

GOODWIN PROCTER ALERT

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SEC Proposes Hedging Policy Disclosure Rule

by Daniel P. Adams, John O. Newell, Marian A. Tse

Speed Read

The SEC has proposed a rule that would require new hedging policy disclosure by companies that are subject to SEC proxy rules. The proposed rule would in most cases expand the hedging policy disclosure currently provided by companies. The proposed rule would also extend this requirement to companies that are not currently required to provide hedging disclosure, such as smaller reporting companies and emerging growth companies. The proposed rule is subject to public comment through April 20, 2015 and therefore is very unlikely to affect disclosure in proxy statements for 2015 annual meetings by companies with calendar year-end fiscal years.

On February 9, 2015, the Securities and Exchange Commission proposed a rule that would require companies to disclose their policies with respect to hedging of equity securities of the company, as well as its parent and subsidiaries of the company or its parent, by the company's employees, officers and directors. The proposed rule, which expands current SEC disclosure requirements for hedging policies, is one of four compensation-related disclosure mandates under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

To date, the SEC has proposed rules covering [CEO pay ratio disclosure](#) and hedging policy disclosure. The SEC has not yet proposed rules covering clawbacks of incentive compensation under stock exchange rules or pay for performance disclosure. The goal of the proposed rule is to provide investors with additional information about the governance practices of companies in which they invest.

The proposed rule is subject to public comment through April 20, 2015. Even if the SEC were to adopt a final rule promptly after the comment period closes, the final rule is therefore very unlikely to affect disclosure by companies with calendar year-end fiscal years in proxy statements for 2015 annual meetings. The full text of the [proposed rule](#) is available on the SEC web site.

In the proposing release, the SEC solicits public comment on a significant number of questions, so it is possible that the final rule may be somewhat different from the proposed rule. A joint statement released on February 9 by Commissioners Gallagher and Piwowar, who voted for the proposed rule, identified five areas about which they "remain quite concerned" and for which they "hope to receive robust public comment." These include:

- lack of an exemption for emerging growth companies and/or smaller reporting companies;
- lack of an exemption for certain investment companies (specifically, listed, closed-end funds);
- lack of an exemption for hedging by employees that cannot affect a company's share price;
- application of the proposed rule to the equity securities of a company's subsidiaries, parents, and brother-sister companies; and
- whether the proposed rule reflects the best prioritization of SEC staff and resources.

Proposed Hedging Disclosure

Companies and SEC Filings Covered. The proposed rule would require hedging policy disclosure in proxy and information statements for the election of directors by companies subject to the federal proxy rules, including smaller reporting companies, emerging growth companies, and registered closed-end investment companies with shares listed and registered on a national

securities exchange. The proposed rule would not require companies to adopt anti-hedging policies. However, as discussed below, many companies have already done so, and, depending on the scope of the final rule, other companies may choose to do so.

Persons Covered. The proposed disclosure of hedging policies would apply to hedging activities by any employees (including officers) and directors of the company and any of their designees. A company that permits hedging transactions by some, but not all, of the categories of persons covered by the proposed rule would be required to disclose the categories of persons who are permitted to engage in hedging transactions and those who are not.

Hedging Activities Covered. The proposed rule would require a company to disclose whether it permits its employees, officers or directors (1) to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) or (2) otherwise to engage in transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of equity securities that (A) have been granted to the employee, officer or director by the company as part of the compensation of the employee, officer or director or (B) are held, directly or indirectly, by the employee, officer or director.

The proposed rule would require a company to disclose the categories of hedging transactions that it permits and those that it prohibits. The proposed rule would permit a company to disclose that it prohibits or permits particular categories and permits or prohibits, respectively, all other hedging transactions, if true. If a company does not permit any hedging transactions, or permits all hedging transactions, it would be required to disclose that fact and would not be required to describe specific categories of hedging transactions. A company that permits hedging transactions would be required to disclose sufficient detail to explain the scope of the permitted hedging transactions.

The proposed rule would apply to hedging policies with respect to equity securities that are registered under Section 12 of the Securities Exchange Act of 1934 and that have been issued by the company, any parent of the company, any subsidiary of the company, or any subsidiary of any parent of the company.

The disclosure required by the proposed rule would not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, the Securities Exchange Act of 1934 or the Investment Company Act of 1940 except to the extent that the company specifically incorporates the disclosure by reference.

Current Hedging Disclosure Requirements and Practice

There are current disclosure requirements relating to hedging policies, and many companies have adopted hedging policies, often in response to the policies of proxy advisory firms. However, the new rule as currently proposed would extend disclosure of hedging policies to companies that are not currently subject to these disclosure requirements, and would expand disclosure requirements significantly beyond the disclosure that most companies currently provide.

Under current SEC rules, the principal disclosure requirement relating to hedging policies in proxy statements is the requirement to disclose in Compensation Discussion and Analysis the material information necessary to understand a company's compensation policies and decisions regarding its named executive officers. In addition, in recent years, proxy advisory firms have implemented policies that encourage companies to adopt and disclose anti-hedging policies. As a result, many companies have already adopted and disclose the existence of anti-hedging policies. A study published in September 2014 by Meridian Compensation Partners LLC indicated that 91% of the 250 large publicly traded companies that comprise the Meridian 250 disclosed the existence of an anti-hedging policy, up from 82% in 2013.

Because the principal current disclosure requirement is part of CD&A, it does not apply to smaller reporting companies, emerging growth companies, registered investment companies or foreign private issuers. In addition, the current CD&A disclosure requirement does not cover hedging policies that apply to directors, executive officers who are not named executive officers, or other employees. Although anti-hedging policies adopted by companies often apply to a broader group of people than the company's named executive officers, they generally do not apply to all employees. Additionally, these policies may not cover registered securities, if any, issued by a subsidiary or the company's parent or another subsidiary of the parent, and may not apply to as broad a range of hedging transactions as those covered by the proposed rule.

GOODWIN PROCTER ALERT

As a result, when the final rule is adopted, most companies with existing anti-hedging policies will need to review their policies and disclosure in light of the new rule. In addition, many companies that have not adopted anti-hedging policies may need to consider doing so.

Actions to Take

The SEC has solicited public comment on a large number of questions that could affect which employees and securities are subject to disclosure under the new rule. The SEC has also solicited comment on whether the final rule should apply to classes of companies such as emerging growth companies and smaller reporting companies. As a result, we expect that many companies will wait for the SEC to adopt the final rule before amending existing anti-hedging policies or considering whether to adopt anti-hedging policies in response to these new disclosure requirements.

Ultimately, when the SEC adopts the final rule, we expect that companies may have additional policy decisions to consider. For example, if the proposed rule is adopted in its current form, companies would need to consider whether anti-hedging policies should apply to all employees. Companies would also need to consider the types of hedging transactions that will be subject to a company policy. Companies that wish to comment on the proposed rule should consider submitting comments on the proposed rule to the SEC on or before April 20, 2015.

Contacts:

Daniel P. Adams

Partner

617.570.1966

dadams@goodwinprocter.com

John O. Newell

Counsel

617.570.1475

jnewell@goodwinprocter.com

Marian A. Tse

Partner

617.570.1169

mtse@goodwinprocter.com

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