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Beneficial Ownership Reporting by Non-U.S. Institutions

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Client Advisory
November 5, 2008 by Guy P. Lander and Peter Flägel

Rule 13d Amendments

Generally, reporting of beneficial ownership is required of any person who acquires more than 5% of a class of equity securities ("Registered Securities") registered under Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Within ten days of the acquisition, a Schedule 13D must be filed disclosing the number of shares beneficially owned, background of the acquirer and the acquirer's plans and intentions with respect to the issuer.

Under Rule 13d-1(b)(1)(ii), certain institutional investors may file their beneficial ownership reports for Registered Securities on the much less burdensome Schedule 13G rather than Schedule 13D. These Schedule 13G filers include securities brokers and dealers, investment advisers and investment companies registered with the Securities and Exchange Commission (the "SEC"); banks and insurance companies regulated in the United States; employee benefit plans and pension plans subject to ERISA; and related holding companies and groups. The institutional investors eligible to file a short form Schedule 13G did not include non-U.S. institutions.

Qualifying institutional investors only need to file their Schedule 13G within 45 days after the end of the calendar year in which they made the acquisition bringing them over the 5% threshold if they still hold more than 5% at the end of the year. In 1978, the SEC permitted qualifying institutional investors to file on the short form 13G but did not extend that right to non-U.S. institutions because the SEC thought it might encounter "substantial enforcement difficulties" in that non-U.S. institutions might not provide the SEC upon request with the information that they would be required to file under Schedule 13D.

Nonetheless, the SEC has granted exemptive orders permitting non-U.S. institutional investors to report Registered Securities acquisitions on the short form Schedule 13G so long as (a) the institutional investors were subject to regulation comparable to that imposed in the U.S. on similar institutions, and (b) the acquisitions were in the ordinary course of business and not with the purpose nor with the effect of changing or influencing the control of the issuer of the Registered Securities nor in connection with or as a participant in any transaction having such purpose or effect.[1] In 1998, instead of expanding the list of qualified institutional investors to include non-U.S. institutions, the SEC adopted the Rule 13d-1(c) passive investor exemption, and the SEC stated that it would continue to grant no-action relief to non-U.S. qualified institutional investors under then current practices.[2] Filing as a passive investor is more burdensome than filing as a qualified institutional investor. While qualified institutional investors may report beneficial ownership on Schedule 13G annually, passive investors must report on Schedule 13G within 10 days after the relevant acquisition of Registered Securities.

The SEC recently amended Rule 13d-1(b)(1)(ii) to permit non-U.S. institutions that are substantially comparable to the U.S. institutions listed in the Rule to file a Schedule 13G instead of Schedule 13D. The availability of the exemption enabling non-U.S. institutions to file a short form Schedule 13G is subject to the following requirements:

First, the non-U.S. institution must certify on Schedule 13G that it is subject to a regulatory scheme comparable to the regulatory scheme applicable to its U.S. counterparts. When making this determination, the non-U.S. institution must consider a number of factors, including whether the institution is engaged in a business similar to the business engaged in by the qualified institutional investors listed in Rule 13d-1(b)(1)(ii), and whether the non U.S. institutions provide protections similar to those offered by U.S. institutions (e.g., minimum capital requirements, deposit guarantees, licensing requirements, periodic reporting of information in the home country, power of inspection by home country regulators, etc.).

Second, in its certification on Schedule 13G, the non-U.S. institution must undertake to provide the SEC staff, upon request, with the information it would otherwise be required to provide in a Schedule 13D.

Third, in its certification, the non-U.S. institution must confirm that it acquired and holds the Registered Securities in the ordinary course of business and not with the purpose or effect of influencing or changing control of the issuer.

A non-U.S. institution currently filing on Schedule 13G under a previously issued no-action letter may continue to rely on that no action letter as long as it continues to meet the conditions and facts upon which relief was granted. But, for new filings of, and amendments to, a Schedule 13G, the non-U.S. institution must assess whether it complies with the new rules and make appropriate certifications when it files or amends its Schedule 13G.

Section 16 Amendments

Under Section 16 of the Exchange Act, investors owning more than 10% of Registered Securities must submit initial ownership reports on Form 3 upon crossing the 10% threshold and thereafter report any changes in beneficial ownership on Form 4. Additionally, over 10% investors are subject to short-swing profit recapture for any profits made on any combination of purchases and sales of Registered Securities within any six-month period. Qualifying U.S. institutional investors are exempt from these reporting and short-swing profit rules. Now, Rule 16a-1(a)(1) also exempts eligible non-U.S. institutions as described above so that these institutions are not deemed to be beneficial owners of securities held for the benefit of third parties or in customer or fiduciary accounts. Therefore, these holdings will not subject the non-U.S. institutions to Section 16 reporting or liability.

Transition Rules

The new rules are effective on December 8, 2008. Non-U.S. institutions comparable to those listed in current Rule 13d-1(b) that are currently filing on Schedule 13G under a no-action letter from the SEC staff may continue to do so, to the extent they continue to meet the conditions upon which the no-action relief was granted. However, as noted above, when these institutions otherwise must file an amendment to the Schedule 13G, they must provide the certification required under our revised rules to continue to file on Schedule 13G. Non-U.S. institutions that do not have no-action letters may rely on the revised rule to file on Schedule 13G if the filing deadline for the Schedule 13D they would otherwise be required to file falls after the effective date of these revised rules.

Questions regarding this client advisory may be directed to **Guy P. Lander** (212-238-8619, lander@clm.com) or **Peter Flagel** (212-238-8649, flagel@clm.com).

Endnotes

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[1] See Exchange Act Release No. 14692 (Apr. 21, 1978).

[2] See Exchange Act Release No. 39538 (Jan. 12, 1998).

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