

# SEC Adopts Final Rules to Amend Beneficial Ownership Reporting Rules

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## Overview

On October 10, 2023, the SEC adopted rule amendments related to Section 13 beneficial ownership reporting rules (the “**Final Rules**”). In brief, the Final Rules accelerate the filing deadlines for Schedules 13D and 13G, provide guidance on the formation of a “group” and provide guidance on the treatment of cash-settled derivatives. The Final Rules adopted by the SEC addressed the concerns raised in many of the comment letters. The final rulemaking is the culmination of a deliberative and thorough process undertaken by Chair Gensler, the other SEC Commissioners, and its staff members. We believe the end result is a final rule that balances the considerations of all market participants and achieves a principal purpose of the SEC, which is to maintain fair, orderly and efficient markets and facilitate capital formation. Further details of the rule amendments are provided below.

## Accelerated Schedule 13D and 13G Filing Deadlines

Section 13(d) and Section 13(g) of the Securities Exchange Act of 1934, as amended (the “**Exchange Act**”) require any person (or group of persons acting together) who acquires beneficial ownership of more than 5% of any class of equity securities to make certain disclosures regarding their identity and intentions on a Schedule 13D or,

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if eligible,<sup>1</sup> on a short-form Schedule 13G.

Under the current reporting regime, Schedule 13D filers have 10 calendar days after crossing the 5% ownership threshold to file a Schedule 13D, and must amend the filing “promptly” upon any material changes to the information reported. Under the Final Rules, the deadline to file a Schedule 13D is shortened to five business days, and the deadline to amend a Schedule 13D is fixed at two business days after any material changes.

The two business day deadline to amend a Schedule 13D also resolves some uncertainty among investors with respect to certain situations involving the decision to sell securities. The current reporting regime, which requires an amendment be made “promptly” upon any material change in the information provided, led some market participants to believe that an amendment was required immediately upon a decision to sell a material amount of securities (which is 1% or more of the issuer’s securities or could be a lower amount depending on the facts or circumstances of a position). Such amendment to the Schedule 13D would be triggered under Item 4 of Schedule 13D as soon as there was a plan to sell a material amount of securities, which could happen prior to any actual sales taking place. This lack of clarity led to inconsistency in the timing of Schedule 13D amendments in sale circumstances and created uncertainty in the markets. By fixing the deadline at two business days, the Final Rules provide valuable clarity to investors that once a material change occurs, investors are obligated to file an amendment within two business days but also have this period to execute sales prior to disclosing the information.

With respect to Schedule 13G filers, the applicable deadlines to file an initial Schedule 13G, under both the current reporting regime and the Final Rules, depend on the type of filer and amount of beneficial ownership. In general, the Final Rules accelerate the timeline in which an initial Schedule 13G is to be filed, as discussed below:

- Qualified Institutional Investors (“QII”)
  - *Initial Filing; Beneficial Ownership >5%:* Under the current regime, QIIs have **45 days after the end of the calendar year** in which they crossed the 5% ownership threshold to file a Schedule 13G. The Final Rules require a QII to file a Schedule 13G within **45 days after the end of the quarter** in which they crossed the 5% ownership threshold.
  - *Initial Filing; Beneficial Ownership >10%:* Under the current regime, QIIs have **10 calendar days** after the end of the month in which they crossed the 10% ownership threshold to file a Schedule 13G. The Final Rules require a QII to file a Schedule 13G within **5 business days** after the end of the month in which they crossed the 10% ownership threshold.

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- Passive Investors
    - *Initial Filing; Beneficial Ownership >5%:* Under the current regime, passive investors have **10 calendar days** after crossing the 5% ownership threshold to file a Schedule 13G. The Final Rules require a passive investor to file a Schedule 13G within **5 business days** of crossing the 5% ownership threshold.
  - Exempt Investors
    - *Initial Filing; Beneficial Ownership >5%:* Under the current regime, exempt investors have **45 days after the end of the calendar year** in which they crossed the 5% ownership threshold to file a Schedule 13G. The Final Rules require exempt investors to file a Schedule 13G within **45 days after the end of quarter** in which they crossed the 5% threshold.

The Final Rules also call for more frequent amendments to Schedule 13G. For example, under the current regime, all Schedule 13G filers have to amend their Schedule 13G within 45 days after the **end of the calendar year** in which **any change** to the information reported in the previous Schedule 13G occurred. The Final Rules, however, provide that Schedule 13G filers must amend their Schedule 13G within **45 days after the end of the quarter** in which a **material change** to the information reported in the previous Schedule 13G occurred.

Given the shortened filing deadlines, the Final Rules extend the EDGAR filing “cut-off” times for Schedules 13D and 13G from 5:30 p.m. to 10:00 p.m. Eastern Time.

## Guidance on Cash-settled Derivatives

The SEC originally proposed amending the beneficial ownership reporting rules so that certain holders of cash-settled derivative securities would be considered beneficial owners of the underlying securities. Following input from commenters, the SEC ultimately declined to adopt the proposed amendments, and instead, offered guidance in its adopting release as to the particular circumstances in which a holder of a cash-settled derivative could be deemed a beneficial owner of the underlying security, including: (i) when the cash-settled derivative confers voting or investment power over the underlying security; (ii) when the cash-settled derivative is used to divest the holder of or prevent the vesting of beneficial ownership or to evade reporting requirements; or (iii) when the cash-settled derivative grants the holder a right to acquire beneficial ownership of the underlying security (x) within 60 days or (y) with a control purpose. In our view, the guidance accurately describes current law, and should assist in achieving uniformity in the practice.

Additionally, the SEC amended Item 6 of Schedule 13D, which currently requires that the filer describe any contracts, arrangements, understandings or relationships they have with respect to any securities of the issuer, to clarify that disclosure of interests in all derivative securities, including cash-settled derivatives, is required to be disclosed.

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## Guidance on Group Status

Under Section 13(d)(3) and Section 13(g)(3) of the Exchange Act, two or more persons acting together as a “group” must also report their beneficial ownership on Schedule 13D or Schedule 13G, as applicable, if they acquire beneficial ownership of more than 5% of any class of equity securities. Rule 13d-5(1) under the Exchange Act further provides that a group is formed “[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.”

In proposed amendments, the SEC considered amending the definition of “group” in Rule 13d-5. Following the comment period, the SEC determined not to adopt the proposed amendment, and instead issued guidance in the proposing release.

The SEC’s guidance centers around the circumstances in which a group may be formed. Although Rule 13d-5(b)(1) references that an agreement to act together must be present in order to be considered a “group,” the SEC clarified that no *express* agreement is required. Instead, two or more persons taking concerted actions for the purpose of acquiring, holding or disposing of securities may be sufficient to constitute a group. Again, we believe that the guidance is consistent with current law. To address concerns from commenters that this interpretation would chill shareholder engagement, the SEC’s guidance also includes a Q&A which identifies and discusses certain activities that commonly occur in the early stages of shareholder engagement with a company. These examples in the Q&A provide greater clarity and guidance on permissible shareholder activities that, without further action, would not in the SEC’s view constitute the formation of a group. We believe this SEC guidance is beneficial to market participants and provides greater clarity on many fact patterns that frequently arise.

## Additional Rule Amendments and Effective Dates

Consistent with the original proposed amendments, the Final Rules also require Schedule 13Ds and Schedule 13Gs (other than exhibits) be filed using a machine-readable, XML-based language.

The Final Rules will be effective 90 days after publication in the Federal Register, except that (i) compliance with the revised Schedule 13G deadlines will be required starting September 30, 2024, and (ii) compliance with the XML structured data requirement will apply December 18, 2024.

## Commentary

On February 10, 2022, the SEC proposed amendments to the Section 13 beneficial ownership rules that would have dramatically changed the reporting regime.

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Advocates who supported these rule changes argued such rule changes were warranted because they would provide investors with more timely information regarding the full economic interests of Schedule 13D filers that would enable investors to make informed investment and voting decisions and to decide whether to support or oppose an activist's proposals.<sup>2</sup> However, many industry participants and academics believed that the purported benefits of such rules were inconsistent with available evidence and law<sup>3</sup> and would stifle much productive market behavior that benefits all shareholders.<sup>4</sup> During the comment period, the SEC received over 850 comment letters and engaged in multiple meetings with a variety of market participants in order to consider all viewpoints. As Commissioner Uyeda remarked in his statement concerning the final rules, "[c]ollectively, these changes reflect a recognition by the Commission that 'a reduction in investment research and in significant shareholdings by [activist investors] could reduce market efficiency...because of the role that investments based on such research and analysis play in moving stock prices closer to their fundamental values.' Importantly, the Commission 'acknowledge[s] that benefits may stem from the information asymmetry between a Schedule 13D filer and the market,' which results 'from their own expenditures on research and analysis or from their efforts and expenditures to pursue changes at the issuers in which they accumulate these shareholdings.'"<sup>5</sup> We believe the final rulemaking is the culmination of a very thoughtful and deliberative process undertaken by Chair Gensler, the other SEC Commissioners, and its staff members. We believe the end result is a final rule that appropriately balances the considerations of all market participants and achieves a main purpose of the SEC, which is to maintain fair, orderly and efficient markets and facilitate capital formation.

1 Section 13(d) of the Exchange Act provides that certain investors — qualified institutional investors (Rule 13d-1(b)), passive investors (Rule 13d-1(c)) and exempt investors (Rule 13d-1(d)) — are eligible to report their beneficial ownership on a short-form Schedule 13G.

2 See, e.g., Letter from Wachtell, Lipton, Rosen & Katz to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n (Oct. 4, 2022), *available at* <https://www.sec.gov/comments/s7-06-22/s70622-20145487-310717.pdf>.

3 See Letter from the International Institute of Law and Finance to Vanessa A. Countryman, Sec'y, U.S. Sec. & Exch. Comm'n, at 6 (April 11, 2022), *available at* <https://www.sec.gov/comments/s7-06-22/s70622-20123323-279616.pdf> ("[T]he Proposed Rules are a significant departure from past Commission statements and policy...[and] contain assertions about 'information asymmetry' that are inconsistent with available evidence of law."). One of the authors of this article, Mr. Stephen Fraidin, is Chairman of the Board of Directors of the International Institute of Law and Finance.

4 See *id.* at 7 (“[A] more pressing concern for the Commission would be to encourage new forms of activism, not suppress them. Moreover...given the development of poison pills, public company boards are no longer monitored by hostile takeovers, so activism is the remaining recourse. It is important not to inhibit it.”). See also Mark T. Uyeda, Statement on Modernization of Beneficial Ownership Reporting (Oct. 10, 2023), *available* at <https://www.sec.gov/news/statement/uyeda-statement-modernization-beneficial-ownership-reporting-231010> (“Collectively, these changes reflect a recognition by the Commission that ‘a reduction in investment research and in significant shareholdings by [activist investors] could reduce market efficiency...because of the role that investments based on such research and analysis play in moving stock prices closer to their fundamental values.’ Importantly, the Commission ‘acknowledge[s] that benefits may stem from the information asymmetry between a Schedule 13D filer and the market,’ which results ‘from their own expenditures on research and analysis or from their efforts and expenditures to pursue changes at the issuers in which they accumulate these shareholdings.’”).

5 See Mark T. Uyeda, Statement on Modernization of Beneficial Ownership Reporting (Oct. 10, 2023), *available* at <https://www.sec.gov/news/statement/uyeda-statement-modernization-beneficial-ownership-reporting-231010>.

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National Law Review, Volume XIII, Number 299

Source URL: <https://natlawreview.com/article/sec-adopts-final-rules-amend-beneficial-ownership-reporting-rules>