New SEC Rules Regarding Disclosure of Hedging Policies Are Now Effective

July 29, 2019 Bruce Newsome

PRACTICES Corporate, Capital Markets and Securities

On July 1, 2019, Item 407(i) of Regulation S-K went into effect, requiring registrants to provide additional disclosure of policies or practices related to hedging of their equity securities by employees and directors. The new rule applies equally to securities granted as compensation or otherwise acquired, including in open market transactions. While the new rule does not require registrants to have or develop practices or policies related to hedging transactions, it does require that registrants without hedging policies disclose that no such policy exists and that hedging transactions are generally permitted.

The full text of the new rule is available here.

Under Item 402(b)(2)(xiii) of Regulation S-K, registrants have already been required to describe material policies regarding hedging the economic risk of the ownership of their securities when discussing the compensation of named executive officers within Compensation Discussion and Analysis.[1] Item 407(i) expands upon these requirements by requiring disclosures concerning hedging policies from a corporate governance perspective rather than an executive compensation perspective. Accordingly, registrants will now be required to make more fulsome disclosures concerning their hedging policies, including the following, among other things:

- Either a fair and accurate summary or the full text of their hedging policies.
- The categories of hedging transactions that are specifically permitted and the categories of hedging transactions that are specifically disallowed.
- How hedging policies affect all employees and directors, as opposed to just executive officers.
- If they do not have a hedging policy, that no such policy exists, without regard to whether they view hedging policies as material from a compensation perspective.

While the Securities and Exchange Commission did not explicitly define the term “hedge,” it indicated through the adopting release that the term is to be interpreted broadly. It is up to the registrants to describe their policies with enough specificity and to identify which transactions are intended to “hedge” against risk of any decrease in market value of the registrant’s equity securities. Certain instruments enumerated in the rule as examples of “hedges” include prepaid variable forward contracts, equity swaps, collars and exchange funds.

The new disclosure requirement applies to all proxy and information statements related to the election of directors during the fiscal years beginning on or after July 1, 2019. Smaller reporting companies and emerging growth companies will also be required to begin providing hedging policy disclosures, although such disclosures will not be required until their proxy or information statements for the election of directors for the fiscal year beginning on or after July 1, 2020.

It is worth noting that proxy advisory firms generally view hedging by a registrant’s insiders as a problematic practice. In ISS’s view, hedging is a type of governance failure in risk oversight that could lead to a recommendation against a director, committee or the full board, if material. Glass

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Lewis believes that hedging may weaken the alignment of interests between the executive and shareholders, and therefore favors strict anti-hedging policies.

Registrants should:

- Carefully review any existing hedging policies and procedures to determine if any changes might be necessary considering the heightened public disclosure requirements.
- If registrants do not have any such policy, consider creating and implementing hedging policies and procedures in time for their next proxy or information statement.

For additional information regarding the new hedging disclosure requirements, please contact any member of Haynes Boone’s Capital Markets and Securities Practice Group.

2019 summer associate Sawyer Smith contributed to this alert.

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[1] Registrants that are smaller reporting companies and emerging growth companies are exempt from the requirement to provide a Compensation Discussion and Analysis and therefore have not been required to disclose their policies regarding the hedging of their securities.

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