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At Long Last, Dodd-Frank Hedging Policy Disclosure is Now Effective

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A mere nine years after passage of the Dodd-Frank Act, the rules related to Section 955 of the Act with respect to disclosure of a company's hedging policies are now effective. Although final rules were published in December of 2018, July 1st of this year marked the date that most companies must begin compliance.

In a nutshell, the final hedging disclosure rules require certain companies to describe any practices or policies they have adopted regarding the ability of employees (including officers) or directors to engage in financial transactions that hedge or offset any decrease in the market value of the company's equity securities granted as compensation to, or otherwise held, directly or indirectly, by such individual. If the company does not have a hedging policy, that fact must also be disclosed.

Let's drill down into a few specifics to jog your memory.

Which companies are covered? Generally, all public companies, including smaller reporting companies (SRCs) or emerging growth companies (EGCs), although SRCs and EGCs don't need to comply until July 1, 2020.

Which individuals are included? All employees, officers, and directors are covered.

What compensation is covered? The new disclosure requirement applies to any equity securities issued by the company, including its parents, subsidiaries, or subsidiaries of its parents.

What is the definition of "hedge"? The rule does not contain a specific definition but refers to hedging as a broad principle for transactions that hedge or offset, or are designed to hedge or offset, any decrease in the market value of covered equity securities.

What needs to be disclosed? Companies must provide a fair and accurate summary of the practices or policies that apply, including the categories of persons covered and any categories of hedging transactions that are specifically permitted and any categories that are specifically disallowed. Alternatively, the full text of the practices or policies can be provided.

Are companies required to adopt a policy? The rule does not require companies to adopt any specific kind of policy (or any policy at all). Instead, it focuses on the disclosure and allows each company to make its own judgments in determining what activities, if any, should be covered by a practice or policy.

What if a company does not have a policy? Then it must disclose that fact or state that hedging transactions are generally permitted. Clearly, this will serve as an impetus for most companies to adopt a policy.

Where should this disclosure be located in the proxy? Companies have flexibility as to where to insert this discussion. The CD&A rules already required a less-specific discussion about hedging policies, but only as they applied to named executive officers. The new rules allow companies flexibility to consolidate this discussion with the new Dodd-Frank requirement, which will likely result in placing hedging disclosure outside of the CD&A and adding a cross-reference to it within the CD&A.

When will first disclosures be required? Compliance is required in proxy statements for the election of directors during the fiscal years beginning on or after July 1, 2019 **which means that some companies may have been subject to the requirement since July 1 of this year.** For calendar year-end reporting companies, the disclosures should be included proxy statements that are filed in 2020. SRCs and EGCs have an additional year (until 2021) to comply.

Pearl Meyer Observations

For most companies, the new rules will likely have little impact as many have already adopted and disclosed an outright prohibition on hedging by their employees and directors. Adoption of a policy and its disclosure in advance of the final rule was likely the result of proxy advisor pressure as both ISS and Glass Lewis have been looking for these governance practices and disclosure for quite a few years.

Companies that have not yet done so, however, should take immediate action to discuss, implement, and be prepared to disclose in their next proxy statements. Pearl Meyer can help clients get there.

In closing, nine years seems like a long time to get something as non-controversial as disclosure of hedging policies finalized. It's hard to imagine the impending timeline for the more complex outstanding Dodd-Frank compensation rules that are still in proposed form, which include clawbacks, pay for performance, and, for financial institutions, regulation of incentive-based compensation. The SEC currently states that these are still longer-term actions. Whether and if they have any hope of moving forward in an election year is questionable but we will keep you posted.

About the Author

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