



# [Client Alert] SEC Adopts Final Rules for Disclosure of Hedging Policies

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On December 18, 2018, the SEC adopted a new rule that will require disclosure of an issuer's hedging policies in proxy statements or information statements relating to the election of directors. The rule, which implements Section 955 of the Dodd-Frank Act and sets forth a new Item 407(i) of Regulation S-K, is intended to provide shareholders with information, at the time they are asked to elect directors, about whether employees, officers or directors may engage in transactions that could reduce the extent to which their equity holdings and equity compensation are aligned with shareholder interests.

## Summary of Final Rule

The new Item 407(i) of Regulation S-K will require an issuer to describe any practices or policies it has adopted, whether written or not, regarding the ability of its employees, officers, directors or any of their designees, to purchase financial instruments, or otherwise engage in transactions, that hedge or offset or are designed to hedge or offset, any decrease in the market value of issuer's equity securities granted as compensation or held directly or indirectly by the individual or designee. The term "financial instrument" includes prepaid variable forward contracts, equity swaps, collars and exchange funds.

An issuer could satisfy this requirement by either providing a fair and accurate summary of the practices or policies that apply, including the categories of persons they affect and any categories of hedging transactions that are specifically permitted or specifically disallowed, or, alternatively, by disclosing the practices or policies in full. If an issuer does not have any such practices or policies, the issuer must disclose that fact or state that hedging transactions are generally permitted.

## Practical Implication

Prior to the new rule, issuers were already required to disclose in their Compensation Discussion & Analysis ("CD&A") any material policies on hedging by named executive officers. Due to pressure from various proxy advisory firms and institutional shareholders (who view hedging activity of issuer stock by

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directors and officers as an issue in risk oversight), many of our public company clients have already adopted relatively expansive anti-hedging policies and some have chosen to disclose these policies in past proxy statements.

The new rule does not require companies to adopt hedging practices or policies or dictate the content of any such practices or policies. And to reduce possible duplicative disclosure from the items in CD&A mentioned above, the rule provides that an issuer may satisfy the CD&A requirement to disclose policies on hedging by named executive officers, if material, by including a cross-reference to its Item 407(i) disclosure. The SEC Adopting Release also notes that issuers will have flexibility as to where they present the new Item 407(i) disclosure.

### Next Steps

Generally, issuers that are not smaller reporting companies or emerging growth companies must comply with new Item 407(i) of Regulation S-K in proxy and information statements relating to the election of directors during fiscal years beginning on or after July 1, 2019. Smaller reporting companies and emerging growth companies have an additional year to comply. Foreign private issuers are not subject to the new disclosure requirements.

Although the new disclosure called for by Item 407(i) of Regulation S-K will not impact proxy statements in the 2019 proxy season, given the relatively low compliance burden, public companies should take the new rule into account when deciding whether to adopt or revise their hedging practices and policies and when drafting proxy statement disclosure regarding their company's hedging policies.

SEC Hedging Disclosure Adopting Release: <https://www.sec.gov/news/press-release/2018-291>

SEC Final Rule "Disclosure of Hedging by Employees, Officers and Directors": <https://www.sec.gov/rules/final/2018/33-10593.pdf>

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