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Securities Law ALERT

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SEC Proposes Hedging Disclosure Rule

On February 9, 2015, the Securities and Exchange Commission (SEC) voted unanimously to propose a rule that would require companies to disclose whether employees, directors and officers may engage in transactions designed to hedge against declines in their companies' stocks. The proposed rule would implement Section 955 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which added a new Section 14(j) to the Securities Exchange Act of 1934, as amended (the "Exchange Act"). It is one of several corporate governance disclosures required by Dodd-Frank that remains to be implemented. The proposed rule is aimed at providing more information and transparency to investors about whether employees and directors are able to skirt company requirements to hold stock for the long term by entering into hedging contracts that would allow them to receive their compensation even if the company does not perform well.

The proposed rule would add a new paragraph (i) to Item 407, Corporate Governance, of Regulation S-K which would:

- Require disclosure about whether directors, officers and other employees are permitted to hedge or offset any decrease in the market value of equity securities granted by the company as compensation or held, directly or indirectly, by employees or directors;
- Specify that the equity securities for which disclosure is required are only equity securities of the company, any parent of the company, any subsidiary of the company or any subsidiary of any parent of the company that registered under Section 12 of the Exchange Act;
- Require the disclosure of election of directors in any proxy statement on Schedule 14A or information statement on Schedule 14C20; and
- Specify the definition of "employee."

What transactions would be subject to disclosure under the proposed rule?

The proposed rule would require disclosure of whether any employee or director of the company is permitted to purchase financial instruments, or otherwise engage in transactions that are designed to have the effect of, hedging or offsetting any decrease in the market value of equity securities. Smaller reporting companies or emerging growth companies would not be exempt from disclosure under the proposed rule.

Where would companies provide the required disclosures?

The proposed rule would require disclosure in any proxy or consent solicitation for an annual meeting of the shareholders. Specifically, the proposed rule would amend Schedule 14A to call for hedging information to be provided if any action is to be taken on the election of directors. The proposed rule would not require this information to be disclosed in registration statements or in Part III of Form 10-K. The proposed rule would also amend Item 402(b) of Regulation S-K to allow companies to cross-reference to the disclosure required by the proposed rule in the company's Compensation Discussion and Analysis (CD&A) to the extent such disclosure is responsive to the requirements of the CD&A.

Which employees and directors would be subject to the proposed disclosure?

Hedging transactions conducted by any employee or board member would be covered by the proposed rule. The term "employee" would include everyone, including officers, employed by the company.

Unanimous, but not unqualified, support by the five commissioners

Although the proposed rule received unanimous support from the five SEC commissioners, Commissioners Daniel Gallagher and Michael Piwowar released a joint statement noting that their vote should not be construed as "unqualified support" of the proposed rule as currently drafted. The joint statement noted several areas of concern in the proposed rule, including that it would not exempt smaller reporting companies or emerging growth companies. Additionally, Commissioners Gallagher and Piwowar expressed their view that the proposed rule was not central to the financial crisis and should not have been prioritized over more pressing areas of concern such as credit ratings reference removal or the regulation of swap markets. Conversely, Commissioner Luis Aguilar also released a statement on the proposed rule citing it as crucial to providing maximum transparency to investors.

Looking forward

The SEC will collect public comment on the rule for 60 days following its publication in the *Federal Register* and will hold a second vote before the rule can go into effect. If approved, the rule would not likely be applicable for the 2015 proxy season; however, companies should contact their counsel to proactively evaluate how the proposed rule may impact their disclosure regarding hedging contracts.

If you have any questions or would like additional information on how to best prepare for these new standards, please contact your Alston & Bird attorney.

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