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# HISTORICAL SHAREHOLDER ENGAGEMENT PRACTICES PUT UNDER MICROSCOPE DUE TO MID-PROXY SEASON GUIDANCE FROM SEC

*One of the more striking developments to emerge from the 2025 proxy season was the decision by the staff in the Division of Corporation Finance at the US Securities and Exchange Commission to issue updated guidance in the form of Compliance and Disclosure Interpretations in February 2025 — the peak of proxy season — addressing certain activity in connection with shareholder engagement and activism. The guidance sought to clarify when investor engagement with issuers — especially engagement that may be deemed to exert pressure or seeks to influence control — may cause passive investors to lose eligibility to report beneficial ownership on Schedule 13G and require transition to the more disclosure-intensive Schedule 13D. The Staff's timing prompted a swift and widespread response from both investors and issuers. This article examines these developments, along with the resulting market reactions, practical considerations and strategic adjustments now facing investors and issuers as they navigate the 2025 proxy season and beyond.*

By Reid S. Hooper and Justin A. Kisner *

## 'PASSIVE' INTENT AND 'SHORT-FORM' SCHEDULE 13G REPORTING

The beneficial ownership reporting regime of the US Securities and Exchange Commission ("SEC") is primarily governed by Section 13(d) and Section 13(g) of the Securities Exchange Act of 1934, as amended ("Exchange Act"). These sections require that beneficial owners of more than 5% of a voting class of equity securities registered under Section 12 of the Exchange Act report their beneficial ownership on a Schedule 13D or, if eligible, a Schedule 13G. The "long-form" Schedule 13D requires significant disclosure regarding, among other things, plans or proposals with respect to the issuer, transactions in securities of the issuer, and agreements with respect to securities of the issuer, as well as the reporting person's beneficial ownership of the relevant class. The "short-form" Schedule 13G requires substantially less disclosure, focusing primarily on the reporting person's beneficial ownership of the relevant class, and, unlike Schedule 13D, does not require a description of any plans or proposals of the reporting person that would result in significant transactions with the issuer. The purpose of beneficial ownership reporting is to promote market transparency through the timely public dissemination of accurate

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information, particularly regarding shareholder engagement and activist initiatives, thereby creating a clearer picture of the ownership and influence dynamics of publicly traded companies.

Many institutional investors report on Schedule 13G in reliance on Rule 13d-1(b) under the Exchange Act, which provides an exemption from reporting on Schedule 13D for qualified institutional investors ("QIIs") that acquire securities in the covered class in the ordinary course of business, and not with the purpose nor with the effect of changing or influencing control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect.[1] Institutional investors also report beneficial ownership of covered securities on Schedule 13G relying in many cases on Rule 13d-1(c) under the Exchange Act, which provides an exemption from reporting on Schedule 13D for non-QIIs with beneficial ownership of less than 20% of a covered class and that acquire and hold such securities without the purpose or effect of changing or influencing control of the issuer of such securities, and that were not acquired in connection with or as a participant in any transaction having such purpose or effect (passive investors).[2]

In 1998 — 21 years after exempting QIIs from reporting on Schedule 13D — the SEC adopted Rule 13d-1(c) to expand the eligibility to file on Schedule 13G to passive investors.[3] The SEC stated that the amendments were necessary and would "improve the effectiveness of the beneficial ownership reporting scheme" because the existing reporting scheme "imposed unnecessary disclosure obligations on persons whose acquisitions do not affect the control of issuers," given that many Schedule 13D filings at that time did not implicate the primary goal of Section 13(d) of the Exchange Act — market transparency of rapid accumulations and changes in stock ownership that might affect the control of a public company.[4]

Accordingly, the SEC viewed the shifting of passive investors to Schedule 13G as benefiting all market participants because it would allow market participants, as well as the staff of the SEC, "to focus more quickly on acquisitions involving the potential to change or influence control."[5] However, in opening Schedule 13G eligibility to passive investors, the SEC acknowledged that certain shareholder engagements, particularly those relating to corporate governance and control matters, could result in certain investors having a disqualifying purpose or effect of "influencing" control of the issuer, depending on the circumstances.[6] Ever since, investors have been comfortable that certain corporate governance stewardship activities do not trigger a disqualifying purpose or effect of influencing control of an issuer.

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[1] The SEC exercised its exemptive powers under the Exchange Act in 1977 to adopt Rule 13d-5, which permitted certain institutional investors to file a short-form acquisition notice in lieu of Schedule 13D. Rel. No. 34-13291 (1977), describing the SEC's adoption of new Rule 13d-5 and related new Form 13D-5, which permitted brokers, dealers, banks, investment companies, investment advisers, and employee benefit plans to utilize an abbreviated disclosure notice. Rule 13d-5 was subsequently redesignated as Rule 13d-1(b)(1) in 1978. Rel. No. 34-14692 (1978).

[2] A different category of investors, known as "exempt investors," are exempt from filing a Schedule 13D in reliance on Rule 13d-1(d) under the Exchange Act. "Exempt investors" are a category of investors who may make their initial filing on Schedule 13G to report that their beneficial ownership exceeds 5% of a covered class of securities. This category includes investors who acquired their beneficial ownership prior to the issuer registering such class of securities — such as founders and pre-initial public offering investors, investors who have not acquired 2% or more

*footnote continued from previous column…*

of the outstanding covered class of securities within a consecutive 12-month period, and investors whose beneficial ownership increased to more than 5% of a covered class because of issuer share repurchases or other issuer transactions. Accordingly, unlike QIIs and passive investors, exempt investors are not required to certify a passive intent when filing a Schedule 13G.

[3] Rel. No. 34-39538 (1998).

[4] *Id.*

[5] *Id.*

[6] *Id.*

However, in an attempt to improve clarity and provide more consistency in how certain shareholder engagement should be disclosed under the beneficial ownership reporting regime, the SEC's staff of the Division of Corporation Finance ("SEC staff") issued materially updated guidance on February 11, 2025, in the form of Compliance and Disclosure Interpretations ("C&Dis") on Regulation 13D-G addressing the circumstances under which shareholder engagement with an issuer's management on a particular topic would cause shareholders to hold securities with a disqualifying "purpose or effect of changing or influencing control of the issuer" and, therefore, trigger a loss of eligibility to report beneficial ownership on Schedule 13G.[7] If eligibility is lost, such shareholders are required to transition and report beneficial ownership on Schedule 13D within five business days of losing eligibility to report on schedule 13G.[8]

Published in the middle of the 2025 proxy season, the SEC staff's updated guidance reinforces the long-standing analysis that traditional shareholder activism is likely to require a shareholder to transition from Schedule 13G to Schedule 13D if the shareholder approaches issuer's management with control-related recommendations. The updated guidance also refines the SEC's prior guidance by emphasizing how the context in which an engagement occurs, in addition to the subject matter, may factor into determining a "passive" intent.

## 'PASSIVE' INTENT — A MORE REFINED APPROACH

For context, C&DI Question 103.11 is framed within the context of the Hart-Scott-Rodino ("HSR") Act, which provides an exemption from the HSR Act's notification and waiting period provisions if, among other things, the acquisition of securities is made "solely for the purpose of investment," with the acquiror having "no intention of participating in the formulation, determination, or direction of the basic business decisions of the issuer." Revised C&DI Question 103.11 reaffirms the SEC staff's view that an investor's *inability* to rely on the HSR Act's exemption from notification and waiting period requirements for an acquisition made "solely for the purpose of investment" does *not* disqualify it from using Schedule 13G. Instead, the SEC staff reminded QIIs and passive investors that continued eligibility to report on Schedule 13G depends on a fact-specific analysis of whether they acquired or are holding the covered securities with the purpose or effect of changing or influencing "control" of the issuer, and that "control" means "the power to direct or cause the direction of the [issuer's] management and policies. . . whether through the ownership of voting securities, by contract, or otherwise."[9]

Fundamentally, the SEC staff's new C&DI Question 103.12 withdraws a portion of the prior iteration of C&DI Question 103.11, which stated that engagement on particular topics, such as executive compensation, environmental and social ("E&S") issues, and certain corporate governance topics, would not, on its own, and when "not undertaken with the purpose or effect of changing or influencing control," preclude investors from reporting on Schedule 13G. Essentially, the prior guidance did not meaningfully elaborate upon the SEC's reliance in the 1998 rule amendments (broadening the Schedule 13G exemption to include passive investors) on a facts-and-circumstances analysis when analyzing whether certain shareholder engagements fit within the purpose of Schedule 13G.

New C&DI Question 103.12 deviates from the general standard set forth in the 1998 rule amendments and the prior iteration of C&DI Question 103.11 by emphasizing that shareholder engagement may constitute an attempt to influence or control issuers if it involves an attempt to exert pressure on management to take specific actions or change policy. The updated guidance retains a facts-and-circumstances approach that looks to the "subject matter of the engagement," but refines the analysis by highlighting the "context in which the engagement occurs" as an important factor in determining whether the shareholder is holding the issuer's securities with a disqualifying purpose or effect of "influencing" control of the issuer.[10] As examples of activity that may constitute attempts to influence control, new C&DI Question 103.12 cites common topics in investment stewardship engagement on the part of institutional investors that have in the past filed on Schedule 13G, such as:

- Explicitly or implicitly conditions voting support of one or more director nominees upon the issuer's adoption of the shareholder's recommendation that the issuer:
  - — remove its staggered board;
  - — switch to a majority voting standard in

[7] Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, Compliance and Disclosure Interpretations, Questions 103.11 and 103.12 (2025).

[8] Exchange Act Rule 13d-1(e)(1).

[9] Exchange Act Rule 12b-2.

[10] C&DI Question 103.12.

uncontested director elections;

— eliminate its poison pill plan;

— change its executive compensation practices;

— undertake specific actions on an E&S issue or political policy; and/or

- Discusses with management its voting policy on a particular topic and how the issuer fails to meet the shareholder's expectations on such topic, and, to apply pressure on management, states or implies during any such discussions that it will not support one or more of the issuer's director nominees at the next director election unless management makes changes to align with the shareholder's expectations.

In many ways, the new guidance protects ordinary course engagement that is less likely to be considered an attempt to change or influence control of the issuer (e.g., general governance, executive compensation, or E&S issues) while putting a spotlight on investor-initiated or investor-driven engagements that result in investors pressuring an issuer to take certain actions or implement policy changes, including through conditioning director support on such actions and changes.

## IMPACT OF NEW GUIDANCE AND SHAREHOLDER ENGAGEMENT CONSIDERATIONS

Because the distinction between purely informative discussions and engagement that "pressures" an issuer's management to adopt practices consistent with an investor's views can be difficult to define in practice, the new guidance led to some institutional investors, including BlackRock and Vanguard, the two largest asset managers in the US, to temporarily pause shareholder engagement meetings with US public companies due to concerns that such meetings could cause them to lose Schedule 13G eligibility. Many institutional investors, including BlackRock and Vanguard, have since resumed their shareholder engagement meetings with an emphasis on their "passive" investor role at the outset of each engagement.[11]

Given that the new guidance has the potential to be disruptive due to its release during the heart of the 2025 proxy season, investors for whom Schedule 13G eligibility is a priority will need to carefully evaluate their ability to continue their planned issuer-specific engagement and, in some cases, are expected to modify their processes when engaging with issuer's management.[12] The following is a summary of such potential modifications and considerations:

- **Historical engagement tactics**. Some investors may abandon certain historical engagement tactics, such as targeted discussions over governance or policy, in favor of publicly available policies describing their positions and reliance on issuer disclosures, particularly annual meeting proxy statements and E&S reports, when making voting determinations.

- **Setting the agenda**. Investors may be cautious about requesting an engagement and may defer to issuer's management regarding control over the timing, structure, and substance of the engagement. As a result, the new guidance is likely to result in issuers having more leverage in setting the agenda and ensuring that certain issues are prioritized. To the extent that investors suggest agenda topics, investors are likely to be less prescriptive with their questions and more engaged in "listening mode." Questions from investors are more likely to be open-ended, and issuer's management should be prepared to respond with adequate context to ensure investors understand the issuer's position and rationale.

- **General governance topics favored over targeted discussions**. Productive engagements are more likely to be had over general governance topics (e.g., board composition and refreshment) and executive compensation as opposed to control-related governance topics (e.g., eliminating antitakeover charter provisions) or requests for specific E&S policy actions.

- **Responding to issuer-driven questions**. Investors who merely respond to inquiries from issuers about

[11] Ross Kerber, "Vanguard Resumes Stewardship Meetings After Reviewing SEC Guidance," Reuters (March 3, 2025), https://www.reuters.com/business/finance/vanguard-resumes-stewardship-meetings-after-reviewing-sec-guidance-2025-03-03; Ross Kerber, "BlackRock Resumes Stewardship Talks After Reviewing New ESG Guidance," Reuters (February 20, 2025), https://www.reuters.com/ sustainability/blackrock-resumes-stewardship-talks-after-reviewing-new-esg-guidance-2025-02-21.

[12] Because the context in which an engagement occurs has been highlighted as an important factor in determining whether an investor holds securities with a disqualifying purpose or effect of "influencing" control of the issuer, off-season ordinary course engagements, particularly issuer-initiated engagements, are likely to pose less of a risk of losing Schedule 13G eligibility.

their views on particular corporate governance or E&S issues, including how their views may inform their voting decisions, are not likely to have a disqualifying purpose or effect of "influencing" control of the issuer, provided that the investor response does not condition their vote on the issuers reacting favorably to their recommendation. In addition, investors will likely not respond to questions about how they intend to vote and may be perceived as less responsive as compared to recent years.

- **Investor advocacy**. Advocating for governance or E&S initiatives is not likely to have a disqualifying purpose or effect of "influencing" control of the issuer, provided that the investor does not condition their vote on the issuer reacting favorably to their advocacy and recommendations. For example, discussions regarding nonbinding proposals, such as votes on issuer management's say-on-pay proposals, and discussions with non-proponents regarding shareholder proposals are likely to present less risk of being viewed as applying pressure on issuer's management or attempting to influence control of the issuer.

In sum, the SEC staff's updated guidance represents a significant mid-proxy season development for investors and issuers, and it may take the better part of the 2025 proxy season and beyond for investors and issuers to evaluate — and perhaps reformulate — their shareholder engagement strategies in the face of the SEC's increased scrutiny of investment stewardship engagement. However, the recent guidance is not divorced from the SEC's historical approach to beneficial ownership reporting, as it reinforces the long-standing approach to traditional shareholder engagement and activism, and refines the SEC's prior guidance with an emphasis on engagement as a factor that may impact Schedule 13G eligibility. With the benefit of a proxy and annual meeting season in the rearview mirror and measured adjustments to shareholder engagement strategies, the SEC staff's updated guidance is not likely to significantly chill the type of routine engagements that many investors and issuers have become accustomed to over the years. ■