SECURITIES LAW ALERT

SEC ADOPTS FINAL RULES FOR DISCLOSURE OF HEDGING POLICIES

By Jeffrey T. Haughey and Jeff Roderick

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On December 18, 2018, the SEC approved a final rule requiring companies to disclose in proxy or information statements for the election of directors any practices or policies regarding the ability of employees (including officers) or directors to engage in certain hedging transactions with respect to company equity securities.[1] New Item 407(i) of Regulation S-K implements Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The purpose of the new rule is to inform shareholders of whether executives can effectively avoid losses on stock they hold or receive as compensation by purchasing financial instruments that allow them to receive compensation even if their company does not perform.

Companies may comply with the new rule's disclosure requirement by summarizing their hedging practices or policies or by disclosing them in full. Companies generally must make this disclosure in proxy and information statements for the election of directors during fiscal years beginning on or after July 1, 2019 (2020 for calendar year companies), although smaller reporting companies and emerging growth companies must do so during fiscal years beginning on or after July 1, 2020 (2021 for calendar year companies). Should a company wish to disclose its hedging policy in 2019 to highlight its corporate governance practices, it may disclose its hedging policy in its 2019 proxy statement voluntarily.

Prior to that time, companies may wish to review their current hedging practices or policies to consider any substantive changes or to determine the form of their disclosure under the rule.

SCOPE OF THE DISCLOSURE REQUIREMENT

The rule requires a company to describe any practices or policies it has adopted (whether written or not) regarding the ability of its employees (including officers) or directors, or any of their designees, to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds), or otherwise engage in transactions, that hedge or offset, or

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[1] The SEC's release adopting the rule is available here. *See* SEC Release No. 33-10593; 34-84883; IC-33333; File No. S7-01-15. The SEC's fact sheet is available here.

are designed to hedge or offset, any decrease in the market value of company equity securities granted to the employee or director by the company as part of their compensation, or held, directly or indirectly, by the employee or director.

A company must disclose its hedging practices or policies in full or provide a fair and accurate summary of them, including the categories of persons covered and any categories of hedging transactions that are specifically allowed or disallowed. The rule does not require companies to have practices or policies regarding hedging, or dictate the content of any such practices or policies. If a company does not have any practices or policies regarding hedging, it must disclose that fact or state that hedging transactions are generally permitted. A company that discloses a policy covering only a subset of employees or directors is not required to further disclose that it does not have a policy with regard to its other employees or directors.

The scope of the disclosure requirement is not limited to any particular types of hedging transactions, but rather focuses on disclosure of a company's practices or policies. A company is only required to describe portfolio diversification transactions, broad-based index transactions, or other types of transactions if its hedging practices or policies address them.

The disclosure requirement applies to hedging transactions relating to company equity securities "held, directly or indirectly," by employees or directors (in addition to equity securities granted as part of their compensation). Although the SEC did not define the phrase "held, directly or indirectly," the SEC noted that companies will describe the scope of their hedging practices or policies, which may include whether and how they apply to securities that are "indirectly" held.

Defining the Term "Equity Securities"

The rule applies to equity securities issued by the company and its parents, subsidiaries or subsidiaries of the company's parents. The rule uses the term "registrant equity securities," rather than "equity securities," to indicate the scope of the rule is narrower than potentially any equity security, but broader than only the equity security of the particular company that is the employer or on whose board the director sits. Consistent with the rule's broader focus on hedging practices or policies, coverage is not limited to equity securities that are registered under Exchange Act Section 12. Instead, a company's practices or policies will determine which, if any, classes of securities are covered. Accordingly, the rule covers convertible debt securities and convertible preferred stock, whether or not listed on a stock exchange.

Employees and Directors Subject to the Disclosure Requirement

The rule requires disclosure of hedging practices or policies that apply to employees (including officers) or directors of the company, or any of their designees. The SEC chose not to define the term "designee," stating that whether someone is a "designee" depends on the particular facts and circumstances involved. However, the SEC reiterated that the focus of the disclosure requirement is on hedging practices or policies, and that companies will determine who is covered, as described in their practices or policies.

Implementation

The rule requires a company to disclose its hedging practices or policies in any proxy statement on Schedule 14A or information statement on Schedule 14C with respect to the election of directors, but not in the Securities Act or Exchange Act registration statements or in proxy solicitations not involving the election of directors. The SEC has provided companies with flexibility in where to present this description of hedging practices or policies. Companies may choose to include this disclosure in Compensation Discussion and Analysis (CD&A), directly or by cross-reference, or to make the disclosure outside of CD&A. Note that including the disclosure in CD&A will result in the disclosure being covered by the advisory say-on-pay vote required by Dodd-Frank.

The disclosure requirement applies to smaller reporting companies, emerging growth companies, and business development companies, but not to mutual funds, closed-end funds, exchange traded funds, or foreign private issuers.

COMPLIANCE DATES

Companies that qualify as smaller reporting companies or emerging growth companies must comply with the rule for fiscal years beginning on or after July 1, 2020, while all other companies must comply with the rule for fiscal years beginning on or after July 1, 2019.

Jeffrey T. Haughey and Jeff Roderick are attorneys in GableGotwals' Corporate & Securities Law Group. For help analyzing the amendments recently adopted by the SEC or navigating the complexities of federal and state securities laws, contact GableGotwals.

Jeffrey T. Haughey
(918) 595-4837
jhaughey@gablelaw.com

Jeff Roderick
(918) 595-4827
jroderick@gablelaw.com

GableGotwals
1100 ONEOK Plaza
100 West Fifth Street
Tulsa, OK 74103-4217
www.gablelaw.com