

SEC Proposal: Risk Assessment Director's Responsibility

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On July 10th, the SEC issued proposed amendments that may require companies to disclose their director's individual risk assessment skills, as well as a board's involvement in the company risk management process. The SEC is also proposing to amend its Compensation Discussion and Analysis ("CD&A") requirement, originally designed to disclose material elements of the company's compensation for named executive officers. The proposed CD&A amendment requires information about the overall compensation policy and whether it creates incentives that affect the company risk and the management of that risk. In short, a company will be required to discuss its broader compensation policies if risks arising from those policies might materially affect the company.

In targeting the requirements of individual board members and the overall qualifications of the board as a whole the SEC provides: "Companies today face ever-increasing challenges from the business and social environments in which they operate. As recent market events have demonstrated, the capacity to assess risk and respond to complex financial and operational challenges can be important attributes for directors of public companies.... We are proposing that, for each director... disclosure be included that discusses the specific experience, qualifications or skills that qualify that person to serve as a director and committee member. The types of information that may be disclosed include ... information about a director's ... risk assessment skills and any specific past experience that would be useful to the company..." Proxy Disclosures and Solicitation Enhancements 74 Fed. Reg. 35082-83 (proposed July 17, 2009). Emphasis added.

Part of the new proposed disclosure requirements is the board's role in the risk management process of the company. This includes information about the relationship between the board and senior management in handling the material risks faced by their particular company.

The SEC provides: "[g]iven the role that risk and the adequacy of risk oversight have played in the recent market crises, we believe it is important for investors to understand the board's or board committee's role in this area. For example, how does the board implement and manage its risk management function, through the board as a whole or through a committee, such as the audit committee? Such disclosure might address questions such as whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and whether and how the board ... monitors risk." Proxy Disclosures and Solicitation Enhancements 74 Fed. Reg. 35085 (proposed July 17, 2009).

Should these amendments become requirements, it seems clear that companies will need to have a risk process in place which includes director involvement in material or critical company risks. This means that a risk process must be in place so that company risks are mined and massaged allowing critical risks to rise to the surface so that they can be considered and addressed by directors as necessary. The last step in this process, and one which is not directly addressed by the SEC proposed amendments, is the consideration of what to do with the material or critical risk once it is unearthed. A company will need to address whether it chooses to retain that risk, transfer it or engage in a combination of both (a hybrid risk retention practice). This is an important next step as there is no right or wrong in finding a particular risk as the risk is simply there, waiting to be unearthed and discussed. The critical piece, however, is what the company chooses to do with the risk once it is found. This choice can, and does, affect not only the assets of the company but also its immediate bottom line.

