SEC Adopts Hedging Disclosure Rule

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The Securities and Exchange Commission recently adopted a final rule requiring public companies to disclose any practices or policies as to whether their officers, other employees or directors are permitted to engage in hedging transactions.[1] According to the SEC, the rule, which implements a provision of the Dodd-Frank Wall Street Reform and Consumer Protection Act, is designed to provide transparency as to whether a company's officers, employees or directors may engage in transactions that reduce or eliminate the alignment of incentives associated with equity ownership.

What must be disclosed?

Under new Item 407(i) of Regulation S-K, a company must describe any practices or policies it has adopted regarding the ability of its employees (including officers) or directors, or any of their designees, to purchase financial instruments, or otherwise engage in transactions, that hedge or offset, or are designed to hedge or offset, any decrease in the market value of equity securities granted as compensation to, *or* are otherwise held directly or indirectly by, the employee or director. Companies may provide either a summary of their hedging practices or policies, or provide such policies or practices in full.

The practices or policies covered by the rule are those regarding the ability of employees (including officers) or directors to engage in hedging transactions with "registrant equity securities." These equity securities include equity securities issued by the company, its parents or subsidiaries, or its parents' subsidiaries. The disclosure applies both to equity securities acquired as compensation and to other holdings of such securities.

[1] SEC Release No. 33-10593, *Disclosure of Hedging by Employees, Officers and Directors*, December 18, 2018, available here.

If a company chooses to summarize its practices or policies, the summary must include the categories of persons covered and any categories of hedging transactions that are specifically permitted or disallowed.

The definition of "practices or policies" is intended to be broad. Even if a company does not have a written hedging policy, disclosure would be required of a practice of reviewing, and potentially restricting, hedging transactions as part of a program of reviewing employee trading in company securities. Disclosure of a practice of including anti-hedging provisions in employment agreements or equity award documentation would be similarly required.

What if you do not have any practice or policy regarding hedging transactions?

Companies that do not have any hedging practices or policies must affirmatively disclose that fact or, alternatively, may state that hedging transactions are generally permitted.

The SEC even provided sample language for companies in such a situation: "Our company does not have any practices or policies regarding hedging or offsetting any decrease in the market value of registrant equity securities."

Who must make these new disclosures and when?

Most reporting companies must comply with the new disclosure requirements during fiscal years beginning on or after July 1, 2019. However, "smaller reporting companies" and "emerging growth companies" have an extra year to comply (fiscal years beginning on or after July 1, 2020).

Listed closed-end funds and foreign private issuers will not be subject to the new requirement, although business development companies will be subject to the rule.

Where should these disclosures be made?

Disclosure is required in proxy statements (Schedule 14A) or information statements (Schedule 14C) for meetings at which directors are elected. Disclosure is required even if the meeting is not an annual meeting.

How does this requirement compare to the CD&A disclosure requirements?

The Compensation Discussion & Analysis (CD&A) section (Item 402(b) of Regulation S-K) requires, if material, disclosure of any policies on hedging by named executive officers. This disclosure requirement is narrower than that required by the new rule, because the CD&A disclosure is limited to hedging policies related to "named executive officers." To minimize duplicative disclosure, companies may include a cross-reference in their CD&A to the new disclosure, although doing so would mean that it would be covered by the "say-on-pay" vote.

Conclusion

Although this new rule does not mandate that companies adopt hedging policies, like many other SEC or stock exchange corporate governance disclosure requirements, it is likely to encourage companies to adopt policies implementing best practices in this area. Accordingly, companies should review their current hedging policies, if any, and consider whether changes are necessary in light of the impending disclosure requirements. Companies should consider including disclosure regarding such policies in their 2019 proxy statements, in advance of the effective date of the rule.

If you have any questions regarding this client alert, please contact the following attorney or the Willkie attorney with whom you regularly work.

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