

NOW & NEXT

Securities Alert

FEBRUARY 23, 2022

SEC proposes significant changes to Regulation 13D-G

By Pierce Haesung Han and Lloyd H. Spencer

The SEC's proposed amendments to Regulation 13D-G are intended to increase transparency and provide more timely information to the public.



What's the Impact?

The proposed rules would:

- / accelerate the filing deadlines for Schedules 13D and 13G beneficial ownership reports including amendments
- / expand and clarify circumstances relating to beneficial ownership and group formation
- / require Schedules 13D and 13G to be filed using XML-based language

On February 10, 2022, the U.S. Securities and Exchange Commission (the "SEC") announced a comprehensive [proposal to amend the rules](#) governing beneficial ownership reporting under Sections 13(d) and 13(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").

Filing deadlines for Schedules 13D and 13G

In an effort to address concerns that the current deadlines for Schedule 13D and 13G filings are creating information asymmetries in the market and in recognition of the technological advances and the use of modern information technology in today's market, the SEC is proposing changes to its rules to revise the current filing deadlines for such filings.

If adopted, the proposed rules would require filers to meet the new deadlines described below:

FILING	CURRENT DEADLINE	PROPOSED DEADLINE
Initial Schedule 13D	Within 10 days after the person acquires beneficial ownership of more than 5% of an issuer's registered equity securities, or lost the ability to file on Schedule 13G	Within 5 days after the person acquires beneficial ownership of more than 5% of an issuer's registered equity securities, or lost the ability to file on Schedule 13G
Amendments to Schedule 13D	Promptly after a material change in the facts set forth in initial Schedule 13D or any amendment to Schedule 13D	Within 1 business day after a material change in the facts set forth in initial Schedule 13D or any amendment to Schedule 13D
Initial Schedule 13G	<i>For qualified institutional investors (QIIs):</i> Within 45 days after the calendar year-end (i.e., February 14) in which beneficial ownership exceeds 5% of an issuer's registered equity securities, or within 10 days after the month-end in which beneficial ownership 10% of an issuer's registered equity securities <i>For exempt investors¹:</i> Within 45 days after the calendar year-end (i.e., February 14) in which beneficial ownership exceeds 5% of an issuer's registered equity securities	<i>For QIIs and exempt investors:</i> Within 5 business days after the month-end in which beneficial ownership exceeds 5% of an issuer's registered equity securities <i>For passive investors:</i> Within 5 days after acquiring beneficial ownership of more than 5% of an issuer's registered equity securities

¹ The term "exempt investors" refers to persons holding beneficial ownership of more than 5% of an issuer's registered equity securities at the end of the calendar year, but who have not made an acquisition of beneficial ownership subject to Section 13(d).

*For passive investors*²: Within 10 days after acquiring beneficial ownership of more than 5% of an issuer's registered equity securities

Amendments to Schedule 13G

For all: Within 45 days after the calendar year-end (i.e., February 14) following any change in the facts set forth in initial Schedule 13G or any amendment to Schedule 13G
For QIIs: 10 days after month-end in which beneficial ownership exceeds 10% or there was, as of the month-end, a 5% increase or decrease in beneficial ownership
For passive investors: Promptly after exceeding 10% beneficial ownership or a 5% increase or decrease in beneficial ownership

For all: Within 5 business days after the month-end following any material change in the facts set forth in initial Schedule 13G or any amendment to Schedule 13G
For QIIs: Within 5 days after acquiring beneficial ownership of more than 10% of an issuer's registered equity securities, or a 5% increase or decrease in beneficial ownership of an issuer's registered equity securities
For passive investors: Within 1 business day after acquiring beneficial ownership of more than 10% of an issuer's registered equity securities, or a 5% increase or decrease in beneficial ownership of an issuer's registered equity securities

In addition, the proposed rules would extend the EDGAR filing "cut-off" times for Schedules 13D and 13G from 5:30 p.m. to 10:00 p.m. Eastern time. In connection with this proposal to extend the cut-off times, the SEC is proposing to eliminate a temporary hardship exemption for Schedules 13D and 13G filings.

Cash-settled derivative securities

The proposed amendments would add a new paragraph to Rule 13d-3 to provide that holders of cash-settled derivative securities will be deemed beneficial owners of the registered equity securities referenced by such derivative securities, if such holders hold the derivative securities

² The term "passive investors" refers to beneficial owners of more than 5% but less than 20% of an issuer's registered equity securities 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.

with the intent to influence control over the issuer, or in connection with or as a participant in any transaction having such intent.

To provide clarity on the meaning of “beneficial ownership,” the SEC adopted Rule 13d-3, which provides standards for the purpose of determining whether a person is a beneficial owner subject to Section 13(d). Rule 13d-3(a) provides that a person who directly or indirectly has or shares voting or investment power is a beneficial owner. The SEC noted that holding derivatives that, by their terms, entitle the holder to nothing more than economic exposure to registered equity securities historically has not been considered sufficient to constitute beneficial ownership. The SEC also noted that, over the years, commenters have raised concerns about the fact that current Rule 13d-3 fails to explicitly address the circumstances in which an investor in a cash-settled derivative may influence or control an issuer by pressuring a counterparty to make certain decisions regarding the voting and disposition of substantial blocks of securities. The SEC indicated that, although holders of derivatives settled exclusively in cash ordinarily would lack the express legal power under the terms of such instruments to direct the voting or disposition of registered equity securities, such holders may possess economic power that can be used to produce desired outcomes through engagement with a counterparty or the issuer of the reference security and potentially could impact the stock price. Further, in the SEC’s view, cash-settled derivatives imitate the economic performance of a direct investment in an issuer’s equity securities and, in turn, may economically empower the holders of such derivatives to influence the issuer or the price of its securities. Thus, the SEC is proposing new Rule 13d-3(e), designed to make information available about any large positions in cash-settled derivative securities and, by implication, the related reference securities.

The proposed new rule would also set forth the formula for calculating the number of equity securities that a holder of a cash-settled derivative will be deemed to beneficially own. The proposed rule provides that the number of securities that a holder of a cash-settled derivative security will be deemed to beneficially own will be the larger of: (i) 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 delta³ of the derivative security; and (ii) the number of securities calculated by (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. The notes to the proposed rule would provide that when calculating the number of securities that a holder of such derivative security will be deemed to beneficially own pursuant to the new rule, the calculation described in (ii) above should be performed on a daily basis.

³ The proposed rule defines “delta” to mean, with respect to a derivative security, the ratio that is obtained by comparing (i) the change in the value of the derivative security to (ii) the change in the value of the reference equity security. If a derivative security does not have a fixed delta (i.e., if the delta is variable and changes over the term of the derivative security), then a person who holds such derivative security should calculate the delta on a daily basis, for purposes of determining the number of equity securities that such person will be deemed to beneficially own, based on the closing market price of the reference equity security on that day.

The proposed Rule 13d-3(e) would exclude security-based swaps, as defined in Section 3(a)(68) of the Exchange Act and the rules and regulations thereunder. By excluding security-based swaps, the new rule would not be subject to Section 13(o) of the Exchange Act. Section 13(o) provides that a person shall be “deemed” a beneficial owner of an equity security based on the purchase or sale of a security-based swap “only to the extent that the Commission determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security.”

Further, Item 6 of Schedule 13D would be revised to expressly state that interests in all derivative securities (including cash-settled derivative securities) that use the issuer’s equity security as a reference security must be disclosed to comply with Rules 13d-1(a) and 13d-101.

Formation of a “Group”

In the proposing release, the SEC stated that it is proposing amendments to Rule 13d-5 to clarify and affirm its application to two or more persons who “act as” a group under Sections 13(d)(3) and (g)(3) of the Exchange Act. The determination of whether coordinated efforts among two or more persons constitutes a group subject to regulation as a single “person” under these two statutory provisions is a question of fact. The SEC stated that when it adopted Rule 13d-5(b) it was addressing situations in which the factual record does not establish the existence of an acquisition attributable to a group, and that following its adoption, an acquisition by a group could be “deemed” to occur even in the absence of an associated market-based purchase or other transaction. Thus, it was defining “acquisition” and not “group.”

Rule 13d-5(b)(1) provides that “[w]hen two or more persons agree to act together for the purpose of acquiring, holding, voting or disposing of equity securities of an issuer, the group formed thereby shall be deemed to have acquired beneficial ownership, for purposes of sections 13(d) and (g) of the Act, as of the date of such agreement, of all equity securities of that issuer beneficially owned by any such persons.” The SEC notes that in rendering opinions regarding group formation, some courts have suggested that a group can only be formed if an agreement exists among its purported members, and that these decisions suggest that a plaintiff must prove, and by extension, a court must affirm, the presence of an agreement for purposes of satisfying the legal standards in Rule 13d-5(b)(1). The SEC goes on to clarify its view that the existence of an agreement between two or more persons to act together is not a necessary condition for group formation.

In an effort to clarify the SEC’s views, the proposed amendments would amend Rule 13d-5 to track the statutory text of Sections 13(d)(3) and (g)(3) and be revised to, among other things, remove the reference to an “agreement” between two or more persons and instead state that when two or more persons “act as” a group under Sections 13(d)(3) and (g)(3), the group will be deemed to have acquired beneficial ownership of all of the registered equity securities

beneficially owned by each of the group's members as of the date on which the group was formed. In other words, an agreement between two or more parties is not a requirement to form a "group"; rather, the parties only need to act together to be deemed a group.

The proposed rules would also amend Rule 13d-5 to provide that a person who shares non-public information about an upcoming Schedule 13D filing that such person will be required to make and with the purpose of "tipping" another person to make purchases, and such person subsequently purchases the issuer's securities based on such information, will be deemed to have formed a group and acquired beneficial ownership as of the earliest date on which the "tippee" received such non-public information. The proposed rule would not apply to communications with professionals necessary for the preparation and filing of the Schedule 13D.

Additionally, the proposed amendments clarify that a group will be deemed to acquire any securities acquired by a group member after the date the group was formed, and that any intra-group transfers of securities would not be deemed additional acquisitions by the group.

Lastly, the proposal would create two new exemptions related to group formation. Two or more persons would not be deemed to have formed a group solely based on: (i) their concerted actions related to an issuer or its securities, including engagement or communication with one another or the issuer, so long as such engagement or communication are not made with the intent to influence control over the issuer, and (ii) their entrance into an agreement governing the terms of a derivative security provided it is a bona fide purchase and sale agreement entered into in the ordinary course of business.

XML-based language requirements for Schedules 13D and 13G

If adopted, the proposed rules would require that Schedules 13D and 13G be filed using an XML-based language specific to Schedule 13D and 13G. All information disclosed on the Schedules, including any quantitative disclosures, textual narratives, and checkboxes would need to be structured using the specific XML-based language, while exhibits filed with the Schedules would remain unstructured.

Section 16 implications

Section 16 of the Exchange Act was designed both to provide the public with information about securities transactions and holdings of every person who is the beneficial owner of more than 10% of a class of equity security registered under Section 12. Rule 16a-1(a)(1) defines 10% holders under Section 16 as persons deemed 10% beneficial owners under Section 13(d) and the rules thereunder. 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. Consequently, holders of cash-settled derivative securities could become 10% holders subject to Section 16, and more holders may be deemed to be acting as a group, such as tipper-tippees, that are 10% holders. On the other hand, with additional exemptions from being deemed to have formed a group, certain holders will be less likely to be a 10% holder subject to Section 16. The SEC is seeking public comment on the Section 16 implications resulting from the proposed amendments to Rules 13d-3, 13d-5, and 13d-6.

What's next?

The proposed rules are subject to a 60-day public comment period following publication of the proposing release on the SEC's website or 30 days following publication of the proposed release in the *Federal Register*, whichever period is longer.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

Pierce Haesung Han

202.585.8139

phan@nixonpeabody.com

Lloyd H. Spencer

202.585.8303

lspencer@nixonpeabody.com
