

SEC Risk Management Disclosure Rule

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New Disclosure Rule Demands Immediate Compliance Actions

Many public companies face an imminent deadline to comply with new Securities and Exchange Commission (SEC) disclosure requirements about their risk management practices. This follows from the SEC's recent identification of the absence of risk management as a root cause of the economic downturn.

In addition to the SEC, numerous regulatory and credit rating agencies worldwide are developing standards and requirements that aim to improve corporate accountability and increase transparency for investors. These emerging regulations and standards present challenges and opportunities for boards, executives, and risk managers to become more knowledgeable about a broader range of business risks and reevaluate risk management oversight practices.

Of immediate concern for companies is SEC Rule No. 33-9089. Approved on December 16, 2009, the rule mandates several new requirements for companies, including increased disclosure of compensation and corporate governance practices. Effective February 28, 2010, the majority of public companies will be obligated to comply with the complete ruling.

Overview of Risk Matters Within SEC Rule No. 33-9089

Two provisions of Rule No. 33-9089 may be of specific interest to board members, senior leaders, and risk managers.

Section A1: Narrative Disclosure of the Company's Compensation Policies and Practices as They Relate to the Company's Risk

This provision states that public companies are required to analyze and describe compensation policies and practices for all employees, including non-executive officers, "if compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company". The disclosure in financial reports and proxy statements must include discussion of compensation practices and policies in relation to risk management and risk-taking incentives.

The rule includes the following illustrative list of generally applicable compensation policies and practices that might warrant discussion:



While the new rule offers some flexibility in the specifics to be discussed, companies should quickly and judiciously plan how they intend to prepare new disclosures as there is little precedent in previous filings.

- Compensation policies and practices at business units:
 - > that carry a significant portion of the company's risk profile;
 - > with compensation structured significantly differently from the rest of the company's business units;
 - > that are significantly more profitable than other business units; and
 - > where compensation expense is a significant percentage of the unit's revenues.
- Compensation policies that vary significantly from the overall risk and reward structure of the company, such as policies under which bonuses are awarded upon accomplishment of a task for which income and risk to the company extend over a significantly longer time.

The rule also details the following example scenarios that companies may need to address:

- The company's risk assessment or incentive considerations in structuring its compensation policies and practices.
- Material adjustments the company has made to its compensation policies and practices as a result of changes in its risk profile.
- The extent to which the company monitors its compensation policies and practices to determine whether its risk management objectives are being met.

- How the company's compensation policies and practices relate to the realization of risks resulting from the actions of employees in both the short and long term.
- The general philosophy of the company's compensation policies for employees whose behavior would be most affected by the created incentives.

Section C: New Disclosure About Board Leadership Structure and the Board's Role in Risk

Under this provision, public companies are required to disclose details about their boards' roles in risk oversight. The SEC calls for organizations to describe how the function of risk oversight is administered.

Although not promoting a particular framework or structure, the SEC explains that the disclosure must include a description of risk oversight at the board level, whether it occurs through the entire board, the audit committee, or a separate risk committee. Companies may also discuss policies related to risk identification, risk tolerance, and management of risk/reward tradeoffs throughout the enterprise.

Implications for Public Companies

Although the new rule only requires disclosure about current practices and does not mandate a specific course of action, it indirectly promotes the adoption of best practices

in risk management. Companies need to understand the compensation, risk, and governance policies and structures they have in place and determine if any best practice gaps exist. While the new rule offers some flexibility in the specifics to be discussed, companies should quickly and judiciously plan how they intend to prepare new disclosures as there is little precedent in previous filings.

Recommended Action

Marsh recommends that all organizations review the suitability of their risk management philosophy, policies, and processes in this time of heightened risk management scrutiny. Suggested activities include:

- **Institute or refine an enterprise risk management (ERM) process.** Companies that have not already implemented formal processes to identify, assess, respond to, and monitor the full breadth of their business risks should do so immediately. Those that have already instituted processes may wish to benchmark their programs against best practices and remediate any gaps.
- **Implement one of the best practice structures in risk oversight.** Companies should institute one of the prevailing governance models for the regular identification, assessment, and reporting of risk information to their boards.
- **Conduct a compensation risk assessment.** Companies should

inventory the key risks to their organizations and identify how current compensation practices and arrangements influence these risks. Policies may need to be created to limit such risk exposures while still promoting achievement of the company's strategic goals and objectives.

- **Educate the board on its role in the risk management process.** Companies should provide training to their board members on their expected roles in the risk oversight process, namely the board's responsibility to ensure that the company's risk management behaves consistently with the company's corporate strategy and does not exceed the organization's defined appetite for risk.
- **Institute a streamlined risk reporting function.** Companies should consider instituting an ERM technology platform to increase the ease and efficiency of assimilating cross-organizational risk information for board reporting. Several practical options are available in the marketplace.

MRC's Enterprise Risk Management Capabilities

In light of the extremely short effective date and the scope of effort involved, compliance with SEC Rule No. 33-9089 and others like it may be difficult for organizations to achieve in a timely and expert fashion. Marsh Risk Consulting's (MRC) Enterprise Risk Services and Solutions Practice assists organizations in developing and implementing best-in-class ERM programs that align with the SEC rule, ISO 31000, and Standard & Poor's ERM criteria.

Our customized service offerings focus on the assessment, prioritization, and quantification of key risks, as well as the establishment of sustainable ERM programs, compensation practices, training programs, and governance structures by which risks are proactively identified, managed, and monitored.

For More Information

The final SEC Rule No. 33-9089 can be found online at <http://www.sec.gov/rules/final/2009/33-9089.pdf>.

To learn more about how MRC can help you with your ERM needs, please contact your local Marsh representative or:

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