February 10, 2015

SEC Proposes Rules for Disclosure of Company Hedging Policies Applicable to Directors, Officers and Employees

On February 9, 2015, the Securities and Exchange Commission proposed rules requiring disclosure about whether directors, officers and other employees are permitted to hedge or offset any decrease in the market value of equity securities they hold, directly or indirectly (including equity securities granted by the company as compensation).

The proposed rules implement Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and are intended to inform shareholders when a company's employees or directors are permitted to engage in transactions that mitigate or avoid the incentive alignment associated with equity ownership. The proposed amendments would not require a company to prohibit hedging transactions or otherwise to adopt practices or policies addressing hedging, but relate solely to the disclosure of such policies. Prohibitions on hedging may be included in a company's securities trading policy or corporate governance guidelines or as standalone policies.

Requirements of the Proposed Rule

The SEC proposes to amend Item 407 of Regulation S-K to require domestic SEC reporting companies to disclose whether they permit employees (including officers) and directors to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) or to engage in transactions designed to or have the effect of hedging or offsetting any decrease in the market value of their company's securities that are granted to them as part of their compensation or held directly or indirectly by them. In addition, the proposed rules specify the following:

- If a company permits some, but not all, of its employees and directors to hedge, the company would be required to disclose which categories of persons are permitted to hedge and which categories of persons are not. Similarly, if a company permits some types of hedging transactions, but not others, the company would be required to disclose which transactions it permits (including sufficient detail to explain the scope of the permitted transactions) and which it prohibits; and

- The equity securities for which disclosure is required are only equity securities (as defined in Exchange Act Section 3(a)(11) and Exchange Act Rule 3a11-1) of the company, any parent of the company, any subsidiary of the company or any subsidiary of any parent of the company that is registered under Section 12 of the Exchange Act.

The proposed rules would require disclosure in proxy and information statements for the election of directors and apply to companies subject to the SEC's proxy rules, including smaller reporting companies, emerging growth companies, business development companies, and registered closed-end investment companies with shares listed and registered on a national securities exchange. Disclosure would not be required in registration statements or in Form 10-K Part III Item 407 disclosure and foreign private issuers would not be required to provide hedging policy disclosure.

While acknowledging that the JOBS Act excludes emerging growth companies from some, but not all, of the provisions of Title IX of Dodd-Frank and that emerging growth companies and smaller reporting companies are in many instances subject to scaled disclosure requirements, including with respect to executive compensation, the SEC noted that it would be more consistent with its historical approach to corporate governance-related disclosures not to exempt these companies from the proposed disclosure requirement.

To reduce potentially duplicative disclosure in proxy and information statements, the SEC also proposed to add an instruction to Regulation S-K providing that a company may satisfy its Compensation Discussion and Analysis obligation to disclose material policies on hedging by named executive officers by cross referencing to the Item 407 hedging disclosure.

Notably, Commissioners Daniel M. Gallagher and Michael S. Piwowar issued a joint statement critical of several aspects of the proposal, including its failure to exempt emerging growth companies or smaller reporting companies, its requirement that certain investment companies make the disclosures contemplated by the proposed rule, and its coverage of securities of the issuer's affiliates, which they consider to be overbroad.

Comments on the proposed rules are due 60 days following their publication in the Federal Register.

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