "wolf packs" and received substantial comment. However, the SEC states that if a person ("tipper"), in advance of filing a Schedule 13D, intentionally discloses to any other person ("tippee") that such filing will be made and does so for the purpose of causing the tippee to acquire securities in the same covered class, and as a direct result of such disclosure, the tippee acquires such securities, the tipper and tippee may be deemed to have formed a group under Sections 13(d) and 13(g). The SEC noted that the tippee under such circumstances would not have a filing obligation or become a member of the group until it actually acquires the securities (*i.e.*, the provision of the information alone does not create a group).

Entering into Derivative Securities

The SEC's proposal to treat cash-settled derivatives as creating beneficial ownership where a party to the cash-settled derivative had a control intent received many comments. As noted above, the SEC did not adopt this proposal, and since it did not adopt this proposal, it did not adopt the proposed safe harbor for ordinary derivative transactions. The SEC did, however, provide guidance on the application of the group concept to derivative securities.

The SEC generally does not believe derivative securities transactions between financial institutions and persons who acquire derivative securities in the ordinary course of business would create a group under Sections 13(d) and 13(g), notwithstanding an express agreement between the financial institution and the person governing the terms of the derivative security.[8] The SEC also states that this result is not changed by the fact that a counterparty to the derivative transactions purchases securities to hedge its position and holds the securities for the duration of the transaction so long as the financial institution did not enter into the derivative transaction with the purpose or effect of influencing control.

More generally, the SEC states that, absent either *indicia* of group status such as agreements to vote or other factors, a bilateral transaction, negotiated at arm's length, would not by itself be sufficient to create a group.[9]

COMPLIANCE DATES FOR FINAL AMENDMENTS

The amendments will become effective 90 days following their publication in the *Federal Register*. However, the SEC delayed the effectiveness of:

- the structured data requirement until December 18, 2024; and
- the new Schedule 13G filing deadlines until September 30, 2024 — for example, a Schedule 13G filer will need to file an amendment within 45 days of September 30, 2024, if there is a material change to the information previously reported on a Schedule 13G.

Compliance with the other rule amendments will be required upon their effectiveness.

TAKEAWAYS

Some potential takeaways of the amendments and guidance include:

- ***Accelerated Filings by Qualified Institutional Investors***: Under the existing rules, a Qualified Institutional Investor generally only has to file a Schedule 13G once a year within 45 days of year-end based on its holdings at year-end. The adopted amendments change this reporting regime dramatically. Qualified Institutional Investors will need to create systems to monitor new holdings of securities at the end of each quarter to comply with the amended Schedule 13G filing requirements, which, as described above, will become effective September 30, 2024. We expect this to be a significant undertaking for many Qualified Institutional Investors.
- ***Scope of Beneficial Ownership***: The proposed amendments would have expanded the meaning of "beneficial owner" to include persons who hold cash-settled derivative securities with a control purpose. Not only was this proposed amendment not adopted, but the SEC clarified that such securities generally do not give rise to beneficial ownership or trigger a Schedule 13D filing.
- ***Groups***: The proposed amendments would have also significantly increased the number of scenarios in which two or more persons may be deemed to have formed a group for purposes of Sections 13(d) and 13(g). Instead, the Release provides group formation guidance that is largely consistent with existing law and guidance, including as to transactions in derivative securities and certain shareholder engagement activities.

- ***Shareholder Activism***: The Release indicates that in 2022 approximately 29% of initial Schedule 13D filings would have been made within the amended five business day deadline. Shortening the deadline will therefore have a tangible effect in practice. The shorter deadline may reduce the number of shares that an activist can acquire at lower, pre-disclosure prices, thereby reducing the incentives for some activists to initiate campaigns. But the impact may not be that significant, since an activist is free to acquire positions through cash settled derivatives in a manner that delays or even eliminates the filing requirement.
- ***Unsolicited M&A Activity***: The shorter initial reporting deadlines could similarly impact certain M&A transactions by reducing an unsolicited acquirer's ability to acquire shares prior to alerting a target company, although in certain situations the requirement that an acquirer make a Hart-Scott-Rodino filing prior to purchasing more than a certain number of shares may limit the impact.

* * *

ENDNOTES

1 The Release uses the following nomenclature when referencing Schedule 13G filers: (a) "Qualified Institutional Investors" are persons eligible to file a Schedule 13G pursuant to Rule 13d-1(b); (b) "Passive Investors" are persons eligible to file a Schedule 13G pursuant to Rule 13d-1(c); and (c) "Exempt Investors" who are eligible to file a Schedule 13G pursuant to Rule 13d-1(d). For ease of reference, we use the terms in the same manner in this memo.

2 Modernization of Beneficial Ownership Reporting. SEC Release nos. 33-11253 and 34-98704 (Oct. 10, 2023) (the "Release").

3 The comment period initially ended on April 11, 2023 but was re-opened on April 28, 2023. The comment letters submitted in connection with the proposals are available at https://www.sec.gov/comments/s7-06-22/s70622.htm.

4 See the Release at 111, n. 463.

5 *Id.* at 132.

6 *Id*. at 132–133.

7 *Id*. at 136. However, the SEC suggests that a group may be formed if such person consents or commits to a course of action. *Id*.

8 *Id*. at 151–152.

9 *Id*. at 147.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 900 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers, or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

APPENDIX A

Issue	Current Schedule 13D	New Schedule 13D	Current Schedule 13G	New Schedule 13G
Initial Filing Deadline	Within 10 days after acquiring beneficial ownership of more than 5% or losing eligibility to file on Schedule 13G. Rules 13d-1(a), (e), (f) and (g).	Within five business days after acquiring beneficial ownership of more than 5% or losing eligibility to file on Schedule 13G. Rules 13d-1(a), (e), (f) and (g).	QIIs & Exempt Investors: 45 days after calendar year-end in which beneficial ownership exceeds 5%. Rules 13d-1(b) and (d). QIIs: 10 days after month-end in which beneficial ownership exceeds 10%. Rule 13d-1(b). Passive Investors: Within 10 days after acquiring beneficial ownership of more than 5%. Rule 13d-1(c).	QIIs & Exempt Investors: 45 days after calendar quarter-end in which beneficial ownership exceeds 5%. Rules 13d-1(b) and (d). QIIs: Five business days after month-end in which beneficial ownership exceeds 10%. Rule 13d-1(b). Passive Investors: Within five business days after acquiring beneficial ownership of more than 5%. Rule 13d-1(c).
Amendment Triggering Event	Material change in the facts set forth in the previous Schedule 13D. Rule 13d-2(a).	Same as current Schedule 13D: Material change in the facts set forth in the previous Schedule 13D. Rule 13d-2(a).	All Schedule 13G Filers: Any change in the information previously reported on Schedule 13G. Rule 13d-2(b). QIIs & Passive Investors: Upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rules 13d-2(c) and (d).	All Schedule 13G Filers: Material change in the information previously reported on Schedule 13G. Rule13d-2(b). QIIs & Passive Investors: Same as current Schedule 13G: upon exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rules 13d-2(c) and (d).
Amendment Filing Deadline	Promptly after the triggering event. Rule 13d-2(a).	Within two business days after the triggering event. Rule 13d-2(a).	All Schedule 13G Filers: 45 days after calendar year-end in which any change occurred. Rule 13d-2(b). QIIs: 10 days after month-end in which beneficial ownership exceeded 10% or there was, as of the month-end, a 5% increase or decrease in beneficial ownership. Rule 13d-2(c). Passive Investors: Promptly after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rule 13d-2(d).	All Schedule 13G Filers: 45 days after calendar quarter-end in which a material change occurred. Rule 13d-2(b). QIIs: Five business days after month-end in which beneficial ownership exceeds 10% or a 5% increase or decrease in beneficial ownership. Rule 13d-2(c). Passive Investors: Two business days after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership. Rule 13d-2(d).
Filing "Cut-Off" Time	5:30 p.m., Eastern time. Rule 13(a)(2) of Regulation S-T.	10 p.m., Eastern time. Rule 13(a)(4) of Regulation S-T.	All Schedule 13G Filers: 5:30 p.m., Eastern time. Rule 13(a)(2) of Regulation S-T.	All Schedule 13G Filers: 10 p.m., Eastern time. Rule 13(a)(4) of Regulation S-T.

APPENDIX B

Question: Is a group formed when two or more shareholders communicate with each other regarding an issuer or its securities (including discussions that relate to improvement of the long-term performance of the issuer, changes in issuer practices, submissions or solicitations in support of a non-binding shareholder proposal, a joint engagement strategy (that is not control-related), or a "vote no" campaign against individual directors in uncontested elections) without taking any other actions?

Response: No. In our view, a discussion whether held 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, alone and without more, would not be sufficient to satisfy the "act as a . . . group" standard in Sections 13(d)(3) and 13(g)(3). Sections 13(d)(3) and 13(g)(3) were intended to prevent circumvention of the disclosures required by Schedules 13D and 13G, not to complicate shareholders' ability to independently and freely express their views and ideas to one another. The policy objectives ordinarily served by Schedule 13D or Schedule 13G filings would not be advanced by requiring disclosure that reports this or similar types of shareholder communications. Thus, an exchange of views and any other type of dialogue in oral or written form not involving an intent to engage in concerted actions or other agreement with respect to the acquisition, holding, or disposition of securities, standing alone, would not constitute an "act" undertaken for the purpose of "holding" securities of the issuer under Section 13(d)(3) or 13(g)(3).

Question: Is a group formed when two or more shareholders engage in discussions with an issuer's management, without taking any other actions?

Response: No. For the same reasons described above, we do not believe that two or more shareholders "act as a . . . group" for the purpose of "holding" a covered class within the meaning of those terms as they appear in Section 13(d)(3) or 13(g)(3) if they simply engage in a similar exchange of ideas and views, alone and without more, with an issuer's management.

Question: Is a group formed when shareholders jointly make recommendations to an issuer regarding the structure and composition of the issuer's board of directors where (1) no discussion of individual directors or board expansion occurs and (2) no commitments are made, or agreements or understandings are reached, among the shareholders regarding the potential withholding of their votes to approve, or voting against, management's director candidates if the issuer does not take steps to implement the shareholders' recommended actions?

Response: No. Where recommendations are made in the context of a discussion that does not involve an attempt to convince the board to take specific actions through a change in the existing board membership or bind the board to take action, we do not believe that the shareholders "act as a . . . group" for the purpose of "holding" securities of the covered class within the meaning of those terms as they appear in Sections 13(d)(3) or 13(g)(3). Rather, we view this engagement as the type of independent and free exchange of ideas between shareholders and issuers' management that does not implicate the policy concerns addressed by Section 13(d) or Section 13(g).

Question: Is a group formed if shareholders jointly submit a non-binding shareholder proposal to an issuer pursuant to Exchange Act Rule 14a-8 for presentation at a meeting of shareholders?

Response: No. The Rule 14a-8 shareholder proposal submission process is simply another means through which shareholders can express their views to an issuer's management and board and other shareholders. For purposes of group formation, we do not believe shareholders engaging in a free and independent exchange of thoughts about a potential shareholder proposal, jointly submitting, or jointly presenting, a non-binding proposal to an issuer in accordance with Rule 14a-8 (or other means) should be treated differently from, for example, shareholders jointly meeting with an issuer's management without other indicia of group formation. Accordingly, where the proposal is non-binding, we do not believe that the shareholders "act as a . . . group" for the purpose of "holding" securities of the covered class within the meaning of those terms as they appear in Section 13(d)(3) or 13(g)(3). Assuming that the joint conduct has been limited to the creation, submission, and/or presentation of a non-binding proposal, those statutory provisions would not result in the shareholders being treated as a group, and the shareholders' beneficial ownership would not

be aggregated for purposes of determining whether the five percent threshold under Section 13(d)(1) or 13(g)(1) had been crossed.

Question: Would a conversation, email, phone contact, or meetings 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, constitute such coordination as would result in the shareholder and activist being deemed to form a group?

Response: No. Communications such as the types described, alone and without more, would not be sufficient to satisfy the "act as a . . . group" standard in Sections 13(d)(3) and 13(g)(3) as they are merely the exchange of views among shareholders about the issuer. This view is consistent with the Commission's previous statement that a shareholder who is a passive recipient of proxy soliciting activities, without more, would not be deemed a member of a group with persons conducting the solicitation. Activities that extend beyond these types of communications, which include joint or coordinated publication of soliciting materials with an activist investor might, however, be indicative of group formation, depending upon the facts and circumstances.

Question: Would an announcement or a communication by a shareholder of the shareholder's intention to vote in favor of an unaffiliated activist investor's director nominees, without more, constitute coordination sufficient to find that the shareholder and the activist investor formed a group?

Response: No. We do not view a shareholder's independently-determined act of exercising its voting rights, and any announcements or communications regarding its voting decision, without more, as indicia of group formation. This view is consistent with our general approach towards the exercise of the right of suffrage by a shareholder in other areas of the Federal securities laws. Shareholders, whether institutional or otherwise, are thus not engaging in conduct at risk of being deemed to give rise to group formation as a result of simply independently announcing or advising others—including the issuer—how they intend to vote and the reasons why.

Question: If a beneficial owner of a substantial block of a covered class that is or will be required to file a Schedule 13D intentionally communicates to other market participants (including investors) that such a filing will be made (to the extent this information is not yet public) with the purpose of causing such persons to make purchases in the same covered class, and one or more of the other market participants make purchases in the same covered class as a direct result of that communication, would the blockholder and any of those market participants that made purchases potentially become subject to regulation as a group?

Response: Yes. To the extent the information was shared by the blockholder with the purpose of causing others to make purchases in the same covered class and the purchases were made as a direct result of the blockholder's information, 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). Such purchases may implicate the need for public disclosure underlying Section 13(d)(3) and these purchases could potentially be deemed as having been undertaken by a "group" for the purpose of "acquiring" securities as specified under Section 13(d)(3). Given that a Schedule 13D filing may affect the market for and the price of an issuer's securities, non-public information that a person will make a Schedule 13D filing in the near future can be material. By privately sharing this material information in advance of the public filing deadline, the blockholder may incentivize the market participants who received the information to acquire shares before the filing is made. Such arrangements also raise investor protection concerns regarding perceived unfairness and trust in markets. The final determination as to whether a group is formed between the blockholder and the other market participants will ultimately depend upon the facts and circumstances, including (1) whether the purpose of the blockholder's communication with the other market participants was to cause them to purchase the securities and (2) whether the market participants' purchases were made as a direct result of the information shared by the blockholder.