

SEC Adopts Amendments to Beneficial Ownership Reporting Rules: What Investors Need To Know

October 30, 2023

On October 10, 2023, the Securities and Exchange Commission (SEC) adopted amendments to Regulation 13D – G under the Securities Exchange Act of 1934, as amended (Exchange Act), which govern the beneficial ownership reporting requirements of a person acquiring more than 5% beneficial ownership of a voting class of equity securities registered under Section 12 of the Exchange Act.

Most significantly, the amendments impact initial filing deadlines for Schedules 13D and 13G, as well as amendments to those schedules. The SEC also provided guidance on current legal standards related to beneficial ownership reporting – including with respect to the treatment of cash-settled derivative instruments and the circumstances in which a "group" may be considered to exist under the beneficial ownership rules.

In this alert, we summarize these amendments and provide practical takeaways for investors to consider when updating beneficial ownership reporting processes and timelines.

Sections 13(d) and 13(g) of the Exchange Act 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 short-form Schedule 13G.

Rule 13d-3(a) of the Exchange Act provides that a beneficial owner includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise has or shares voting or investment power. This includes the right to acquire shares of a voting class of registered equity securities upon conversion or exercise of other securities – such as preferred stock, promissory notes, warrants or options. Pursuant to SEC rules, more than one person can be considered to beneficially own the same securities. For example, in the fund context, shares held by a fund are generally considered to be owned by the fund and the fund's general partner entity (and, depending on the circumstances, possibly the managers of the general partner).

There are generally four types of filers of beneficial ownership reports under Section 13 of the Exchange Act:

- Schedule 13D (Rule 13d-1(a)). Any person who acquires beneficial ownership of more than 5% of a voting class of registered equity securities is required to file a statement on Schedule 13D, unless the filer is eligible to file a Schedule 13G.
- Schedule 13G
 - Qualified institutional investors (Rule 13d-1(b)). Certain qualified institutional investors (Qlls) such as registered broker-dealers, banks, registered investment advisers, registered investment companies and insurance companies may report their beneficial ownership on Schedule 13G, provided that the institution has acquired shares in the ordinary course of business and without the purpose or effect of changing or influencing control of the company.
 - Passive investors (Rule 13d-1(c)). Certain investors who otherwise do not qualify as Qlls may report their beneficial ownership on Schedule 13G, provided that the investor beneficially owns less than 20% of a voting class of registered equity securities and has not acquired such shares with the purpose or effect of changing or influencing control of the company. Generally, in the eyes of the SEC, a fund with an individual serving on the board of a portfolio company is considered to be ineligible to file on Schedule 13G as a passive investor.
 - Exempt investors (Rule 13d-1(d)). This refers to a category of investors who may make their initial filing on
 Schedule 13G to report that their beneficial ownership exceeds 5% of a voting class of registered equity securities.

This category includes investors who acquired their beneficial ownership prior to the company registering such class of securities – such as founders and pre-initial public offering (IPO) investors, investors who have not acquired 2% or more 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 company share repurchases or other company transactions.

Determining which of these filings applies to an investor's holdings of a particular portfolio company can be very fact-specific and nuanced. Accordingly, an investor that beneficially owns more than 5% of a voting class of registered equity securities should consult outside counsel to confirm the appropriate Schedule 13D or Schedule 13G filing status.

Key aspects of the new rules – including changes to the filing deadlines for initial and amended Schedules 13D and 13G – are described in further detail below.

Background

The SEC adopted the amendments to Regulation 13D – G, particularly, the acceleration of the filing deadlines to report beneficial ownership disclosure on initial and amended Schedules 13D and 13G, in response to long-standing calls from market participants to modernize the beneficial ownership reporting rules, considering technological advances and changes in the financial markets. The amended rules will require investors to implement and/or redesign systems that permit them to closely monitor their beneficial ownership and initiate drafts and supporting documentation of initial and amended filings more promptly. Although the SEC recognized that the amended rules may impose challenges for certain smaller investors, in adopting the rule changes, the SEC concluded that a modernization of the reporting regime was important to improve the operation and efficacy of beneficial ownership reporting to reduce information asymmetries in the market for investor protection.

Summary of changes to filing deadlines for Schedules 13D and 13G

As a general matter, the rule changes accelerate the filing deadlines for investors filing Schedules 13D and 13G, as well as amendments to those filings. The current and amended filing requirements for Schedules 13D and 13G are summarized in the following table:

Filing	Current filing deadlines	Amended filing deadlines	
Schedule 13D Rule 13d-1(a), (e), (f) and (g); Rule 13d-2(a)			
Initial filing	10 calendar days after acquiring more than 5% of beneficial ownership or losing eligibility to file on Schedule 13G	5 business days after acquiring more than 5% of beneficial ownership or losing eligibility to file on Schedule 13G	
Amended filings	Promptly after the date on which a material change occurs	2 business days after the date on which a material change occurs	
Schedule 13G Qualified institutional investors (Qlls) Rule 13d-1(b): Rule 13d-2(b) and (c)			

Filing	Current filing deadlines	Amended filing deadlines
Initial filing	45 calendar days after the end of the calendar year in which beneficial ownership exceeds 5% at year-end; 10 calendar days after the end of the first month in which beneficial ownership exceeds 10% at monthend	45 calendar days after the end of the calendar quarter in which beneficial ownership exceeds 5% at quarter-end 5 business days after the end of the first month in which beneficial ownership exceeds 10% at month-end
Amended filings	Annual amendment: 45 days after the end of the calendar year in which any change occurred (not including changes in percentage ownership due to fluctuations in number of shares outstanding)	Quarterly amendment: 45 days after the end of the calendar quarter in which any material change occurred (not including changes in percentage ownership due to fluctuations in number of shares outstanding)
	Amendments: 10 calendar days after the end of the first month in which beneficial ownership exceeds 10% at month-end	Amendments: 5 business days after the end of the first month in which beneficial ownership exceeds 10% at month-end
	Thereafter, 10 days after the end of the first month in which beneficial ownership, as of month-end, increases or decreases by more than 5%	Thereafter, within 5 business days after the end of any month in which beneficial ownership increases or decreases by more than 5%

Schedule 13G
Passive investors
Rule 13d-1(c); Rule 13d-2(b) and (c)

Initial filing	10 calendar days after acquiring more than 5% beneficial ownership	5 business days after acquiring more than 5% beneficial ownership
Amended filings	Annual amendment: 45 calendar days after the end of the calendar year in which any change occurred (not including changes in percentage ownership due to fluctuations in number of shares outstanding)	Quarterly amendment: 45 calendar days after the end of the calendar quarter in which any material change occurred (not including changes in percentage ownership due to fluctuations in number of shares outstanding)
	Amendments: Promptly after acquiring more than 10% beneficial ownership Thereafter, promptly after beneficial ownership increases or decreases by more than 5%	Amendments: 2 business days after acquiring more than 10% beneficial ownership Thereafter, within 2 business days after beneficial ownership increases or decreases by more than 5%

Filing	Current filing deadline Schedule 13G Exempt investors Rule 13d-1(d); Rule 13d-	Amended filing deadlines 2(b)
Initial filing	45 calendar days after the end of the calendar year in which beneficial ownership exceeds 5% at year-end	45 days after the end of the calendar quarter in which beneficial ownership exceeds 5% at quarter-end
Amended filings	Annual amendment: 45 calendar days after the end of the calendar year in which any change occurred (not including changes in percentage ownership due to fluctuations in number of shares outstanding)	Quarterly amendment: 45 calendar days after the end of the calendar quarter in which any material changes occurred (not including changes in percentage ownership due to fluctuations in number of shares outstanding)

Key takeaways on the amendments to Regulation 13D – G

Schedule 13D

Investors must be mindful of whether a transaction will trigger an amended filing. Historically, Schedule 13D filers have often taken liberties in interpreting the meaning of the term "promptly" when filing amendments, generally without significant consequence. Under amended Rule 13d-2(a), the precision of the two-business day requirement will make adherence to the timeliness of Schedule 13D amendments a priority.

For example, Rule 13d-2(a) provides that the acquisition or disposition of a number of shares exceeding 1% of the outstanding registered class of security is considered per se material, thereby triggering an amendment to a Schedule 13D. However, in practice, it has not been uncommon for investors, particularly venture funds, triggering such amended filings to allow several days to elapse before filing the required amendment. As filers embark on transactions –including open-market purchases or sales and distributions in kind – it will be critically important to closely monitor the quantity of shares being acquired or disposed of and be prepared to file an amended Schedule 13D within the two-business day deadline. This could be especially challenging in the event of transactions effected pursuant to Rule 10b5-1 trading plans, given that investors do not control the timing of such transactions. For funds utilizing Rule 10b5-1 trading or distribution plans, the parameters of those plans will need to be closely monitored to ensure that the fund is prepared to file any required Schedule 13D amendment within two business days of any material change in previously reported information.

Schedule 13G

Funds will have to adjust their quarter-end regulatory processes to also reflect beneficial ownership reporting. The rule changes to Schedule 13G filers are likely to have a more profound impact on funds. What has historically largely been an annual exercise for funds – taking place between December 31 and February 14 – will now transition to a quarterly exercise. Many funds are already required to report certain ownership positions on a quarterly basis through the filing of Form 13Fs or potentially amend their large trader reports through Form 13H filings, which are subject to amendment on a quarterly basis. For those funds, the new Schedule 13G rules will likely be folded into their existing quarter-end regulatory process for Form 13F and/or Form 13H. For other funds not currently subject to these filing regimes, the rule changes to Schedule 13G will likely require the establishment of a new process to identify potential Schedule 13G filing triggering events on a quarterly basis.

The introduction of a materiality concept to the amended Schedule 13G filing requirements will require all funds to establish a new process for assessing the materiality of developments, including transactions effected in the covered class of securities, in order to determine whether an amendment has been triggered. For example, when a fund engages in a transaction involving public company securities, the fund will need to promptly make a preliminary assessment of the materiality of the transaction to determine whether it – either alone or in

combination with other changes that were previously determined to be immaterial – constitutes a material change. If it is determined that a material change has occurred, the fund should be prepared to make a required filing at the end of the relevant quarter. Determination of whether a change is "material" will be heavily fact-dependent and potentially subject to second-guessing with the benefit of hindsight. Accordingly, funds should not wait until the end of the quarter to begin the process of assessing whether amendments are required, and they should consider consulting outside counsel to assist in this assessment.

The SEC clarified in the adopting release that the rules governing amended Schedules 13D and 13G will now share the same materiality standard for determining when an amendment is triggered. As a result, the SEC stated that the Schedule 13D amendment trigger relating to any acquisitions or dispositions of 1% or more of the outstanding class of securities is equally instructive for Schedule 13G purposes.

New guidance and rules on cash-settled derivative securities

Generally, the holder of a cash-settled derivative security has historically not been considered to beneficially own the reference equity securities of the derivative position in the absence of an agreement or understanding with the counterparty's respect to the voting or disposition of such reference equity securities.

In response to concerns that holders of certain cash-settled derivative securities could exert indirect influence over an issuer via a counterparty to a derivative transaction, the SEC proposed amending Rule 13d-3(e) to provide that any person with a control purpose that held cash-settled derivatives (other than security-based swaps) would be deemed to beneficially own the reference equity securities of the derivative position. After reviewing the comments received on the proposed amendments, rather than adopting rule changes, the SEC elected to issue guidance to clarify the circumstances under which a holder of cash-settled derivative securities (other than security-based swaps) could be viewed as beneficially owning the reference equity securities.

In developing its guidance, the SEC adopted an analysis similar to the guidance it had previously provided with respect to security-based swaps. 1 Under the SEC's guidance, a holder of a cash-settled derivative security may be deemed the beneficial owner of the reference equity securities if:

- The derivative security provides its holder, directly or indirectly, with exclusive or shared voting or investment power over the reference equity security through a contractual term of the derivative security or otherwise.
- The derivative security is acquired with the purpose or effect of divesting itself of beneficial ownership of the reference equity security or preventing the vesting of that beneficial ownership as part of a plan or scheme to evade the reporting requirements of Sections 13(d) or 13(g) of the Exchange Act
- The holder has the right to acquire beneficial ownership of the reference equity security within 60 days or acquires the right to acquire beneficial ownership of the reference equity security with the purpose or effect of changing or influencing control of the company, regardless of when the right is exercisable.²

In addition to the above guidance, the SEC also adopted amendments to the text of Item 6 of Schedule 13D to expressly state that interests in all derivative securities, including cash-settled derivative securities, relating to the covered class of registered equity securities must be disclosed. No similar disclosure requirement exists with respect to cash-settled derivatives for filers of Schedule 13G.

Key takeaways on SEC guidance for cash-settled derivative securities

Funds should carefully evaluate the terms of their derivative securities. In recent years, venture funds have with increasing frequency acquired cash-settled derivative securities, including total return swaps, as a means of

gaining additional economic exposure to portfolio companies. The SEC's guidance will require funds to evaluate whether the investment in cash-settled derivatives will be considered beneficial ownership of the underlying reference security. To reduce the risk that such arrangements would result in the fund being deemed to beneficially own the reference security, a fund investing in a cash-settled derivative should ensure that the derivative security does not provide the fund with the right to settle the derivative in stock. In addition, funds also should be clear not to take any actions that would influence the counterparty's voting or disposition of the securities that it may acquire to hedge its economic exposure.

New guidance and rules on formation of a 'group'

Sections 13(d)(3) and 13(g)(3) of the Exchange Act state that a "group" is formed when two or more persons act as a group for purposes of acquiring, holding or disposing of company securities. Rule 13d-5(b)(1) under the Exchange Act states that a "group" is formed when two or more persons agree to act together for purposes of acquiring, holding, voting or disposing of company securities. The purpose of the "group" rules is to treat investors who act together as a single "person" under the beneficial ownership rules, thereby requiring such investors to file reports on Schedules 13D or 13G when they collectively beneficially own in excess of 5% of a registered class of equity security. Without this concept, multiple investors could work together to achieve control of public companies without public disclosures, thereby frustrating the policy of the SEC's beneficial ownership rules. In response to questions regarding whether the coordinated behavior of investors – even in the absence of an agreement among investors to do so – could, in certain circumstances, constitute a "group," the SEC proposed amendments to Rule 13d-5(b) to codify its view that the existence of a "group" is based on facts and circumstances and not merely on the presence or absence of an express agreement among investors to act together.

Although the SEC declined to codify the definition of a "group" as proposed, it issued guidance in the adopting release reiterating its views that the relevant legal standard for determining the existence of a "group" remains rooted in Sections 13(d)(3) and 13(g)(3), which do not require express agreements among investors, notwithstanding the language in Rule 13d-5 that refers to an agreement. Under the guidance, circumstances that may suggest the formation of a "group" include informal arrangements or concerted actions by two or more persons in furtherance of a common purpose to acquire, hold or dispose of company securities. Importantly, the SEC's guidance highlights that the determination is based on an analysis of all the relevant facts and circumstances and not solely on the presence or absence of an express agreement.

During the comment period on the proposed rule, many commenters expressed concerns regarding the ability of investors to engage in ordinary course discussions with management and other investors, including activists, regarding company policies. To address concerns raised in these comments, the SEC provided a helpful nonexhaustive list of common types of shareholder engagement activities that – without more – will not amount to the formation of a "group."

As part of the amendments, the SEC did approve rule changes to clarify that any acquisition of beneficial ownership by a group member after the date of group formation is an acquisition of beneficial ownership by the group, and that intra-group transfers of securities by group members do not constitute an acquisition of beneficial ownership by the group.

Key takeaways on SEC guidance regarding formation of a 'group'

Funds should evaluate internal processes and controls with respect to shareholder communications. It is not uncommon for funds to engage, from time to time, in discussions with other shareholders of a portfolio company – particularly in the context of a potential strategic transaction involving the company. As a general matter, funds should exercise caution when engaging in such discussions to reduce the likelihood that the fund will be considered to have formed a group with other investors. These risks are heightened when the discussions with other investors relate to the acquisition, disposition, holding or voting of equity securities of the portfolio

company. If the facts and circumstances of such communications are determined to create a group, it could trigger Section 13 filing or reporting requirements under Section 16 of the Exchange Act and potentially expose the fund to risk of liability for short-swing profits under Section 16.

If a fund determines that engaging in such communications is nevertheless appropriate, it should be clear that any such communications are for discussion purposes only. Additionally, care should be taken to not express any agreement or coordination with respect to the acquisition, disposition, holding or voting of equity securities. Funds also should avoid communicating to other investors any decision with respect to such matters to reduce the risk that the investors will be considered to be involved in concerted action that would constitute formation of a group.

Impact on investors

What investors should do now

The amendments and guidance demonstrate the importance that the SEC is placing on Section 13 beneficial ownership filing requirements. These requirements can be quite complex – including determination of whether a fund is required to file a Schedule 13D or is permitted to file a Schedule 13G. Moreover, depending on the circumstances, investors filing a Schedule 13G may be subject to differing amendment requirements. Finally, in certain circumstances, funds may have the ability to switch between Schedule 13D and Schedule 13G.

The amended rules and guidance are very nuanced, and subtle differences in facts can often trigger very different filing and disclosure requirements. Accordingly, investors are well advised to consult outside counsel with respect to these matters and should consult outside counsel well in advance of any portfolio company going public – whether that be via the traditional IPO process, de-SPAC transaction, reverse acquisition or direct listing.

Investors should take the following actions now:

- Take time to understand the new filing deadlines and guidance regarding derivative securities. Investors should familiarize themselves with the beneficial ownership reporting regime and ensure they understand how the current rules operate, along with understanding the implications of the recently adopted rule changes. Funds should take extra care to evaluate their current portfolio of public company securities to understand, for each portfolio company for which the fund files a Schedule 13G, whether the fund is filing the Schedule 13G as a QII, passive investor or exempt investor, along with the applicable amendment triggers.
- Review internal processes and controls governing transactions. Investors should consult with their investment team to
 ensure they have processes in place to monitor and, where possible, anticipate future transactions that could trigger filing
 requirements.
- Develop a plan to meet the new filing deadlines. Investors should develop or, as necessary, enhance the fund's
 processes for coordinating with outside counsel for the preparation and timely submission of required filings. For example,
 investors who file on Schedule 13G will now need to consider whether an amendment is required on a quarterly basis rather
 than annually.
- Be thoughtful about shareholder engagement activities. Investors should consult with outside counsel prior to engaging in meaningful shareholder engagement activities to avoid potentially taking steps that may be deemed, in hindsight, to constitute coordinated action in furtherance of a common purpose to acquire, hold or dispose of a company's securities thus resulting in formation of a "group."

Administrative rule changes

Extended EDGAR (Electronic Data Gathering, Analysis, and Retrieval system) filing deadlines

In connection with the accelerated filing deadlines, the amendments extend the end of the filing day for Schedules 13D and 13G from 5:30 pm to 10:00 pm ET, thus aligning Section 13 filings with the approach that has been in place for Section 16 filings for many years. In light of the accelerated deadlines for Section 13 filings under the amended rules, this change will be a welcome accommodation for investors.

Structured data requirements

Effective December 18, 2024, Schedules 13D and 13G must be filed using an XML-based language. This

requirement applies to all disclosures (other than exhibits) – including quantitative disclosures, textual narratives and identification checkboxes – and will be a significant adjustment, given that the process will likely require more involvement from third parties (e.g., financial printers) experienced in tagging such information and compress the timeline for investors to comply with accelerated filing requirements.

Compliance dates

The adopted amendments will become effective 90 days after publication of the adopting release in the Federal Register. However, compliance with the new initial and amended Schedule 13G deadlines will be required beginning on September 30, 2024.

Although compliance with the structured data requirements is not mandatory until December 18, 2024, voluntary compliance is permitted beginning on December 18, 2023.

More information on the new rules is available in the <u>SEC's adopting release</u> and accompanying <u>press release</u> and fact sheet.

Notes

- 1. See Section IC of the SEC's security-based swaps release, No. 34-64628 (June 8, 2011).
- 2. The SEC emphasized that it does not matter if the right to acquire the reference equity security originates in a derivative security that is nominally "cash-settled," because if the right creates an entitlement to acquire the reference equity security within 60 days, then the rules related to beneficial ownership reporting will be deemed to apply.

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