

NIRI Talking Points on 13D Reform and the Brokaw Act

IR professionals, who often are the first to learn that an activist hedge fund is targeting their company, support the bipartisan Brokaw Act to provide greater transparency around hedge fund activism.

13D reform is needed now because hedge fund activism has risen significantly, with more proxy contests being threatened, which creates a greater urgency for companies to engage with their shareholders.

The Brokaw Act seeks to modernize the 13D reporting rules, which are a relic of the Williams Act of 1968. Under these outdated rules, an activist fund doesn't have to report until **10 days** after accumulating a 5% threshold. As a result, hedge funds can cheaply accumulate large positions (often significantly more than 5%) in secret at the expense of other investors and then ambush companies. These funds often pressure executives and directors to agree to plant closings, job cuts, reduced R&D spending, and other concessions that may not be in the long-term interests of shareholders, employees, or other stakeholders.

This threat of ambush activism is a real deterrent to private companies that are considering going public. The number of U.S.-listed companies is about half of what it was 20 years ago; 13D reform is needed to reverse this trend and help encourage more IPOs.

The bipartisan Brokaw Act, which would cut the reporting period to four business days, strikes a reasonable balance between improving transparency, while allowing activists enough time to report their positions. The legislation also would close loopholes by including derivatives and other financial instruments that activists use to mask their positions.

Major overseas markets, such as the United Kingdom (2 days), Australia (2 days), Hong Kong (3 days), and Germany (4 days), all have adopted shorter reporting periods.

Greater transparency would benefit retail investors, pension funds, mutual fund beneficiaries, and other investors who hold shares for the long term. With more timely notice, companies and their directors could respond more effectively to activists' demands and more thoughtfully consider the potential impact on long-term investors, employees, and other stakeholders.

Summary of S. 1744, the “Brokaw Act”

(introduced by Senators Tammy Baldwin (D-WI) and David Perdue (R-GA))

Brokaw is the name of a village in Wisconsin that was harmed by a group of hedge funds that seized control of the Wausau Paper Company in 2011.

Shortens the Schedule 13D Reporting Window. Current Securities and Exchange Commission (SEC) rules require beneficial owners (i.e., street name shareholders) of more than 5% of a registered class of equity security to disclose such ownership interest by filing a beneficial ownership report on Schedule 13D.

A Schedule 13D is required to be filed with the SEC within 10 days after the beneficial owner crosses the 5% threshold. This 10-day window has been the subject of criticism for allowing too much time for activist investors to accumulate large positions in U.S. public companies before being required to disclose anything publicly. To address this problem, the Brokaw Act directs the SEC to shorten this disclosure window to **four business days**, which is the current deadline for filing an 8-K report.

Requires Disclosure of Large Short Positions. Schedule 13D filings only require disclosure of large ownership positions and not large short positions. The Brokaw Act expands SEC disclosure and reporting requirements for investors acquiring a direct or indirect short interest position that represents more than 5% of a registered class of equity security. An investor that crosses the 5% threshold would be required to file the equivalent of a Schedule 13D disclosing such short interest position within 4 business days after crossing the 5% threshold.

Under the Brokaw Act, a beneficial owner holding both long and short positions in a security would not be permitted to calculate beneficial ownership using a net calculation. Instead, the beneficial owner would be required to use the greater percentage of its long or short position to calculate beneficial ownership for these purposes.

Expands the Definition of Beneficial Ownership. Under current SEC rules, investors are considered to be a beneficial owner of a security if they have voting and/or investment power over such security. The definition of beneficial ownership does not include anyone with a purely economic interest in the security.

To address this problem, the Brokaw Act would expand the definition of beneficial ownership to include any person who has a “pecuniary or indirect pecuniary interest in such security.” This would require investors to include in their beneficial ownership calculation certain derivative instruments, such as cash-settled equity swaps, that do not provide an investor with any voting or investment power over the underlying equity security, but do provide the investor with economic exposure to the underlying equity security.

Expands the Definition of “Person” for Reporting Purposes. The Brokaw Act restricts the activities of certain hedge funds by defining “person” for purposes of beneficial ownership reporting to include hedge funds as well as the coordination of certain activities by two or more persons. Specifically, the Brokaw Act defines “person” to include:

2 or more persons acting as a partnership, limited partnership, syndicate, or other group, or otherwise coordinating the actions of the persons, for the purpose of (i) acquiring, holding, or disposing of securities of an issuer; (ii) seeking to control or influence the board, management, or policies of an issuer; or (iii) evading, or assisting others in evading, designation as a ‘person’

The definition of “person” in the bill incorporates the definition of a hedge fund contained in the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)). The definition also includes a group of hedge funds or persons working together to evade the disclosure requirements in Section 13 of the Securities Exchange Act of 1934.