

THE SEC RAISES THE BAR FOR RISK MANAGEMENT DISCLOSURE

New SEC rules demanding greater disclosure related to risk management go into effect February 28 in a much anticipated response to the financial meltdown of 2007-2008. But the mandates fall short of the heavier burden many had feared.

The new rules¹ address governance, compensation and the role of compensation consultants, focusing on ways compensation programs may establish “a system of incentives that can lead to excessive or inappropriate risk taking by employees.” While not as sweeping as some anticipated (concerns have been rampant about new requirements for in-depth reporting on methods of risk identification, risk tolerance and the management of risk/reward tradeoffs throughout an organization), the SEC requirement is still quite broad. SEC registrants must disclose:

- Compensation policies that are likely to have a material effect on risk-taking in the short and long term
- How risk assessment is used in awarding and paying compensation
- How the company monitors whether its risk management objectives are being supported by its employee incentives

The depth of detail that must be disclosed will vary by business unit based on the degree to which the business unit contributes to the overall risk faced by an organization.

Other risk management components under the new rule require directors to disclose:



- Specific information about their “risk assessment skills”²
- The board’s role in the oversight of the company’s risk management process

The SEC suggests that public companies actively discuss whether the person(s) who directly oversee risk management should report to the board as a whole or to a specific committee.

The new rules impact proxy, information and registration statements as well as annual reports.

A BOOST FOR ERM

The new requirements are significant. They will require some degree of risk assessment, consideration of risk appetite and, potentially, restructuring of compensation programs. However, the SEC rule is *not* an explicit mandate to implement a systematic or comprehensive enterprise risk management (ERM) program. Many companies will be able to address these new disclosure requirements without any direct ERM program.

That said, organizations with fully implemented ERM programs should have the framework in place to readily adapt to the new rules. Also, meeting the new requirements should provide a strong boost to ERM activity throughout the organization. What may seem now like a burden may prove valuable to many companies in the long run.

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¹ Documents **33-9052** and **33-9098** on the SEC website.

² The SEC does not define “risk assessment skills.”