SEC Adopts Amendments to Beneficial Ownership Reporting and Introduces Short Sale Disclosure Rules

Introduction

In October 2023, the Securities and Exchange Commission ("SEC") adopted two rules governing shareholder disclosure requirements for the United States. These changes are among the latest in what many are considering an unprecedented period of rulemaking activity for the SEC under chair, Gary Gensler. Institutional investment managers and other parties covered under the scope of these regulations will need to put procedures in place to ensure compliance with the updated rules and reporting requirements.

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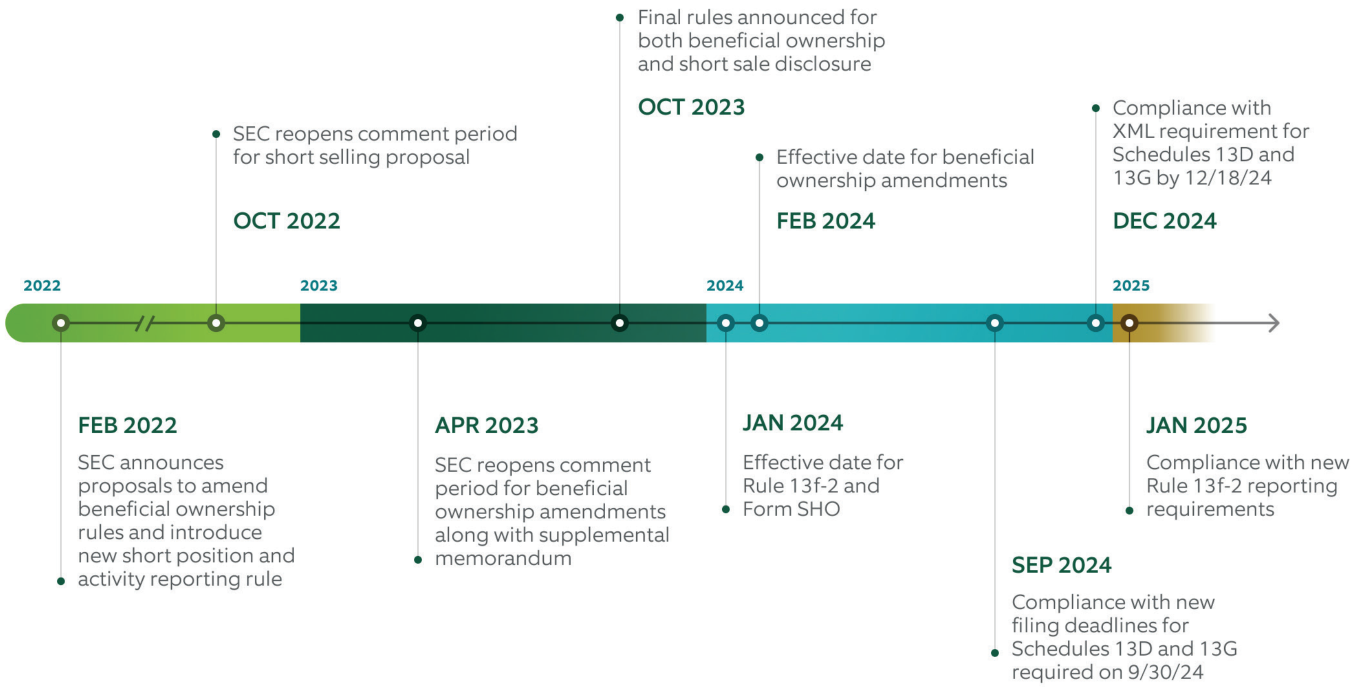
First, the SEC finalized amendments to the rules surrounding beneficial ownership reporting. This included a much-anticipated change to the filing deadlines for Schedules 13D and 13G, which have not been updated since the enactment of these rules in 1968 and 1977, respectively. Second, the SEC adopted Rule 13f-2, a new filing that will require institutional investment managers to report certain short positions and activity data when the prescribed thresholds are met.

Exhibit 1 provides a high-level timeline of the various announcements, effective dates, and compliance dates for both the updated and new rules:

EXHIBIT 1

Timeline for New SEC Shareholder Disclosure Rules and Amendments



Source: SEC.gov | Press Releases

Modernization of Beneficial Ownership Reporting

Background/Timeline

The proposal to change the rules surrounding beneficial ownership reporting was announced in February 2022, citing the desire to improve transparency and provide information to shareholders and the market in a timelier manner. The proposal included four main updates:

- Acceleration of the filing deadline for Schedules 13D and 13G
- Additional guidance surrounding the facts and circumstances that constitute the formation of a "group" under the current legal standard
- Clarification on the inclusion of certain cash-settled derivatives within the coverage of beneficial ownership reporting
- Requirement for the use of a structured, machine-readable data language for the filing submission

The final rule, adopted on October 10, 2023, included a few adjustments to the proposed amendments as a result of the concerns raised during two public comment periods in 2022 and 2023. According to the SEC, many of the deviations from the initial proposal were in response to the comments that were received. Although the SEC is pushing new rule making activity at a rapid pace, it is encouraging that public commentary has been considered when determining the final rules. This demonstrates that the Commission is both willing and able to take stakeholders' opinions into consideration regarding new rules and regulations.

Overview of Changes

Shortened Filing Deadline

Perhaps one of the most impactful amendments included in the SEC's proposal was to shorten the filing deadlines for both Schedules 13D and 13G. As SEC Chair Gary Gensler stated, "In our fast-paced markets, it shouldn't take 10 days for the public to learn about an attempt to change or influence control of a public company. I am pleased to support this adoption because it updates Schedules 13D and 13G reporting requirements for modern markets, ensures investors receive material information in a timely way, and reduces information asymmetries[1]."

Exhibit 3, which can be found in the appendix, summarizes the changes across the two schedules for both the initial filing deadlines and amendment triggering events. The initial filing deadline for 13D was cut in half, and the deadline for amendments was clarified with a set number of business days, rather than "promptly." For 13G filers, the amendments impacted each investor type slightly differently. For qualified institutional investors (QIIs), whose beneficial ownership doesn't exceed 10%, and exempt investors, the initial filing deadline will change from a yearly obligation to quarterly. Lastly, for passive investors, the initial deadline was shortened by five days. For Schedule 13G amendments, the triggering event language was updated from "any" change to a "material" change, with the various deadlines by investor type outlined in Exhibit 3. In addition to these amendments, the filing "cut-off" time in Regulation S-T was extended from 5:30 P.M. to 10 P.M. EST for all filers and schedules.[2]

Clarification of Group Formation

The framework laid out in Sections 13(d)(3) and 13(g)(3) of the Exchange Act defines the circumstances under which a group is formed, which can impact how investors may decide to report on Schedules 13D and 13G under the beneficial ownership rules (i.e., parties acting as a group may be treated as a single person for reporting purposes). In the Proposing Release[3], the SEC suggested an amendment to Rule 13d-5 clarifying that the formation of a group is not solely based on the presence or absence of an express agreement among investors but is rather based on the facts and circumstances of the arrangement.

However, the SEC did not adopt the above amendments – instead, the Commission issued guidance to affirm the existing rule that two or more persons who act as a group for acquiring, holding, or disposing securities are sufficient to constitute the formation of a group.

Clarification on Cash-Settled Derivatives

The SEC proposed an amendment to Rule 13d-3(e) that would deem holders of certain cash-settled derivative securities (other than security-based swaps) as beneficial owners of the reference equity securities if the derivative is held with control intent of the issuer of the reference securities. This proposal included a formula to calculate the number of equity securities that the holder of a cash-settled derivative beneficially owns.

The Commission elected to forgo adoption of the proposal, and instead provided guidance to define instances under which a holder of cash-settled derivative securities (other than security-based swaps) could be viewed as beneficially owning the reference equity securities. The final rule also included an amendment to Item 6 of Schedule D to more clearly state that a 13D filer must disclose interest in all derivatives, including cash-settled derivatives, with respect to that covered class of registered equity securities.

Requirement to Use Extensible Markup Language (XML)

As part of the final rule, the SEC will require that Schedules 13D and 13G be filed using a structured, machine-readable data language versus current formats. This means that all disclosures (including quantitative, textual narratives, and identification checkboxes) on Schedules 13D and 13G need to be filed using an XML-based format in efforts to introduce streamlined filings and ease of access to the data reported on these schedules.

1 SEC.gov | SEC Adopts Amendments to Rules Governing Beneficial Ownership Reporting

2 Final rule; guidance: Modernization of Beneficial Ownership Reporting (sec.gov)

3 SEC.gov | SEC Proposes Rule Amendments to Modernize Beneficial Ownership Reporting

Compliance Deadline

The amendments for the modernization of beneficial ownership reporting are effective on February 5, 2024. Compliance with the revised filing deadlines will not be required before September 30, 2024. Compliance with the structured data requirements is not required until December 18, 2024, but voluntary compliance is permitted starting December 18, 2023. To help filers prepare for the new submission requirements, the SEC published the XML technical specifications in December 2023.[4]

Short Sale Disclosure

While Schedules 13D and 13G and Form 13F have been well established for many decades, on October 13, 2023, the SEC adopted a new rule, 13f-2, that will require institutional investment managers to report equity security short positions on Form SHO. The rule was initially suggested in February 2022 with vague details and a broad scope, which raised concerns from market participants. The concerns raised by investment managers about the adoption of the rule ranged from the operational expense of implementation, the broad scope, and the potential of proprietary information being derived from the filings. With Form 13F and Schedules 13D and 13G, many individuals and market participants use these public disclosures to derive certain fund managers' investment decisions.

Despite these concerns, the SEC has decided to move forward with the adoption of the rule starting in January 2024. Institutional investment managers will see an increase in operational costs implementing this new rule with the broad scope and speedy implementation. Unlike Form 13F, where the SEC publishes a list of "in scope" securities that must be reported, Form SHO will require managers that participate in short selling to monitor a broader definition of securities that are caught under the rule, along with the prescribed thresholds. The final rule stated, "Specifically, the final rule will cover equity securities as defined in section 3(a)(11) of the Exchange Act and Rule 3a11–1 thereunder. This scope of securities includes both exchange-listed and OTC equity securities, including, inter alia, ETFs, certain derivatives, and options, warrants and other convertibles, which is consistent with the equity securities to which Rules 200, 203, and 204 of Regulation SHO apply[5]."

To properly assess Rule 13f-2, investment managers will need to break down equities into Reporting Company Issuers and Non-Reporting Company Issuers and disclose based on their Gross Short Position or Ownership Percentage as shown in Exhibit 2:

EXHIBIT 2

ISSUER TYPE	GROSS SHORT POSITION THRESHOLD	OWNERSHIP PERCENTAGE THRESHOLD
REPORTING COMPANY	$10,000,000	2.5%
NON-REPORTING COMPANY	$500,000	N/A

Investment managers will have 14 calendar days after month's end to compile and perform the necessary computations to submit Form SHO to the SEC. The form itself will consist of a cover page and two information tables and should be submitted in XML format. The first information table requires the monthly gross short position for which the manager is reporting, and the second table will contain daily activity affecting the manager's short position during the month. The SEC plans to publish the aggregated short positions (across managers) once the filing period is over.[6]

4 Final rule; guidance: Modernization of Beneficial Ownership Reporting (sec.gov)

5 Final rule: Short Position and Short Activity Reporting by Institutional Investment Managers (sec.gov)

6 Final rule: Short Position and Short Activity Reporting by Institutional Investment Managers (sec.gov)

The broad scope of the rule and quick implementation of Rule 13f-2 may be seen as a reactive response to a volatile market, anchoring to events from prior years that have highlighted the impact of short selling in the equity markets. However, this will bring many challenges for investment managers that may not have the systematic monitoring and reporting in place to provide the necessary level of detail required to disclose for the filing.

Compliance Deadline

Rule 13f-2 will be implemented in January 2024. However, investment managers will have a 12-month grace period to comply with the new rule. By January 2025, all managers must be in compliance with Rule 13f-2 and the SEC will begin publishing the aggregated short positions three months after January 2025.

Reporting Challenges and Key Takeaways

Investors should be aware of some of the challenges presented by these new and amended rules as outlined below:

Beneficial Ownership Reporting

- Investors will have to monitor not only the initial filing threshold, but amendment triggering events on a more frequent basis. This requires a timely, accurate regulatory book of record, to ensure compliance with the reporting thresholds and timelines outlined in the new guidance.
- The shortened filing deadlines could make it difficult to run manual processes and may necessitate the use of automated reporting solutions that include data validation prior to regulator submission.
- The introduction of XML submission for beneficial ownership reporting will require technical expertise to produce.
- Investors will need to put processes in place to monitor announcements made by the SEC for additional changes and/or new rules.

Form SHO

- Investors will see an increase in operational costs to provide regulatory monitoring for short sale disclosures.

To prepare for the upcoming changes, investment managers should spend time reviewing the new rules and requirements for beneficial ownership reporting and short selling disclosure to ensure that the necessary policies and procedures are in place to comply with the reporting requirements. The SEC has demonstrated its intent to closely monitor compliance with these rules and willingness to impose fines and other penalties.

To ease the demand of monitoring thresholds and compiling regulatory submissions, managers should consider avoiding supporting these on a filing-by-filing basis. Instead, they should utilize a platform or service provider with an architecture that standardizes the design of required positional, reference, and market data to monitor regulatory filing requirements. This provides operational scale for managers to meet their needs as the landscape evolves whether through changes to required filings or announcements of new disclosures.

Additional information can be found in the final rule, fact sheet and press releases from the SEC.

TO LEARN MORE

To learn more about how Northern Trust can support managers with evolving reporting requirements, contact Front_Office_Analytics@ntrs.com.

Appendix

EXHIBIT 3

EXISTING RULE	PROPOSED RULE	FINAL RULE
SCHEDULE 13D – INITIAL FILING		
Within 10 days after acquiring beneficial ownership of more than 5%	Within five days after acquiring beneficial ownership of more than 5%	Within five business days after acquiring beneficial ownership of more than 5%
SCHEDULE 13D – AMENDMENT TRIGGERING EVENT		
Event: Material change in the facts set forth in the previous Schedule 13D **Deadline:** "Promptly" after the triggering event	**Event:** No Change **Deadline:** Within one business day after the triggering event	**Event:** No Change **Deadline:** Within two business days after the triggering event
SCHEDULE 13G – INITIAL FILING		
QIIs and Exempt Investors: 45 days after each calendar year end in which beneficial ownership exceeds 5% **QIIs:** 10 days after month end in which beneficial ownership exceeds 10% **Passive Investors:** 10 days after acquiring beneficial ownership of more than 5%	**QIIs and Exempt Investors:** Five business days after month end in which beneficial ownership exceeds 5% **Passive Investors:** Within five days after acquiring beneficial ownership of more than 5%	**QIIs and Exempt Investors:** 45 days after calendar quarter end in which beneficial ownership exceeds 5% **QIIs:** Five business days after month end in which beneficial ownership exceeds 10% **Passive investors:** Five business days after acquiring beneficial ownership of more than 5%
SCHEDULE 13G – AMENDMENT TRIGGERING EVENT		
Event: Any change in the information previously reported on Schedule 13G. For QIIs and passive investors, amendments also triggered upon exceeding 10% beneficial ownership, or 5% increase/decrease **Deadlines:** **All 13G filers:** 45 days after calendar year end in which any change occurred **QIIs:** 10 days after month end in which beneficial ownership exceeded 10% or a 5% increase/decrease in beneficial ownership **Passive Investors:** Promptly after exceeding 10% beneficial ownership or a 5% increase/decrease in beneficial ownership	**Event:** Material change in the information previously reported on Schedule 13G. For QIIs and passive investors, amendments also triggered upon exceeding 10% beneficial ownership, or 5% increase/decrease (no change) **Deadlines:** **All 13G filers:** Five business days after month end in which material change occurred **QIIs:** Five days after month end in which beneficial ownership exceeded 10% or a 5% increase/decrease in beneficial ownership **Passive Investors:** Within one day after exceeding 10% beneficial ownership or a 5% increase/decrease in beneficial ownership	**Event:** Material change in the information previously reported on Schedule 13G. For QIIs and passive investors, amendments also triggered upon exceeding 10% beneficial ownership, or 5% increase/decrease (no change) **Deadlines:** **All 13G filers:** 45 days after calendar quarter end in which material change occurred **QIIs:** Five business days after month end in which beneficial ownership exceeded 10% or a 5% increase/decrease in beneficial ownership **Passive Investors:** Within two business days after exceeding 10% beneficial ownership or a 5% increase/decrease in beneficial ownership

Source: SEC.gov | Modernization of Beneficial Ownership Reporting

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