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Via Electronic Submission

July 8, 2015

Mr. Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-01-15
Release Nos. 33-9723; 34-74232; IC-31450
Disclosure of Hedging by Employees, Officers and Directors

Dear Mr. Fields:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "**Committee**" or "**we**") of the Section of Business Law of the American Bar Association (the "**ABA**"), in response to the requests for comment by the U.S. Securities and Exchange Commission (the "**Commission**") presented in the proposing release referenced above (the "**Proposing Release**"). As set forth in the Proposing Release, the Commission has proposed amendments to Items 402 and 407 of Regulation S-K and Schedule 14A to implement Section 955 ("**Section 955**") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd-Frank Act**"). Section 955 amends Section 14 of the Securities Exchange Act of 1934 (as amended, the "**Exchange Act**")[1] to add subsection (j), directing the Commission to adopt a rule requiring annual meeting proxy or information statement disclosure of whether employees or members of the board of directors are permitted to purchase financial instruments that are designed to hedge or offset any decrease in the market value of equity securities granted to the employee or director as part of his or her compensation, or held directly or indirectly by the employee or director.

The comments expressed in this letter (this "**Comment Letter**") represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this Comment Letter does not represent the official position of the Section of Business Law of the ABA.

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[1] 15 U.S.C. 78a *et seq.*

The Committee thanks the Commission for this opportunity to comment on the Proposing Release and the proposed amendments to its rules relating to the implementation of Section 955 of the Dodd-Frank Act.

Summary of Our Comments

A. Transactions Subject to the Proposed Disclosure Requirement

1. We agree with the Commission's decision to treat the disclosures required by Section 14(j) of the Exchange Act as primarily corporate governance-related, subject to our recommendation (as described below) that registrants be permitted the flexibility to satisfy their disclosure obligation under proposed Item 407(i) of Regulation S-K by including the disclosure in their Compensation Discussion and Analysis (pursuant to Item 402(b) of Regulation S-K), if so desired.

2. While we agree with the Commission's "principles-based" approach to identifying the transactions that would be covered by proposed Item 407(i), we are concerned that, by expanding the scope of the statutorily-mandated disclosure to encompass all "transactions" that "have the effect of" hedging, registrants will face significant challenges in complying with proposed Item 407(i). Consequently, we recommend that the Commission either modify the proposed rule or provide guidance making clear that otherwise routine financial diversification transactions are not within the scope of the required disclosures.

3. We recommend that the Commission clarify that transactions involving an index that includes a broad base of equity securities, one component of which is the registrant's equity securities, are expressly excluded from the scope of proposed Item 407(i) of Regulation S-K.

4. We recommend that proposed Item 407(i) be modified to require registrants simply to (i) disclose whether they permit any employee or member of the board of directors to purchase financial instruments that are designed to hedge or offset any decrease in the market value of their equity securities and (ii) to the extent that such activities are permitted, disclose sufficient detail to explain the scope of such permitted transactions, to the extent material.

B. Specifying the Term "Equity Securities"

1. While we agree with the Commission's decision to clarify that the term "equity securities" does not include the equity securities of any issuer other than the registrant that are held, directly or indirectly, by a registrant's employees or members of its board of directors, we recommend that the scope of proposed Item 407(i) of Regulation S-K be narrowed to cover only a registrant's equity securities that are registered under Section 12 of the Exchange Act.

2. If the Commission decides to retain its requirement to include the equity securities of certain affiliated entities within the scope of proposed Item 407(i), we recommend that the affiliated entities covered be limited to parents owning a majority of the registrant's voting securities and the registrant's majority-owned subsidiaries.

3. We recommend that the Commission provide guidance on the meaning of the concept "held, directly or indirectly" by an employee or member of the board of directors as used in proposed Item 407(i), and re-evaluate its approach to the treatment of "designees" of a registrant's employees and directors under Section 14(j) of the Exchange Act.

C. Employees and Directors Subject to the Proposed Disclosure Requirement

1. We recommend that the Commission exercise its general exemptive authority to limit the scope of the term "employee" to refer solely to the executive officers of a registrant.

2. We believe that it is not necessary for the Commission to develop an additional disclosure requirement for transactions that have actually occurred which either constitute "hedging," or are designed to or have the effect of hedging by executive officers and members of the board of directors who are subject to the reporting requirements of Section 16(a) of the Exchange Act.

D. Implementation

1. We agree with the Commission's determination that the disclosures required by proposed Item 407(i) of Regulation S-K should be provided in proxy or information statements with respect to the election of directors. We do not believe that the disclosure contemplated by proposed Item 407(i) should be included in registration statements filed under either the Securities Act of 1933, as amended, or the Exchange Act, or in the Part III Item 407 disclosures required in an annual report on Form 10-K.

2. We agree with the Commission's decision to forego amending Item 1 of Schedule 14C to include the disclosures contemplated by proposed Item 407(i) in the information called for by Schedule 14C.

3. While we agree with the Commission's proposal to amend Item 402(b) of Regulation S-K to permit registrants to satisfy their obligation to disclose any material policies regarding hedging the economic risk of company securities ownership in their Compensation Discussion and Analysis by means of a cross-reference to the disclosures required by proposed Item 407(i), we recommend that, as an alternative, the Commission add an instruction permitting registrants the flexibility to satisfy their disclosure obligation under proposed Item 407(i) by including the disclosure in their CD&A if so desired.

4. While we agree with the Commission's decision to exclude open-end funds from the proposed disclosure requirement, we request that the Commission reconsider its proposal to require closed-end investment companies with "shares that are listed and registered on a national securities exchange" to provide the proposed hedging-related disclosures.

5. We recommend that the Commission exclude smaller reporting companies and emerging growth companies from the scope of proposed Item 407(i). We agree with the Commission's proposed exclusion of foreign private issuers.

Discussion

A. Transactions Subject to the Disclosure Requirement

1. Should the disclosure required by Section 14(j) be implemented by amending the corporate governance disclosures required by Item 407, as proposed? Alternatively, should it be implemented by amending the Item 402 executive compensation disclosure requirements? Are there advantages or disadvantages to requiring these disclosures under Item 402? If so, please explain why.

As the Commission indicates in the Proposing Release, it is reasonable to infer that the statutory purpose of Section 14(j) of the Exchange Act is to provide transparency to security holders, if action is to be taken with respect to the election of directors, about whether employees and members of the board of directors are permitted to engage in transactions that mitigate or avoid the incentive alignment associated with equity ownership. We note that many institutional investors, as well as the major proxy advisors Institutional Shareholder Services, Inc. and Glass Lewis & Co., LLC, consider the presence or absence of hedging restrictions to be a matter of risk management oversight within the province of the board of directors.[2] Accordingly, we believe that it is appropriate to treat the disclosures required by Section 14(j) as primarily a corporate governance-related, rather than an executive compensation-related, disclosure item.[3]

We agree that the information to be provided by registrants pursuant to Section 14(j) is intended to address the issue of the alignment of the interests of employees and members of the board of directors with those of security holders. While this issue can be (and often is) addressed within the framework of a registrant's description of its corporate governance-related compensation policies in its Compensation Discussion and Analysis, we believe that, in many instances, it may be useful for security holders to receive this information as part of a registrant's presentation of its corporate governance policies and practices. Ultimately, as we discuss in our response to Question 17 below, we recommend that, even though the text of the disclosure requirement will be located in the corporate governance provisions of Item 407 of Regulation S-K, registrants be given the flexibility to locate the disclosure in that portion of their proxy (or information) statement where its presentation best fulfills their communication objectives and otherwise complies fully with Exchange Act Rule 14a-9.

2. Should the scope of the proposed Item 407(i) disclosure requirement cover transactions that are not expressly listed in Exchange Act Section 14(j) but have economic consequences comparable to the purchase of the financial instruments specifically identified in Section 14(j), as proposed? If not, why not?

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[2] *See* Institutional Shareholder Services, Inc., United States Summary Proxy Voting Guidelines, 2015 Benchmark Policy Recommendations (Dec. 22, 2014), at Section 1.18; Glass Lewis & Co., LLC, Guidelines, 2015 Proxy Season, United States, at page 30.

[3] We believe this conclusion to be true even if, as we recommend in our response to Question 10 below, the Commission were to decide to limit the disclosure requirement to employees who are also executive officers of the registrant.

As discussed at length in the Proposing Release, the Commission is proposing an expansive approach to identifying the transactions that would be covered by proposed Item 407(i) of Regulation S-K. This approach reflects the Commission's pragmatic concern that, were it to define the term "hedging" or otherwise identify the specific instruments that would be deemed hedges, security holders would receive only partial, incomplete, or potentially misleading[4] disclosure, and/or employees and members of the board of directors would be incentivized to create and use instruments not identified in the rule to offset or guard against a possible market price decrease.

Generally, we agree with this "principles-based" approach[5] to the proposed hedging disclosures, and find it preferable to an attempt to define the term "hedge." As described in the preceding paragraph, we believe that any such definition would simply encourage circumvention over time. Further, any such definition may very well need constant updating as new financial instruments are developed over time that could serve as hedging vehicles. Consequently, we believe that it is reasonable for the Commission to go beyond the plain language of Section 14(j) of the Exchange Act to require the disclosure of transactions with economic consequences comparable to the purchase of the specified financial instruments without specifically defining the term "hedge" in the final rule.

Having said this, however, we are concerned that by expanding the scope of the statutorily-mandated disclosure to encompass all "transactions" that "have the **effect** of" (emphasis added) hedging, registrants will face significant challenges in complying with proposed Item 407(i) if it is adopted as proposed. In our view, absent some modifications to the proposed rule or further guidance from the Commission, the expansive scope of proposed Item 407(i) could result in the inclusion of otherwise routine financial diversification transactions in the disclosure because they may be viewed as establishing, either in whole or in part, some level of downside price protection. We are skeptical that the contours of the concept of hedging are as well understood by market participants as the Commission assumes. In our experience, most hedging policies are included as a feature of a registrant's insider trading policy and tend to be quite brief – often simply indicating that the registrant prohibits one or more categories of individuals from engaging in hedging transactions involving the registrant's equity securities. Some of these policies may go farther and specify, either as an illustrative or exhaustive list, the types of transactions that are covered by the policy. Often, these lists go no further than the instruments enumerated in Section 14(j) itself.

We are concerned that if the rule is adopted as proposed, many financial transactions that have otherwise been considered routine and prudent under well-established principles of

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[4] As the Commission notes, if, for example, a company discloses that it prohibits the purchase of the types of financial instruments specifically listed in the statute, and does not otherwise disclose whether it permits other types of hedging transactions that may have the same economic effects as the purchase of the listed financial instruments, a shareholder might assume that the company does not permit any hedging transactions at all, even though that may not be the case.

[5] We also agree with the Commission's belief's that, by specifying "exchange funds," Section 14(j) can be interpreted to cover transactions involving dispositions or sales of securities and that whether a disposition to an exchange fund is a hedging transaction will depend on the terms of the fund.

portfolio management (or not a hedging transaction in violation of a voluntary policy) would now have to be re-examined to determine whether they are potentially subject to disclosure and/or are captured by the policy. Such transactions may have as their principal purpose portfolio diversification, financial or estate planning, or the execution of an investment strategy which only secondarily may serve to have an economic effect comparable to a "hedge." A wholly open-ended provision, such as that reflected in proposed Item 407(i), leaves room for potential plaintiffs to assert that such routine portfolio diversification transactions are within the scope of the required disclosure. We note in this regard that Section 14(j) speaks only in terms of "design" or purpose, rather than "effect."

For example, many corporate executives who hold a meaningful stake in the registrant's equity securities may desire to reduce the heightened financial risks attendant to an overly-concentrated equity position through the diversification of the rest of their investment portfolio. Such diversification may lead to investment in particular securities (or financial instruments) or market sectors that are counter-cyclical to the registrant's equity securities or market sector. Based on the limited legislative history of Section 955, we believe that this is not what Congress was seeking to regulate.[6] Nonetheless, without further Commission guidance – preferably in the text of the final rule as supplemented by interpretive guidance in the adopting release, such transactions arguably could be viewed as transactions that may provide downside price protection and, therefore, registrants may be compelled to evaluate and disclose such transactions as transactions that are either prohibited or permitted under their hedging policy.

We are concerned that some registrants may not appreciate the magnitude of this new disclosure obligation and, as a result, inadvertently provide disclosure that, in hindsight, may be viewed as incomplete or inaccurate. Further, absent a clearer understanding of what must be disclosed under the final rule, such disclosures are likely to be inconsistent across registrants, thereby frustrating the important goal of comparability for investors and creating an undue risk of private litigation in a sphere where public companies have been subject to abusive lawsuits.[7] Accordingly, we believe that it is important that the Commission clarify that routine financial transactions in securities other than a registrant's equity securities (and related derivative securities) are not within the ambit of proposed Item 407(i).

We therefore recommend that the Commission expressly provide – preferably in the line-item requirement itself, or an interpretive section of the adopting release – that long and short positions in equity securities other than the registrant's own (or, as we discuss in response to Question 6 below, an affiliated issuer's) equity securities that are not based, in whole or in part, on the equity securities of the registrant, are outside the scope of the proposed disclosure. As noted above, we expect that, once the Commission adopts final rules to implement Section 14(j),

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[6] Instead, Congress appeared to be focused more narrowly on facilitating disclosure that "will allow shareholders to know if executives are allowed to purchase financial instruments to effectively avoid compensation restrictions that they hold stock long-term, so that they will receive their compensation even in the case that their firm does not perform. Dr. Carr Bettis has written that derivatives instruments 'provide a mechanism that insiders can use to trade on inside information prior to adverse corporate events without the level of transparency typically associated with open market sales.'" Report of the Senate Committee on Banking, Housing, and Urban Affairs, S. 3217, Report No. 111-176 (Apr. 30, 2010), at page 136.

[7] *See, for example*, Mancuso v. The Clorox Company, No. RG12-651653 (Cal. Super. Ct. Alameda Cnty).

registrants will be compelled to review carefully their existing hedging policies both to understand what is currently prohibited or permitted under such policies, and to decide how to identify and classify transactions covered by new Item 407(i). Since we believe that Congress did not intend to require registrants to disclose whether their employees and members of their board of directors are prohibited from purchasing equity securities in other, non-affiliated registrants or purchasing or selling instruments that relate to securities of other non-affiliated issuers or broad-based indexes or baskets of which registrant equity securities are a nominal component, it would greatly simplify compliance if the Commission were to exclude these transactions from the scope of the required disclosure.

Finally, we note that at least one commenter[8] has suggested excluding financial instruments from proposed Item 407(i) if they are not a "derivative security" (as defined in Exchange Act Rule 16a-1(c)) with respect to a registrant's equity securities that is designed to hedge or offset decreases in the market value of the registrant's equity securities. We believe that this recommendation deserves serious consideration by the Commission. Making use of the existing regulatory framework and common understanding of equity-based derivative securities that potentially allow insiders to benefit at the expense of other security holders (see, for example, note 6, above) would greatly simplify compliance with the proposed rule. The rules and guidance under Section 16 of the Exchange Act are well-established and understood by registrants and their legal counsel. Further, this approach would clearly cover three of the instruments identified in Section 14(j) – prepaid variable forward contracts, equity swaps, and collars, each of which has been determined to be a covered derivative security for purposes of Section 16. Moreover, Exchange Act Rule 16a-1(c) is sufficiently flexible to cover comparable financial instruments that may be developed in the future. We believe that this approach would greatly ease the application of the new disclosure requirement and, in so doing, promote compliance with Congressional objectives underpinning Section 14(j).

In sum, we believe that the application of the proposed rule to transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of a registrant's equity securities for purposes of Section 14(j) should be accompanied by appropriate guidance, preferably within the text of the rule itself, limiting the intended scope of this provision to exclude transactions in securities issued by other, non-affiliated registrants. We believe that this is necessary both to ensure that the parameters of the covered transactions are clear and readily understood, and to minimize the costs and burdens of compliance.

3. **Should the scope of transactions covered by proposed Item 407(i) be clarified? We are of the view that there is a meaningful distinction between an index that includes a broad range of equity securities, one component of which is company equity securities, and a financial instrument, even one nominally based on a broad index, designed to or having the effect of hedging the economic exposure to company equity securities. Should we clarify the application of Item 407(i) to account for this situation? If so, how? For example, if an issuer prohibited hedging generally, but permitted the purchase of broad-based indices, should we specify that the issuer could nonetheless disclose that it prohibits all hedging transactions? Should the rule explicitly distinguish between instruments that**

[8] *See* Comment Letter from McDermott Will & Emery (April 22, 2015).

provide exposure to a broad range of issuers or securities and those that are designed to hedge particular securities or have that effect? Would a principles-based or numerical threshold approach be most helpful in this regard? If not, what other clarification should be provided?

We recommend that the Commission clarify that transactions involving an index that includes a broad base of equity securities, one component of which is registrant equity securities, are expressly excluded from the scope of proposed Item 407(i) of Regulation S-K. As discussed in more detail in our response to Question 2 above, we believe that it is not appropriate, or within the intent of Congress, for the required disclosure to capture transactions that are primarily intended to mitigate an individual's exposure to decreases in the equity markets generally. In our view, this exclusion would cover financial instruments that offer exposure to a broad range of issuers or securities (such as broad-based indices, equity "baskets" of securities, and other similar financial instruments). To minimize the potential for this exclusion to serve as a loophole permitting non-compliance, we recommend that the Commission specify a set of objective criteria that would need to be satisfied for an equity position to be considered "broad-based" (for example, a minimum number of component securities that must comprise the index or basket and/or a ceiling on the weighting of the index or basket that may consist of the registrant's equity securities).

Not only is such an exclusion reasonable, we also believe that security holders are unlikely to obtain any meaningful information even if registrants are required to disclose whether they restrict their employees and members of their board of directors from engaging in transactions, the value of which is based on changes in valuations in broad-based equity instruments. Further, given the potential stigma of characterizing transactions involving broad-based indices as "hedging" transactions (which, as noted, are disfavored by the major proxy advisory firms), we are concerned that the inclusion of such transactions within the scope of proposed Item 407(i) may lead registrants to limit or prohibit them entirely in spite of their routine nature and overall financial benefit. In this regard, we note that the positive goal of stock ownership guidelines or requirements adopted by many registrants to align management's incentives with those of security holders could be undermined if employees and members of the board of directors are not permitted to use conservative portfolio diversification techniques to protect against undue personal financial risk.

As has been proposed by another commenter,[9] we believe that the Commission should consider using the regulatory framework established for purposes of Section 16(c) of the Exchange Act[10] to define the scope of broad-based instruments that would be excluded from the scope of the proposed rule. Specifically, we recommend that the Commission modify proposed Item 407(i) to provide explicitly that transactions involving an index that contains a registrant's

[9] *See* Comment Letter from Cleary Gottlieb Steen & Hamilton LLP (April 17, 2015).

[10] Section 16(c) of the Exchange Act prohibits executive officers and directors from engaging in short sales of an issuer's equity securities.

equity securities that would not otherwise be prohibited by Section 16(c)[11] for the executive officers and directors of the registrant, are not subject to the Item 407(i) disclosure requirement.

Please also see our response to Question 2 above.

4. **If a company prohibits some, but not all, of the categories of transactions described in the proposed amendment, in order to fully describe what hedging transactions are permitted and by whom, is it necessary to require disclosure, as proposed, of both the categories of transactions that are permitted and the categories of transactions that are prohibited? If not, please explain why not. Does proposed Instruction 3 to Item 407(i) provide a way for companies that permit or prohibit only certain covered transactions to disclose this information in a clear and effective manner? Alternatively, should the company simply be required to describe its policy, if any, without further elaboration?**

We note that a registrant would be required by Instruction 3 to proposed Item 407(i) of Regulation S-K to disclose both the categories of hedging transactions it permits and the categories of such transactions it prohibits. Alternatively, a registrant may, if true, disclose that it prohibits or permits particular categories of hedging transactions and permits or prohibits, respectively, all other hedging transactions.

In our view, such a disclosure requirement will likely impose an onerous burden on registrants without providing material information to investors. Given the potential breadth of the proposed disclosure requirement (see our response to Question 2 above), we believe that most registrants will need to review carefully and, in all likelihood, revise their existing hedging policies to address the effect of a disclosure requirement geared towards both well-understood hedging transactions and other transactions that are designed to, or have the effect of, hedging. Drafting a concise, yet complete and accurate disclosure following this exercise could pose a challenge for many registrants. Unless a registrant either establishes or reaffirms a policy of permitting or prohibiting all hedging transactions, it will need to disclose and describe the different categories of transactions that are permitted and prohibited. This approach would likely involve disclosure about a wide range of possible transactions (and persons[12]) that are not covered by its hedging policy, leading to detailed and potentially complex disclosure, which may confuse investors and reduce comprehension. Conversely, it could lead to extensive disclosure about the transactions and persons that are subject to the restrictions of the policy. While a "principles-based" disclosure regime has distinct advantages for this disclosure requirement, we are concerned that, with respect to this particular aspect, it will make compliance more difficult for registrants and the resulting disclosure less meaningful for security holders.

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[11] But without regard to Exchange Act Rule 16c-4 [17 CFR 240.16c-4].

[12] We note that both Section 14(j) of the Exchange Act and proposed Item 407(i) require disclosure of the potential hedging activities of "designees," a term that the Commission proposes to require registrants to interpret based on the particular facts and circumstances. *See* Proposing Release, at footnote 37. We believe that, to facilitate both compliance and clarity, the Commission should either define or provide guidance as to who should be considered a "designee" of an employee or director. *See* our response to Question 9 below.

Consequently, we believe that proposed Item 407(i) should simply require registrants to disclose whether they permit any employee or member of the board of directors to purchase financial instruments that are designed to hedge or offset any decrease in the market value of their equity securities. To the extent that a registrant permits such activities, it should disclose sufficient detail to explain the scope of such permitted transactions (per Instruction 4), to the extent material. We recommend that Instruction 3 either be deleted or revised to address the concerns that we discuss in our response to Question 2, above. Alternatively, the Commission could require registrants to disclose the categories of hedging transactions that they prohibit and permit them to state that they permit all other transactions, without requiring the registrant to categorize such transactions as involving or having the effect of hedging or non-hedging.

5. **A company that permits hedging transactions would be required to disclose sufficient detail to explain the scope of such permitted transactions. For example, a company may permit hedging transactions only if pre-approved, or only after the company's stock ownership guidelines have been met. Should proposed Instruction 4 be more specific about the types of details, such as a pre-approval requirement, that the company must disclose?**

Please see our response to Question 4 above. We believe that if a registrant's policy permits hedging transactions only in specified circumstances or subject to specified conditions, a requirement to describe the content and scope of the hedging policy would pick up a requirement to describe those circumstances and/or conditions.

B. Specifying the Term "Equity Securities"

6. **Does our proposal to define the term "equity securities" as equity securities of the company or any of its parents, subsidiaries or subsidiaries of its parents that are registered under Section 12 of the Exchange Act appropriately capture the disclosure that shareholders would find useful? Should the Commission limit the term "equity securities" to only equity securities of the company? If so, please explain why and the costs and benefits that would result. How often are directors and employees compensated through equity securities of an affiliated company that are not registered under Section 12(b) of the Exchange Act? If the definition of equity securities includes only equity securities registered under Section 12(b) of the Exchange Act, would that affect either compensation structure or corporate structure? Do companies typically have policies addressing hedging of equity securities of their parents, subsidiaries or subsidiaries of their parents? What would be the costs and benefits of disclosing whether hedging the equity securities of these affiliates is permitted or prohibited? Would any on-going compliance efforts be different? If so, please explain why and the costs and benefits that would result.**

The Commission is proposing that the term "equity security" (as defined in Section 3(a)(11) of the Exchange Act[13] and Exchange Act Rule 3a11-1[14]) encompass equity securities

[13] 15 U.S.C. 78c(a)(11).

issued by a registrant or any parent of the registrant, any subsidiary of the registrant, or any subsidiary of any parent of the registrant to the extent that such equity securities are registered under Section 12 of the Exchange Act. Thus, we understand that the disclosure required by proposed Section 407(i) of Regulation S-K would apply to the equity securities issued by a registrant and certain affiliated entities (that is, any parent, subsidiary, or subsidiary of the registrant's parent) that are registered on a national securities exchange under Section 12(b)[15] of the Exchange Act or under Section 12(g)[16] of the Exchange Act.

We agree with the Commission's decision to clarify that the term "equity securities" does not include the equity securities of any issuer other than the registrant that are held, directly or indirectly, by a registrant's employees or members of its board of directors. We believe that Congress did not intend Section 14(j) of the Exchange Act to apply so expansively, but, instead, intended the disclosure to apply only to the equity securities of the subject registrant (and certain affiliated entities), whether granted in a compensatory transaction or acquired in any other manner.[17]

Beyond that, however, we recommend that the Commission narrow the scope of the proposed Section 407(i) to cover only a registrant's equity securities that are registered under Section 12 and, in situations where the Section 12-registered equity securities of an affiliated entity are used to compensate the registrant's employees or members of its board of directors or are counted towards satisfying equity holding or retention requirements, such equity securities. We believe that, absent such a connection, it does not further the objective of Section 14(j) to extend the proposed rule to include equity securities registered under Section 12 of any parent or subsidiary of the registrant, or any subsidiary of any parent of the registrant, without regard to whether such securities were intended to serve a compensatory or risk mitigation purpose.

In our experience, it would be unusual for a registrant to award the equity securities of a publicly-traded affiliated entity to its employees or members of its board of directors in a compensatory context.[18] Similarly, it would be uncommon for the board of directors of a publicly-traded affiliated entity to award their equity securities to an employee or member of the board of directors of the registrant. Nonetheless, we can envision situations where such an arrangement may exist and, accordingly, confirming an actual, rather than an illusory, alignment of the economic interests of the recipients of such securities and the other security holders of the registrant (or affiliated entity) would be a matter of interest to investors.

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[14] 17 CFR 240.3a-11-1.

[15] 15 U.S.C. 78l(b).

[16] 15 U.S.C. 78l(g).

[17] And which, by reason of their registration under Section 12 of the Exchange Act, are more likely to be readily traded and, accordingly, more easily hedged.

[18] Further, we are not aware of any registrants that consider equity securities of an affiliated entity (publicly-traded or otherwise) when evaluating compliance with their stock ownership or retention policies.

Further, we believe that such an interpretation would be consistent with the objectives of Section 14(j). As noted in the Proposing Release, Congress indicated that the purpose of Section 14(j) is to "'allow shareholders to know if executives are allowed to purchase financial instruments to effectively avoid compensation restrictions that they hold stock long-term, so that they will receive their compensation even in the case that their firm does not perform.'"[19] We read this statement to mean that the proscriptions, if any, subject to disclosure are those that directly involve the equity securities of the registrant or an affiliated entity, the securities that are both subject to these holding restrictions and the principal vehicle for promoting the alignment of the long-term interest of a registrant's employees and its security holders, incent appropriate risk-taking, and discourage executives from avoiding the risks associated with long-term ownership. To the extent the Commission is concerned with the equity securities of a controlled subsidiary of a publicly-traded registrant that subsequently conducts an initial public offering, as noted by at least one other commenter, we believe that this situation could be covered by simply providing that any equity securities of an affiliated entity that are subject to reporting for purposes of Item 402 of Regulation S-K are subject to proposed Item 407(i). If the Commission elects to proceed with a definition that encompasses the equity securities of publicly-traded affiliated entities without regard to the presence of a compensatory purpose, however, we recommend that such equity securities be registered under Section 12 of the Exchange Act, and that the covered affiliated issuers themselves be limited to parents owning a majority of the registrant's voting securities and the registrant's majority-owned subsidiaries. We believe that the costs of compliance in the case of entities in which there is not a majority controlling or controlled relationship with the registrant would outweigh any limited benefits to security holders of providing the extraneous information about such entities.

7. **Should the proposed definition be broadened to include equity securities that are not registered under Exchange Act Section 12 or narrowed to only include equity securities registered under Section 12(b) of the Exchange Act? If so, explain why and the costs and benefits that would result. Alternatively, should the proposed definition be revised to exclude equity securities that do not trade in an established public market? If so, how would "established public market" be defined? To the extent the amendment applies to equity securities that do not trade on an established public market, should we provide guidance about how to interpret "market value" for purposes of the proposed amendment? In either case, please explain why, and what costs and benefits would result from the recommended change.**

Given our concerns about the potential breadth of the proposed disclosure requirement (see our response to Question 2 above), we believe that it would be unduly burdensome to expand the coverage of the term "equity security" to encompass equity securities that are not registered under Section 12 of the Exchange Act.

8. **Should we define "parent" and "subsidiary" specifically for purposes of this disclosure requirement? The definition of "parent" of a person in the Exchange Act Rules is an affiliate controlling such person directly, or indirectly through**

[19] *See* Proposing Release, at pages 5 and 11 (citing the Report of the Senate Committee on Banking, Housing, and Urban Affairs, S. 3217, Report No. 111-176 (Apr. 30, 2010)). *See also* note 6 and accompanying text, above.

one or more intermediaries. Similarly, the Exchange Act Rules definition of "subsidiary" of a person is an affiliate controlled by such person directly, or indirectly through one or more intermediaries. Will these definitions, in the context of hedging disclosure, present any implementation challenges in determining what needs to be disclosed? Should we consider an alternative term, or alternative definition of "parent" for this disclosure requirement, such as an affiliate that owns a majority of the voting securities in the company? Similarly, with respect to subsidiaries, should we consider an alternative term, or alternative definition of "subsidiary" for this disclosure requirement, such as a majority-owned subsidiary, wholly-owned subsidiary, consolidated subsidiary or significant subsidiary? In each case, please explain why, and what costs and benefits would result from the recommended change.

Please see our response to Question 6 above. While we believe the final rule should be limited to hedging of only the registrant's equity securities, if the Commission decides to move forward with its proposal to include the equity securities of certain affiliated entities, we recommend the affiliated entities covered be limited to parents owning a majority of the registrant's voting securities and the registrant's majority-owned subsidiaries.

9. **Section 14(j) does not define the circumstances in which equity securities are "held, directly or indirectly" by an employee or director. Is the concept of "held, directly or indirectly" unclear, such that we should provide more certainty about what is meant by the phrase? If so, how should we clarify it? Section 14(j) also does not define who is a "designee," nor is this term otherwise defined in the rules under the Securities Act or the Exchange Act. One commenter has recommended that the Commission define the term "designee." Should the proposed amendment include an instruction clarifying who is a "designee"? If so, please explain how this term should be defined, and the costs and benefits that would result.**

We recommend that the Commission provide guidance on the meaning of the concept "held, directly or indirectly" by an employee or member of the board of directors as used in proposed Item 407(i) of Regulation S-K. We believe that such guidance will be critical to easing the challenges that will confront registrants when attempting to comply with the disclosure requirement if adopted substantially as proposed. While it may be plausibly maintained that some registrants will be able to determine how to interpret this concept within the context of their particular facts and circumstances, we expect that, given the potential reach of disclosure – particularly in the case of "transactions that are designed to or have the effect of hedging," such guidance will be necessary to enable many registrants to understand fully which transactions and arrangements may need to be disclosed and how they should be categorized.

As has been suggested by other commenters, replacing the current proposed formulation with the term "beneficial ownership" as used for purposes of Section 13(d) of the Exchange Act[20] would be one way to reduce registrants' compliance burden while satisfying the dictates of

[20] The term "beneficial ownership" is defined in Exchange Act Rule 13d-3(d)(1) [17 CFR 240.13d-3(d)(1)].

Section 14(j) of the Exchange Act. This concept of "beneficial ownership" is readily understood by registrants and enjoys a robust history of interpretive and other guidance, thereby eliminating the potential ambiguities that are likely to arise when attempting to ascertain how to apply the "held, directly or indirectly" concept to novel or complex situations.[21] Consequently, we believe that the Commission should provide guidance as to how this concept is to be applied in the context of the proposed disclosure or consider an alternative formulation of the concept to reduce or eliminate uncertainty.

We recommend that the Commission re-evaluate its approach to the treatment of "designees" of a registrant's employees and directors under Section 14(j). As noted by other commenters, the Proposing Release neither defines nor provides guidance as to the meaning of the term "designee." This silence gives rise to numerous questions for which the answer is not readily apparent. For example, it is not clear whether the term is intended to extend to the trustee of a "blind" trust established by an executive. Nor is it clear whether it would encompass an investment account in which an executive or a member of his or her immediate family has a pecuniary interest, without regard to who has authority to make investment decisions.

Without such guidance, registrants that permit some form or forms of hedging, or maintain policies that do not contain a blanket prohibition on all forms of hedging (as well as any transactions that either are designed to or have the effect of hedging), could face a formidable challenge in identifying the individuals and/or entities involved in an employee's or director's financial affairs who would be prohibited from engaging in hedging-like transactions.

Absent some context for what is intended by this term, we believe that directing registrants to determine whether an individual or entity is a "designee" based on the surrounding facts and circumstances imposes an unreasonable – and unrealistic – burden on registrants and is unlikely to result in either adherence to the objectives of the rule or meaningful disclosure. Registrants will struggle to identify and ensure that such individuals and entities are in compliance with their hedging policies or, at a minimum, to ensure that employees and members of the board of directors understood the scope of coverage of these policies. Thus, we believe that, to facilitate compliance, the Commission should either define or provide guidance as to which persons or entities should be considered a "designee" of an employee or director. For example, this group could be defined to include immediate family[22] members and family or affiliated investment vehicles.

C. Employees and Directors Subject to the Proposed Disclosure Requirement

10. Section 14(j) is directed to "any employee" and we interpret that to mean anyone employed by the issuer. Should we limit the definition of "employee" to the subset of employees that participate in making or shaping key operating or

[21] Note also that Section 16(a) of the Exchange Act and Exchange Act Rule 16a-2 [17 CFR 240.16a-2] refer to any person who is the "beneficial owner," directly or indirectly.

[22] For this purpose, the definition of "immediate family" set forth in Exchange Act Rule 16a-1(e) [17 CFR 240.16a-1(e)] may be instructive.

strategic decisions that influence the company's stock price? Why or why not? If so, how would that distinction be defined for practical purposes? Alternatively, should we add an express materiality condition to the definition, as is the case under CD&A, to permit each issuer to determine whether disclosure about all its employees would be material information for its investors? Why or why not?

We note that Section 955 of the Dodd-Frank Act expressly provides, as codified in new Section 14(j) of the Exchange Act, that the required disclosure cover an issuer's hedging policy or practices as they relate to "any employee or member of the board of directors." Consistent with this directive, proposed Item 407(i) of Regulation S-K would require disclosure of whether "any employees (including officers) or directors of the registrant, or any of their designees" are permitted to engage in transactions that are designed to or have the effect of hedging or offsetting any decrease in the market value of equity securities. On the other hand, Congress itself acknowledged that Section 14(j) is intended to inform security holders of hedging on the part of executive officers – with no mention of rank-and-file employees.[23]

To resolve these apparent inconsistencies and further what we see as Congress's underlying purpose, we recommend that the Commission exercise its general exemptive authority under Section 36(a)(1) of the Exchange Act to limit the scope of the term "employee" to refer solely to the executive officers of a registrant. Along with the members of a registrant's board of directors, the executive officers are the key decision-makers whose actions have the most direct impact on a registrant's financial performance and stock price. Similarly,[24] these individuals are the most likely to receive equity awards as part of their compensation from the registrant and, therefore, have significant holdings of the registrant's equity securities. We also note that, as a practical matter, many corporate stock ownership and holding policies apply only to a registrant's executive officers and members of the board of directors, policies which have, at their core, the same objectives as a hedging policy.

Given security holders' strong interest in ensuring that a registrant's use of its equity securities as a compensation vehicle truly aligns executive and security holder interests, as well as promoting decision-making consistent with the creation of sustainable long-term value for all security holders, it is important for them to know whether these individuals, as well as the members of the board of directors, have the ability to offset or eliminate any decrease in the market value of such equity securities. We question whether investor access to such information as it relates to a registrant's other employees serves a similar purpose or, for that matter, is even material to a security holder's investment or voting decisions.

Consequently, we recommend that the Commission exercise its general exemptive authority under Section 36(a)(1) to exempt employees, other than executive officers, from the

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[23] *See* note 6, above.

[24] Alternatively, we urge the Commission to exercise its broad interpretive authority, which finds support in the legislative history cited in note 6, above.

scope of proposed Item 407(i).[25] Further, we recommend that, for purposes of the proposed rule, the Commission use the term "officer" as defined in Exchange Act Rule 16a-1(f).[26] We believe that this approach is consistent with Congressional intent and provides a reasonable balancing of the costs of compliance and benefits to security holders of the proposed disclosure. As has been noted by other commenters, the application of proposed Item 407(i) to all employees will likely result in additional costs to registrants that do not already maintain a company-wide hedging policy, without any attendant benefit to security holders from covering such individuals in the policy.

11. Should the amendment define "hedge"? If so, what concepts other than the statutory reference to "offset [ting] any decrease in the market value of equity securities" would be necessary to define this term?

Please see our response to Question 2 above.

12. One commenter has recommended that the Commission "should not only require disclosure of whether hedging is permitted, but should also require disclosure of any hedging that has occurred – both in promptly filed Form 4 filings and in the annual proxy statement." Should the Commission require such disclosure in the final rule for those already subject to Form 4 reporting requirements?

We believe that it is not necessary for the Commission to develop an additional disclosure requirement for transactions that have actually occurred which either constitute "hedging" or are designed to or have the effect of hedging by insiders (that is, executive officers and members of the board of directors who are subject to the reporting requirements of Section 16(a) of the Exchange Act). Not only is such a requirement beyond the scope of Section 14(j) of the Exchange Act, most if not all hedging transactions are already subject to reporting under Section 16(a) (for example, entry into and settlement of a prepaid variable forward contract,[27] entry into an equity swap agreement,[28] entry into a "zero-cost collar" arrangement, a contribution

[25] We note that the Dodd-Frank Act expressly limits the Commission's general exemptive authority in several instances. It does not do so, however, with respect to Section 14(j) of the Exchange Act.

[26] Exchange Act Rule 16a-1(f) [17 CFR 240.16a-1(f)] provides that "[t]he term "officer" shall mean an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust."

[27] *See* Mandated Electronic Filing and Website Posting for Forms 3, 4 an ! 5, Release No. 33-8230 (May 7, 2003) [68 FR 25788], text at footnote 42

[28] *See* Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release No. 34-34514 (Aug. 10, 1994) [59 FR 42449], at Section III.G; Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release No. 34-37260 (May 31, 1996) [61 FR 30376], at Sections III.H and III.I.

of equity securities to an exchange fund, and certain derivative securities transactions (such as a single-stock security future contract[29])), or expressly prohibited (for example, a "naked" short sale or a short sale where the security is not delivered against the sale within 20 days as provided in Section 16(c) of the Exchange Act).

Further, given the adequacy of the existing Section 16 disclosure regime, we believe that such an expansion would increase the registrant compliance costs associated with proposed Item 407(i) of Regulation S-K without providing a concomitant benefit to security holders. We expect that, in the case of registrants that permit some form of hedging (or, as is more likely, do not impose a blanket prohibition on all forms of hedging, including transactions that are designed to or have the effect of hedging), it would be necessary to expend additional time and resources monitoring hedging transactions, collecting and analyzing information about such transactions, and then preparing the requisite disclosure for inclusion in their annual meeting (for election of directors) proxy or information statements. While we are aware that many registrants assist their insiders in complying with their reporting obligations under Section 16(a), such practice is not universal. Registrants that do not have ready access to this information would be forced to develop procedures for its collection, analysis, and disclosure, thereby incurring additional costs without any discernible benefit to security holders from having access to such information.[30]

D. Implementation

1. Manner and Location of Disclosure

13. Should Item 407(i) disclosure be required whenever action is taken with respect to the election of directors, as proposed? Instead, should we require disclosure in any proxy or information statement relating to an annual meeting of shareholders, irrespective of whether directors are to be elected at that meeting? Should the disclosure be limited only to annual meetings, and not special meetings, even if directors are to be elected at a special meeting?

We agree with the Commission's determination that, since the primary purpose of the disclosure is related to corporate governance, the disclosure required by proposed Item 407(i) of Regulation S-K should be provided in proxy or information statements with respect to the election of directors,[31] rather than in connection with any proxy or consent solicitation for an annual meeting of security holders. As the Commission notes throughout the Proposing Release, the disclosure required by proposed Item 407(i) is relevant largely, if not solely, within the

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[29] *See* Commission Guidance on the Application of Certain Provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rules thereunder to Trading in Security Futures Products, Release No. 33-8107 (June 21, 2002) [67 FR 43234] at Q. 13.

[30] In this regard, we acknowledge that Item 405 of Regulation S-K requires annual disclosure by the registrant of delinquent Section 16(a) filings by officers and directors.

[31] We understand that, as indicated in the Proposing Release, this will include disclosure in the materials for annual and special meetings, as well as in connection with an action authorized by written consent, as long as the action relates to the election of directors.

context of evaluating a registrant's corporate governance structure – particularly when it comes to holding management accountable to security holders. And, since the board of directors is ultimately responsible for oversight of this structure, it is appropriate to require this disclosure when the members of the board of directors are subject to election. Requiring the disclosure at, but only at, the time when action is to be taken with respect to the election of directors strikes a reasonable balance between the benefits of providing pertinent information to security holders in connection with their exercise of voting rights and the costs and burdens to reporting registrants of compliance.

14. Should proposed Item 407(i) disclosure also be required in Securities Act and Exchange Act registration statements? Should it be required in Exchange Act annual reports on Form 10-K? Would such information be material to investors in any of those contexts?

Similarly, we agree with the Commission's determination, in the Proposing Release, not to require the disclosure contemplated by proposed Item 407(i) of Regulation S-K in registration statements filed under either the Securities Act of 1933[32] or the Exchange Act, or in the Part III Item 407 disclosure required in an annual report on Form 10-K. We do not believe that, within the context and purposes of these filings, this information is relevant to investors.

2. Disclosure on Schedule 14C

15. To retain consistency in the corporate governance disclosure provided in proxy statements and information statements with respect to the election of directors, Item 407(i) disclosure as proposed would apply to Schedule 14C as well as Schedule 14A. Is there any reason that the proposed Item 407(i) disclosure should be limited to issuers that are soliciting proxies? Why or why not?

We agree with the Commission's decision to forego amending Item 1 of Schedule 14C to include the disclosure contemplated by proposed Item 407(i) of Regulation S-K in the information called for by Schedule 14C. The proposed Item 407(i) disclosure is of a type and nature that differs from the disclosures that are currently excludable from Schedule 14C pursuant to Item 1 of that Schedule. While we understand that this decision will have the effect of expanding the requirement to comply with proposed Item 407(i) to registrants that do not solicit proxies from their security holders but are otherwise authorized by the consent of less than all security holders to take an action with respect to the election of directors, we do not view this result as undesirable. To the contrary, we believe that this result is appropriate as it will fulfill the overarching objective of maintaining consistency in the corporate governance disclosure provided in proxy statements and information statements with respect to the election of directors.

16. In addition to including the new disclosure requirement, the proposed amendment to Item 7 of Schedule 14A would amend this Item to more succinctly organize its current provisions without changing the substance. As so revised, would the requirements of Item 7 be easier to understand? Alternatively, should

[32] 15 U.S.C. 77a *et seq.*

we retain the current structure of Item 7, with the addition of the Item 407(i) disclosure?

We have reviewed the proposed reorganization of Item 7 of Schedule 14A and find the requirements to be readily understandable. For some practitioners and their corporate clients, the present version of Item 7 has been difficult to parse and may lead to an inadvertent error or omission in preparing the required disclosure. We believe that by reorganizing the provision to enumerate the provisions of Item 407 of Regulation S-K that may be excluded (rather than listing those that must be considered), compliance with the Item should be facilitated and therefore enhanced.

3. Relationship to Existing CD&A Obligations

17. We propose to amend the CD&A requirement of Item 402(b) of Regulation S-K to add an instruction providing that the obligation under that item requirement to disclose material policies on hedging by named executive officers in a proxy or information statement with respect to the election of directors may be satisfied by a cross reference to the Item 407(i) disclosure in that document to the extent that the information disclosed there satisfies this CD&A disclosure requirement. Is there an alternative way to avoid possibly duplicative hedging disclosure in these proxy and information statements?

Consistent with its characterization of the disclosure required by proposed Item 407(i) of Regulation S-K as primarily corporate governance-related, the Commission is proposing to amend Item 402(b) of Regulation S-K to permit registrants to satisfy their obligation to disclose any registrant policies regarding hedging the economic risk of company securities ownership, to the extent material, in their Compensation Discussion and Analysis[33] included in a proxy or information statement with respect to the election of directors, by means of a cross-reference to the disclosure required by proposed Item 407(i) that is located elsewhere in such proxy or information statement. We agree with the Commission that such an amendment will serve to reduce potentially duplicative disclosure in proxy and information statements and, therefore, support this proposed change.

At the same time, we believe that there is an additional way to avoid possibly duplicative disclosure that should be considered. For the past several years, registrants have been disclosing their hedging policies in their Compensation Discussion and Analysis, consistent with the non-exclusive example of material compensation-related policies and practices set forth in Item 402(b)(2),[34] to provide security holders with an understanding of whether their named executive officers have the ability to offset the economic risk of ownership of registrant securities. Typically, this information is disclosed in the Compensation Discussion and Analysis either as part of a discussion of the registrant's corporate governance-related compensation policies or on a stand-alone basis.

[33] *See* Item 402(b)(2)(xiii) of Regulation S-K.

[34] *Id.*

As a result of security holder interest in such policies and practices, as well as the application of the policy guidelines of the major proxy advisory firms, these disclosures are typically made without regard to the objective materiality of the information.[35] Further, while some of these disclosures are limited to the application of the policy to a registrant's named executive officers and/or executive officers as a group, others may be comprehensive in nature and address the application of the policy on a registrant-wide basis (that is, that the policy applies to all employees, including executive officers, as well as to the members of the registrant's board of directors). Either way, registrants have become accustomed to integrating this information into the overall presentation of their Compensation Discussion and Analysis and, correspondingly, security holders and other consumers of registrants' executive compensation disclosure have become accustomed to seeing this information in the CD&A.

As a result of this now long-standing practice, we recommend that the Commission add an instruction permitting registrants the flexibility to satisfy their disclosure obligation under proposed Item 407(i) – as narrowed per our recommendation above (in response to Question 10) to focus on executive officers and members of the board of directors – by including the disclosure required by proposed Item 407(i) in their Compensation Discussion and Analysis if so desired. We believe that this flexibility will avoid possibly duplicative hedging disclosure in proxy and information statements without disrupting the current presentation of this information in a location and format that is consistent with current disclosure practice and likewise easy to find.[36]

While we recognize that, for the most part, the scope of the proposed Item 407(i) disclosure is broader than the comparable disclosure required in the Compensation Discussion and Analysis, given that this disclosure is largely descriptive, rather than analytical, we see no reason why a registrant might not prefer to include the more extensive disclosure in its CD&A if it believed that this offered a more effective means for addressing the subject of hedging.[37] While it is true that including the proposed Item 407(i) disclosure in the Compensation Discussion and Analysis would make this information subject to the security holder advisory vote on named executive officer compensation (a "Say-on-Pay" vote) required by Exchange Act Rule 14a-21(a),[38] once again we do not believe that this would be problematic for most registrants. Such information is currently subject to the Say-on-Pay vote to the extent addressed in the CD&A. Further, registrants concerned about subjecting their proposed Item 407(i)

[35] We acknowledge that the burgeoning investor interest in these policies and practices in recent years may be indicative of materiality in situations where action is to be taken with respect to the election of directors.

[36] This flexibility would also be consistent with our recent recommendation of minimizing repetition and increasing the clarity of disclosure by limiting the use of cross-reference citations. *See* Comment Letter from the Disclosure Effectiveness Working Group of the Federal Regulation of Securities Committee and the Law & Accounting Committee of the Business Law Section of the American Bar Association (March 6, 2015), at page 8.

[37] We note that, in at least one respect, the current disclosure required by Item 402(b) is broader than the disclosure contemplated by Proposed Item 407(i). Item 402(b)(2)(xiii) refers to a registrant's "equity or other security ownership" while Proposed Item 407(i) refers only to "equity securities." We believe that registrants can decide for themselves how this distinction will affect their disclosure decision.

[38] *See* 17 CFR 240.14a-21(a).

disclosure to these votes could simply comply with the SEC's proposed optional cross-reference instruction.

18. Is there a better way to align the requirements of Item 402(b) of Regulation S-K and proposed Item 407(i) of Regulation S-K? Are there circumstances in which the current CD&A requirement in Item 402(b) of Regulation S-K would result in more complete disclosure about the company's hedging policies than what would be required under proposed Item 407(i)? For example, although Section 14(j) addresses only hedging of equity securities, would disclosure of employees' and directors' ability to hedge other securities further the statutory purpose? In this regard, should we expand the proposed disclosure in Item 407(i) to include debt securities?

Please see our response to Question 17 above. We believe that the difference in the coverage between Item 402(b)(2)(xiii) and proposed Item 407(i) of Regulation S-K is likely to lead to more comprehensive disclosure under one regime than the other. Given the principles-based analytical framework for each of these line-items, however, we do not anticipate unnecessary redundancy if the Commission allows registrants some degree of flexibility in, for example, cross-referencing. As we note in responding to Question 17, we believe that registrants can decide for themselves which approach best serves their obligation to satisfy each disclosure provision in light of the different purposes of these provisions and the particular registrant's own facts and circumstances.

In our experience, it is highly unusual to see registrant securities that are not equity securities, such as debt securities, be the subject of an individual employee's or director's economic hedge.

4. Issuers Subject to the Proposed Amendments

a. Registered Investment Companies

19. We request comment on all aspects of the proposed disclosure requirements as applied to funds, including whether all funds or additional types of funds other than listed closed-end funds should be required to provide the proposed disclosure. Should we require all funds, including mutual funds and ETFs, to provide the proposed disclosure? Should we, instead, require different specific types of funds to provide the proposed disclosure? For example, should we require ETFs to provide the proposed disclosure? Would shareholders in mutual funds, ETFs, or other types of funds benefit from the information provided by the proposed disclosure?

We agree with the Commission's decision to exclude open-end funds from the proposed disclosure requirement. As the Commission notes, these funds differ markedly from operating companies in the way that their shares are purchased and sold.[39] Further, we urge the

[39] As the Commission explains, "mutual funds sell shares that are redeemable, meaning generally that shareholders are able to present the shares to the fund at the shareholder's discretion and receive the net asset value ("NAV") per

Commission to reconsider its proposal to require closed-end investment companies with "shares that are listed and registered on a national securities exchange" to provide the proposed disclosure.

We believe that it is very difficult for the holders of shares in a listed closed-end fund to hedge their position in such shares, either by selling "short" or by trading in derivatives of such shares. Consequently, it is difficult to identify what would constitute a "hedge" of the shares of a listed closed-end fund for Item 407(i) disclosure purposes. Should the Commission ultimately decide to require disclosure from listed closed-end funds, we request that the final rules be accompanied by appropriate guidance as to the nature of the transactions involving the shares of such funds that would constitute a "hedge" or otherwise be deemed to have the purpose or effect of hedging or offsetting any decrease in the market value of such shares.

b. Emerging Growth Companies and Smaller Reporting Companies

28. Should smaller reporting companies or emerging growth companies be exempted from proposed Item 407(i) or subject to a delayed implementation schedule? If so, please explain why and the benefits and costs that would result. As discussed below, a component of the disclosure costs (especially initial costs) may be fixed, which may have a greater impact on smaller reporting companies and emerging growth companies. Do the proposed disclosure requirements also impose other potential costs on smaller reporting companies or emerging growth companies that are different in kind or degree from those imposed on other companies? Would the proposed disclosure requirements be as meaningful for investors in smaller reporting companies and emerging growth companies as for those in other companies? Do investors in smaller reporting companies and emerging growth companies place more, less, or the same value on corporate governance disclosures of the type proposed here than do investors in larger, more established companies, either alone or in relation to other disclosures?

We note that the Commission is proposing to extend proposed Item 407(i) of Regulation S-K to both smaller reporting companies and emerging growth companies. In the Proposing Release, the SEC states that it is not aware of "any reason why [the proposed disclosure] would be less relevant to shareholders of [these companies] than to shareholders of any other company."[40]

We are concerned that applying proposed Item 407(i) to smaller reporting companies and emerging growth companies would impose costs and burdens that are disproportionate to the benefits to be obtained from providing the required disclosure to the security holders of such companies. For several years, the Commission has been sensitive to the costs and burdens faced

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share determined at the end of each day. For funds like mutual funds whose shares do not trade on an exchange, it may be less efficient or not possible to engage in certain hedging transactions with respect to the fund's shares. And although [Exchange-traded fund] shares trade on exchanges, they often trade on the secondary market at prices close to the NAV of the shares, rather than at discounts or premiums to NAV." *See* Proposing Release at pages 34-35.

[40] *See* Proposing Release at page 36.

by smaller reporting companies in complying with the federal securities laws. Most recently, to encourage capital formation and stimulate the U.S. economy, Congress has seen fit to exempt an entire category of companies – emerging growth companies – from many of the registration and reporting requirements of the federal securities laws pursuant to The Jumpstart Our Business Startups ("JOBS") Act.[41] As the Commission recognizes in the Proposing Release, the JOBS Act exempts emerging growth companies from several, although not all, of the provisions of Title IX of the Dodd-Frank Act, of which Section 955 is a part.[42]

In our experience, the majority of both smaller reporting companies and emerging growth companies eligible for the scaled disclosure requirements of Item 402 of Regulation S-K have, s taken advantage of this privilege when it comes to the disclosure of their executive compensation policies and practices. Accordingly, very few of such registrants provide a Compensation Discussion and Analysis. And, concomitantly, such registrants rarely, if ever, address the subject of their policy regarding the hedging activities of their named executive officers. In fact, it is possible that many of such registrants may not even have a formal policy on hedging activities, either as a feature of their insider trading policy or on a stand-alone basis.

We believe that requiring smaller reporting companies and emerging growth companies to provide the disclosure contemplated by proposed Item 407(i) would impose unnecessary costs and potentially undermine the Congressional objective underlying JOBS Act disclosure relief for emerging growth companies. Moreover, even though neither Section 14(j) of the Exchange Act nor proposed Item 407(i) requires registrants to adopt a formal policy with respect to hedging, we believe that the potential stigma of disclosing a failure to adopt a policy on a subject worthy of Congressional attention (and proxy advisory firm scrutiny and criticism) would compel registrants to consider and adopt such a policy, thereby incurring the attendant legal and/or consulting costs that would be necessary to address the subject in a responsible manner.

In addition, we note that in many emerging growth companies and smaller reporting companies, the executive officers are likely to have a large portion of their personal wealth tied up in the equity securities of their organization. To diversify their net worth, as well as to mitigate their exposure to undue volatility in their holdings, such individuals may engage in financial strategies that, while not involving any of the enumerated activities that are set forth in Section 14(j), may have the effect of offsetting or reducing the potential impact of a decrease in the value of their holdings of the registrant's equity securities. To the extent that such activities would fall within the scope of the required disclosure, the executive officers of these registrants are put in an untenable position – either unable or unwilling to engage in financial activities that could create the appearance of hedging while, at the same time, reluctant to pursue business strategies that could subject the registrant – and their personal holdings – to a perceived undue level of financial risk; even though such risks may ultimately inure to the benefit of the registrant and its security holders. In our view, this latter situation could create an actual or perceived misalignment of the interests of a registrant's executive officers and its well-diversified, non-

[41] Pub. L. No. 112-106, 126 Stat. 306 (2012).

[42] Among these provisions are Section 951, the security holder vote on executive compensation disclosures, and Section 953(b), the Chief Executive Officer pay ratio disclosure. *See* Section 102(a)(1) of the JOBS Act.

affiliated security holders. In sum, we believe that the Commission should not impose a disclosure requirement on smaller reporting companies and emerging growth companies, particularly where the ultimate result of such requirement could lead to such a misalignment of interests with respect to taking reasonable business risks that might enhance the registrant's profitability.

c. Foreign Private Issuers

29. Should foreign private issuers be required to provide the disclosure? If so, please explain why and specify the filing(s) in which the disclosure should be required?

We agree with the Commission's proposed treatment of foreign private issuers. Since Section 955 of the Dodd-Frank Act contemplates disclosure in the proxy or consent solicitation materials for an annual meeting of security holders, and, as noted in the Proposing Release, foreign private issuers with Section 12-registered equity securities are not subject to the proxy filing and disclosure requirements of Section 14 of the Exchange Act,[43] we believe that it would be inconsistent with Congressional intent to require foreign private issuers to provide Item 407(i) disclosure. Currently, foreign private issuers are not required to make any other corporate governance-related disclosures under Item 407 of Regulation S-K. We see no reason to extend this particular disclosure item to such issuers.

30. Are there any other categories of issuers that should be exempt from the requirement to provide Item 407(i) disclosure? If so, please explain why, and the benefits and costs that would result.

At this time, we believe that there are not any other categories of issuers that require exemption from the disclosure requirement of proposed Item 407(i) of Regulation S-K.

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We appreciate the opportunity to comment on the Proposing Release and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission and its staff, and to respond to any questions.

Very truly yours,

Catherine T. Dixon

Catherine T. Dixon
Chair of the Federal Regulation of
Securities Committee

[43] Exchange Act Rule 3a12-3(b) [17 CFR 240.3a12-3(b)] expressly exempts securities registered by a foreign private issuer under Section 12 of the Exchange Act from the application of Sections 14(a) and 14(c) of the Exchange Act.

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