SEC Proposes Hedging Disclosure Rules

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The Securities and Exchange Commission has proposed amendments to its rules under the Securities Exchange Act of 1934 (the "hedging disclosure proposal"). The hedging disclosure proposal would require public companies to disclose whether their employees, officers or directors are permitted to engage in hedging transactions with respect to any equity securities that were granted to them as compensation, as well as other equity securities owned by them.[1] The disclosures would be required in any proxy or information statement for a meeting of shareholders at which directors are being elected.

The proposed amendments would add new paragraph (i) to Item 407 of Regulation S-K to require disclosure 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 SEC notes that this requirement is broader than the statutory mandate (which would only require disclosure of certain specified financial instruments) and would extend to all transactions that establish downside price protection – whether by purchasing or selling a security or derivative security or otherwise. The SEC noted that if the proposed disclosure requirement is not sufficiently principles-based, investors would not receive information concerning transactions with the same economic effects as purchase of the financial instruments listed in the statute.

Under the proposed amendments a company must disclose which categories of transactions it permits and which categories of transactions it prohibits and make disclosures in sufficient detail that explain the scope of the permitted transactions. If a company permits hedging transactions by some, but not all, of the persons covered by Item 407(i), it must disclose the categories of persons who are permitted to engage in hedging transactions and those who are not.

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1 The amendments are designed to implement Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act which amended Section 14 of the Securities Exchange Act of 1934 by adding: ''(j) DISCLOSURE OF HEDGING BY EMPLOYEES AND DIRECTORS.—The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer whether any employee or member of the board of directors of the issuer, or any designee of such employee or member, 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—''(1) granted to the employee or member of the board of directors by the issuer as part of the compensation of the employee or member of the board of directors; or ''(2) held, directly or indirectly, by the employee or member of the board of directors.''

To reduce duplicative disclosure in proxy and information statements, the SEC proposes to amend Item 402(b) of Regulation S-K by adding an instruction that explains that a company may satisfy its obligation to disclose material policies on hedging by named executive officers in the Compensation Discussion and Analysis by cross referencing the information disclosed pursuant to proposed Item 407(i) to the extent that such information satisfies the Compensation Disclosure and Analysis disclosure requirement.

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