**Two years after the SEC mandated disclosure on Board Oversight of Risk,
what insight have investors gained?
Not Enough**

A review of disclosures required by the U.S. SEC Proxy Disclosure Enhancement rule provision on Board Role in Risk Oversight

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Executive Summary

Three years after the woes began that derailed the global economy and two years after the SEC's risk oversight disclosure rule, compared to recognized guidance, investors still lack sufficient information to judge the quality of risk oversight and management that enables companies to more safely seize opportunities for growth. Most disclosures are usually characterized by too much boilerplate and too little insight for investors. Earnings call explanations of losses are too little too late.

The need: Investors have been dismayed to discover how seemingly trivial initial impacts can cascade across enterprises, just as a storm widely disrupts air traffic or rain in Thailand disrupts consumer electronics sales around the world. The failures of corporate management to adequately manage their way through product failures, industrial accidents, frauds, new market missteps, bankruptcies, executive deaths and departure, information technology failures and the global financial crisis have all have raised stinging critiques of risk management and the quality of boards' role in risk management.

The study: February 28 is the two-year anniversary of the SEC's proxy disclosure rule on the board's oversight of risk management. The Commission and some commentors hoped this disclosure would bring valuable insight to investors. Others feared only boilerplate would result. To mark this date, this review of 2011 proxy disclosures was undertaken. The disclosures reviewed were from companies among the top gainers and losers in the S&P 500. In addition, due to the key role in the market played by financial companies, the top bank holding companies (BHCs) were also selected.

The findings: Most disclosures fell far below best practice guidance.
The study was designed to benchmark companies' disclosures against the *Corporate Risk Oversight Guidelines* from the International Corporate Governance Network (ICGN) and the four functions of a governor described in *The Operational Risk Handbook*. The four functions include both the board's own risk-return aware actions and its oversight of management's actions. A key statement in the *Guidelines* is, "The board should concisely disclose information sufficient for investors to make judgments on the quality of the board's oversight of risk management process."

However, none of the disclosures addressed all of the points of the ICGN *Guidelines* or *The Handbook* guidance. Most of the disclosures simply did not address most of the guidance points. Thus, it would have been futile to proceed with the originally intended benchmarking study.

Stepping back and looking at what was disclosed, the overall disclosures seemed to sort themselves into four categories:

- Those that primarily echoed the wording of the rule
- Those that primarily echoed the wording of the rule plus rather boilerplate audit language
- Those that added details about how risk oversight and management processes operated
- Those that added statements about philosophy/approach/objectives toward risk oversight and management

Overall, it would help investors for companies to mature their disclosures with more insights about objectives for risk management, the process by which those objectives are pursued, and how that process is continually improved. Despite low average maturity, several companies have already distinguished themselves with statements that point the way for others. The disclosures with more detail from Bank Holding Companies were from U.S. Bancorp and American Express Company. Among non-BHCs, ONEOK, First Solar and Newfield Exploration Company provided information that is more useful to investors, analysts and regulators. For example,

- ONEOK mentioned, "…risks that could affect our ability to fulfill our business objectives or execute our corporate strategy."
- American Express stated, "This objective is accomplished by investing in talent and global capabilities as well as by creating a company-wide culture focused on risk-return tradeoffs within established risk limits, and identifying excessive, unacceptable, and uneconomic risks."

In addition to those companies that provided more broadly helpful disclosures, others included specific statements that stood out from the crowd:

- Starbucks mentioned, "The involvement of the board of directors in reviewing Starbucks business strategy is an integral aspect of the board's assessment of management's tolerance for risk and also its determination of what constitutes an appropriate level of risk for the Company."
- MasterCard put the emphasis on "balance" in describing their structure that "balances risk and return by having business units and central functions (such as finance and law) identify, own and manage risks, our executive officers set policy and accountability."
- Goldman Sachs phrased it clearly "Risk is assessed from the standpoint of long-term ownership. We believe that effective risk management is of primary importance to the success of our firm."

It is hoped these companies will continue to blaze a trail toward the benchmarks and that all companies will mature toward better information for investors. This is especially the case for those boards who feel they are already engaging in more rigorous risk oversight than is reflected in their disclosures.

<u>Going forward</u>: A modest, four-point proposal is offered to increase disclosure effectiveness:

- Focus on strategy and value creation objectives – not just audit and compliance
- Describe more meaningfully “how it works” – not just committees that exist and talk
- Discuss the board’s own risk-return aware decision-making -- not just what management does
- Demonstrate continual improvement – not just static process mechanics

The current state of affairs conveys that the goals are ambitious, but they should not be dismissed to the realm of the unattainable. The ball is now in the court of investors, analysts, boards and key managers. The opportunity is clear; to not only improve the quality of insight, but also to substantively improve the quality of earnings and, ultimately, economic growth through a more performance-driven approach to risk oversight and management.

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