

## SEC PROPOSES RULES ON DISCLOSURE OF EMPLOYEE AND DIRECTOR HEDGING POLICIES

FEBRUARY 2015

On February 9, 2015, the Securities and Exchange Commission proposed rule amendments to require annual meeting proxy statement disclosure of policies permitting or prohibiting hedging of company securities by employees (including officers) and directors. The proposed rules do not, however, require companies to prohibit hedging transactions or adopt policies addressing hedging. The rule's purpose is to provide transparency to shareholders in the context of director elections regarding whether employees and directors are permitted to engage in transactions that mitigate the long-term incentive alignment associated with employee and director equity ownership. Companies should consider these proposed disclosure requirements when assessing corporate governance controls and procedures, as this proposed rule may heighten scrutiny of hedging policies this proxy season, and if implemented, will create additional disclosure requirements going forward.

### **RULE PROPOSAL SUMMARY**

The SEC proposed an [amendment](#) to annual meeting corporate governance disclosure that primarily amends Regulation S-K Item 407. The proposed amendments implement Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added Section 14(j) of the Securities Exchange Act of 1934 (the "Exchange Act"). The SEC seeks comments on the proposed rules on or before April 20, 2015.

The proposed Item 407(i) would require issuers to disclose whether any employee or director is permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities either (1) granted to the employee or director as part of their compensation, or (2) held, directly or indirectly, by the employee or director. The proposed rule clarifies that the term "employee" specifically includes officers of the company by adding the parenthetical "(including officers)" after the term "employees" within the language of the disclosure requirement.

The Compensation Discussion and Analysis section of the proxy statement already requires disclosure of hedging policies that are material and necessary to an understanding of named executive officers compensation policies and decisions. To reduce duplicative disclosure, the amendments would also provide instructions to Item 402(b) specifying that the Compensation Discussion and Analysis section of the proxy statement requiring disclosure on policies regarding hedging by named executive officers may be satisfied by cross-reference to its Item 407(i) disclosure. Note that by amending Item 407, the SEC would apply these hedging policy disclosure requirements to smaller reporting companies to which 402(b) otherwise does not apply.

The proposal only would require disclosure in proxy or consent solicitation materials and information statements in connection with the election of directors. By requiring disclosures in such circumstances, shareholders would be able to consider the proposed hedging policy disclosure at the same time they consider the company's other corporate governance disclosures and vote for the election of directors.

### **HEDGING INSTRUMENTS – A PRINCIPLES-BASED APPROACH**

The proposed rule would apply a principles-based approach to hedging policy disclosure, covering all transactions designed to hedge or offset any decrease in the market value of equity securities. It covers financial instruments specified in Section 14(j) of the Exchange Act, including prepaid variable forward contracts, equity swaps, collars, and exchange funds hedging transactions, as well as other transactions with comparable economic consequences.

Furthermore, in order to provide a complete understanding of the scope of permitted hedging transactions and the range of persons permitted to engage in such transactions, the proposed rule would require companies to disclose the categories of both permitted transactions and prohibited transactions.

The proposed rule would require Item 407(i) disclosure for equity securities of the company, any parent, subsidiary, or subsidiary of any parent of the company that are registered under Section 12 of the Exchange Act.

#### **PROXY ADVISORY FIRM CONSIDERATIONS**

Proxy advisory firms consider anti-hedging policies an important compensation risk mitigation measure. ISS proxy voting policy flags any hedging by directors or executive officers as a “material failure of risk oversight” and may recommend negative votes for individual directors, members of the governance committee, or the whole board. ISS will also “red flag” a company’s lack of any anti-hedging policy. Glass Lewis’s proxy voting policy provides that hedging by executive employees severs the alignment of interest of the executive with shareholders and that companies should adopt strict anti-hedging policies.

#### **RECOMMENDED ACTION**

Companies should consider these proposed disclosure requirements when assessing corporate governance controls and procedures, because this proposed rule may heighten scrutiny of hedging policies this proxy season. In particular, companies should assess any policies permitting hedging transactions and how they may be viewed in light of these disclosure requirements.

Companies that anticipated this Dodd-Frank rule making and amended their policies to address hedging by executive officers, directors, and employees should include disclosure of the hedging policies in 2015 proxy statements. Those without policies on hedging should consider whether these disclosure requirements warrant the implementation of anti-hedging policies.

#### **ADDITIONAL INFORMATION**

Our Securities and Capital Markets attorneys will be pleased to meet with you to discuss the impact of the proposed disclosure rules. Please contact your attorney at Tucker Ellis or any of the following attorneys.

- **ROBERT LOESCH** | 216.696.5916 | [robert.loesch@tuckerellis.com](mailto:robert.loesch@tuckerellis.com)
- **GLENN MORRICAL** | 216.696.3431 | [glenn.morrical@tuckerellis.com](mailto:glenn.morrical@tuckerellis.com)
- **CHRISTOPHER HEWITT** | 216.696.2691 | [christopher.hewitt@tuckerellis.com](mailto:christopher.hewitt@tuckerellis.com)
- **JAMES WARREN** | 216.696.2590 | [james.warren@tuckerellis.com](mailto:james.warren@tuckerellis.com)
- **CHRISTINA KIM** | 216.696.2487 | [christina.kim@tuckerellis.com](mailto:christina.kim@tuckerellis.com)

This Client Alert has been prepared by Tucker Ellis LLP for the use of our clients. Although prepared by professionals, it should not be used as a substitute for legal counseling in specific situations. Readers should not act upon the information contained herein without professional guidance.