

## *SEC Proposes to Readopt Existing Rules on Beneficial Ownership and Security-Based Swaps*

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On March 17, 2011, the Securities and Exchange Commission (“SEC”) proposed the adoption of rules for determining whether an owner of security-based swaps is a “beneficial owner” under the Securities Exchange Act of 1934 (“Exchange Act”).<sup>1</sup> The proposed rules are identical to the rules currently in effect; the SEC plans to readopt these rules to preserve the status quo following the July 16, 2011 effective date of new subsection (o) to Section 13 of the Exchange Act, which was added by Section 766 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”).

A security-based swap is a swap or other derivative contract containing a material term that references the price, yield, volatility, or interest rate of either a single security or loan or a narrow index of securities, or that references the occurrence or nonoccurrence of an event related to an issuer (or the issuers in a narrow security index) where such event directly affects the financial condition of the issuer. The new Section 13(o) of the Exchange Act directs the SEC to consult with various regulators and the U.S. Treasury, then adopt rules for determining when ownership of security-based swaps constitutes beneficial ownership of the underlying equity securities.<sup>2</sup> After the required consultations, the SEC determined that its existing beneficial ownership rules adequately ad-

dress ownership of security-based swaps. The SEC was concerned that unless it exercised its rulemaking authority to readopt the current rules, the Dodd-Frank Act would invalidate the existing beneficial ownership rules as they apply to owners of security-based swaps. The readoption of these rules without change is intended to prevent an investor from using security-based swaps to accumulate control of a public company without public disclosure.

The rules that the SEC proposes to readopt—Rules 13d-3(a), (b) and (d)(1), together with portions of Rule 16a-1(a)(1) and (a)(2)—establish the framework for determining beneficial ownership. Under this framework the owner of a security-based swap is a beneficial owner for purposes of reporting such ownership under Sections 13(d) and 13(g) of the Exchange Act if that person directly or indirectly holds or shares voting or investment power over the underlying securities or has the right to acquire the underlying securities within sixty days. Using this standard, ownership of security-based swaps settled in cash generally has been viewed as not constituting beneficial ownership under Rule 13d. In addition, if a person who owns a security-based swap has a pecuniary interest in the underlying securities—i.e., has an opportunity to profit from the securities—then those securities are counted in determining whether

the person holds 10 percent or more of the issuer's securities for purposes of the reporting requirements and short-swing profit restrictions under Section 16 of the Exchange Act.

Even where an investor owns security-based swaps that do not trigger these proposed beneficial ownership rules, the investor likely must disclose information regarding such swaps if the investor files a Schedule 13D based on the investor's beneficial ownership of other securities of the issuer. Specifically, Item 6 of Schedule 13D requires that 13D filers describe any contracts or arrangements to which they are a party and which relate to securities of the

issuer (i.e., security-based swaps); Item 7 requires filers to file copies of such contracts or arrangements as exhibits. Furthermore, Item 4 of Schedule 13D requires 13D filers to describe any plans that relate to or would result in the acquisition of additional securities of the issuer. Finally, 13G filers who file pursuant to Rule 13d-1(b) or otherwise rely on Rule 13d-1(b) to govern a future reporting obligation may be required to make disclosures on Schedule 13D instead based upon their purchase or sale of security-based swaps.

Public comments on the proposed rules are due by April 15, 2011.

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## **Endnotes**

[1] See Securities Act Release No. 34-64087 (March 17, 2011) [hereinafter "Proposing Release"].

[2] See Section 13(o) of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

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