

February 11, 2015

Securities Alert

SEC Issues Proposal Regarding Disclosure of Hedging Policies for Employees, Officers and Directors

On February 9, 2015, the SEC [proposed](#) rule amendments to implement Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added new Section 14(j) to the Securities Exchange Act of 1934, as amended (the Exchange Act). Section 14(j) directs the SEC to require, by rule, that each issuer disclose in proxy statements or consent solicitations for annual meetings of shareholders, whether any employee or member of the board of directors of such issuer, or any designee of such employee or director, is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars, and exchange funds) that are designed to hedge or offset any decrease in the market value of equity securities either (1) granted to the employee or director by the issuer as part of the compensation of the employee or director; or (2) held, directly or indirectly, by the employee or director. As this is a disclosure item, neither Section 14(j), nor the proposed rule amendment implementing the statutory mandate, requires a company to prohibit hedging transactions or to otherwise adopt practices or a policy addressing hedging by any category of individuals.

The proposed amendment would add new paragraph (i) to Item 407 of Regulation S-K and require disclosure in proxy statements or information statements regarding the election of directors of whether an employee, officer or director, or any of their designees, is permitted to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) or otherwise engage in transactions that are designed to, or have the effect of, hedging or offsetting any decrease in the market value of equity securities. The

proposed amendment would therefore cover all transactions that establish downside price protection, whether by purchasing or selling a security or derivative security or otherwise.

The proposed rule expands the requirement for disclosure of hedging policies currently provided in Item 402(b) of Regulation S-K, which relates to a company's Compensation Discussion and Analysis (CD+A). The existing rule specifies that the CD+A should include, if material, the company's equity or other security ownership requirements or guidelines (specifying applicable amounts and forms of ownership) and any company policies regarding hedging the economic risk of such ownership (note, however, that the CD+A by its terms pertains to named executive officers). To reduce potentially duplicative disclosure in proxy and information statements, the proposal would amend Item 402(b) of Regulation S-K to add an instruction providing that a company may satisfy its CD&A obligation to disclose material policies on hedging by named executive officers by cross-referencing the information disclosed pursuant to proposed Item 407(i) to the extent that the information disclosed there satisfies this CD+A disclosure requirement.

The proposed requirement to disclose whether a director or employee is permitted to hedge equity securities granted as compensation or otherwise held from whatever source acquired is intended to inform shareholders more fully as to whether employees and directors are able to engage in transactions that reduce the alignment of their interests with the economic interests of other shareholders of the company and any affiliated company in which the employees or directors might have an interest. The term "equity securities," as used in proposed Item 407(i), would mean any equity securities (as defined in Exchange Act Section 3(a)(11) and Exchange Act Rule 3a11-1) issued by the company, any parent of the company, any subsidiary of the company or any subsidiary of any parent of the company that are registered under Section 12 of the Exchange Act. The proposal notes that companies may grant equity securities of affiliated companies to their employees or directors that are intended to achieve similar incentive alignment as grants in the company's equity securities. In these instances, they believe it would be relevant for shareholders to know whether such persons are permitted to mitigate or avoid the risks associated with long-term ownership of these securities.

A proposed instruction would clarify that the company must disclose which categories of transactions it permits and which categories of transactions it prohibits. If a company specifically prohibits certain hedging transactions, it would disclose the categories of transactions it specifically prohibits, and could, if true, disclose that it permits all other hedging transactions in lieu of listing all of the specific categories that are permitted. Conversely, where a company specifies only the hedging transactions that it permits, in addition to disclosing the particular categories of transactions permitted, it may, if true, disclose that it prohibits all other hedging transactions in lieu of listing all of the specific categories that are prohibited. If a company does not permit any hedging transactions, or permits all hedging transactions, it should so state and would not need to describe them by category. Sufficient detail would be required to explain the scope of permitted transactions. In addition, if a company permits some, but not all, of the categories of persons covered by the proposed amendment to engage in

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hedging transactions, the company would disclose both the categories of persons who are permitted to hedge and those who are not.

No exception to the rule is contemplated for closed-end investment companies that have shares listed and registered on a national securities exchange, smaller reporting companies or emerging growth companies, but as securities registered by a foreign private issuer are not subject to the proxy statement requirements of Exchange Act Section 14, foreign private issuers would not be required to provide Item 407(i) disclosure.

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