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Meridian Client Update

SEC Adopts Final Rules for Disclosure of Hedging Policies

On December 18, 2018, the Securities and Exchange Commission (SEC) adopted final rules that require companies to disclose in proxy statements their policies on hedging employer securities.

In 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which, among other things, directed the SEC to adopt rules requiring public companies to disclose their hedging policies. On February 9, 2015, the SEC issued proposed rules on the required disclosure of hedging policies. Nearly four years later, the SEC adopted final rules on December 18, 2018.

In the press release announcing the SEC's adoption of the new disclosure requirement, Chairman Jay Clayton noted that "[t]he new rules will provide for clear and straightforward disclosure of company policies regarding hedging. These disclosures in themselves, and in combination with our officer and director purchase and sale disclosure requirements, should bring increased clarity to share ownership and incentives that will benefit our investors, registrants, and our markets."

New Disclosure Requirement

The newly adopted rules will require a public company to disclose any practices or policies it has adopted regarding the ability of its employees (including officers) or directors (or their designees) to engage in transactions that hedge or offset (or are intended to hedge or offset) any decrease in the market value of the company's equity securities granted as compensation to an employee or director or held directly or indirectly by an employee or director. However, the final rules do not mandate that companies adopt hedging policies.

Definition of Hedge

Neither Dodd-Frank nor the final rules define the term "hedge." The final rules provide the following illustrative list of hedging transactions: prepaid variable forward contracts, equity swaps, collars and exchange funds. However, in the release to the final rule, the SEC notes that the term "hedge" should be broadly applied to cover any financial transactions that are designed to hedge or offset any decrease in market value of the company's equity securities.

Placement of Disclosure

The final rules do not mandate the placement of the hedging disclosure within a company's proxy statement. Therefore, a company may place the new hedging disclosure within its CD&A or elsewhere in its proxy statement. However, companies will remain obligated to disclose hedging policies covering named executive officers in their respective CD&As. The new hedging disclosure may be used to satisfy the foregoing CD&A disclosure requirement. In such a case, the final rules do not require duplicative

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disclosures in the proxy statement. Instead, a company may simply include in its CD&A a cross-reference to the new hedging disclosure.

Content of Disclosure

A company may satisfy the disclosure requirement as follows:

- If the company has a practice or policy on hedging, then the company could satisfy the requirement by either:
  - — Disclosing a fair and accurate summary of its hedging practices or policies, including the categories of persons they affect and any categories of hedging transactions that are specifically permitted or specifically disallowed, or
  - — Disclosing the hedging practices or policies in full.
- If the company does not have any practice or policy on hedging, the company must disclose that fact or state that hedging transactions are generally permitted.

In addition, under the new rules, a company will be required to disclose its hedging policy on equity securities of the company, any parent of the company, any subsidiary of the company, or any subsidiary of any parent of the company.

Effective Date and Exempt Companies

Generally, companies must comply with the new disclosure requirements for annual proxy statements filed for fiscal years beginning on or after July 1, 2019. For a calendar year company, this means the new disclosure requirement would first appear in the annual proxy statement filed in 2020. With respect to companies that qualify as “smaller reporting companies” or “emerging growth companies,” the effective date of the new disclosure requirement is pushed back one year to July 1, 2020. Listed closed-end funds and foreign private issuers are not subject to the new disclosure requirements.

Meridian Comment. Compliance with the new disclosure requirement should not prove overly burdensome for most public companies. Currently, the great majority of large public companies already disclose their hedging policies. However, companies should review both their policies and related disclosure to determine the population covered (i.e., executive officers, board members, and/or all employees).

The SEC’s final rules allow a company to separately disclose its hedging policies for officers and other employees. As many companies do not make broad-based equity grants to employees, not all hedging policies cover all employees. Consequently, some companies may need to use the bifurcated disclosure approach, as permitted by the final rules, or they will need to adopt a universal hedging policy.

With the adoption of final rules on hedging policy disclosure, two Dodd-Frank mandates on disclosure and governance matters remain outstanding: (i) disclosure on pay versus performance, and (ii) mandatory recoupment policy and disclosure of the same. The SEC issued *proposed* rules on both of these items over three years ago. Chair Clayton has stated his commitment to move forward with final rulemaking on both of these items. The exact timing and final provisions of those two mandates are not clear, but we would not be surprised to see final rules being issued over the next year or so.

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The ***Client Update*** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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