

ADVISORY

SULLIVAN & WORCESTER LLP CORPORATE ADVISORY

Standard & Poor's Clarifies ERM Analyses for Nonfinancial Companies

In 2008, Standard & Poor's announced that it would expand its ratings analyses to include a review of enterprise risk management not only for financial and insurance companies as was historically the case, but for all other nonfinancial companies as well. In response to the implementation of its ERM initiative, S&P received numerous inquiries. In order to provide greater clarity on the impact of its ERM review, S&P recently provided responses, in the form of FAQs, to some of the most pressing concerns. The following summarizes the key insights emerging from the S&P ERM FAQs. For a more in-depth discussion of ERM, and S&P's review of ERM, please see our March 2009 advisory, "Standard & Poor's to Focus on ERM in Ratings Analyses," which can be found [here](#).

Most prominently, S&P makes clear that its assessment of ERM should not be viewed as different than its current assessment of management and management's credibility, but instead should be viewed as an "avenue to facilitate a deeper management review." As ERM assessment is not separate or distinct from S&P's management assessment, S&P will not publish a separate ERM methodology. S&P believes that by not making its ERM assessment distinct from its general assessment of management, the long-term benefit will be the integration of ERM into everyday corporate governance and senior management's skill set. According to S&P, ERM is more than a compliance exercise and loss management tool. Companies that embrace ERM do so for reasons beyond anticipated credit ratings impact — effective ERM can facilitate improved cash flows and competitive advantages while helping to avoid unexpected large losses or chronic underperformance. S&P notes that any ERM-related enhancements in management analyses will be reflected in its more broad Corporate Ratings Criteria.

S&P has also clarified the meaning of "management credibility." Management may achieve credibility, and support its rating level, by demonstrating the ability to meet self-imposed objectives and to follow its predetermined courses of action. S&P looks for "thoughtful, realistic agendas" rather than those that are merely "hopeful or reactive." By meeting with a company's management year after year, S&P believes

IF YOU WOULD LIKE ADDITIONAL INFORMATION, PLEASE CONTACT:

Howard E. Berkenblit
617 338 2979
hberkenblit@sandw.com

Paul D. Trumble
617 338 2429
ptrumble@sandw.com

BOSTON

Sullivan & Worcester LLP
One Post Office Square
Boston, MA 02109

NEW YORK

Sullivan & Worcester LLP
1290 Avenue of the Americas
New York, NY 10104

WASHINGTON, DC

Sullivan & Worcester LLP
1666 K Street, NW
Washington, DC 20006

ISRAEL

Zysman, Aharoni, Gayer
& Co. / S&W LLP
41-45 Rothschild Blvd., Beit Zion
Tel Aviv, 65784 Israel

SULLIVAN &
WORCESTER

that it can effectively evaluate whether a company has realistic objectives and plans, and whether such objectives and plans are consistently achieved or followed. In times of financial distress for a company, and in the face of a pending or existing credit crisis, S&P believes such an approach is key to determining management's credibility and thus a company's worthiness of maintaining a particular rating level.

Tools and strategies for implementing effective ERM practices are also addressed by S&P. First, S&P recommends the adoption by companies of risk "measurement and reward systems." Such systems would, S&P believes, offer necessary risk measurement benchmarks and related performance incentives to management that would support an effective long-term ERM strategy. Secondly, S&P comments that a growing trend supports the formation of a risk committee of a company's board of directors, similar to audit and compensation committees, to take ownership of a company's risk assessment policies and procedures. S&P notes, however, that the ultimate responsibility for risk oversight would remain with the entire board of directors, and that day-to-day risk management within a company should be the responsibility of all employees, and particularly all managers of an organization. Finally, S&P notes that a key to effective risk management is communication, both to employees and stakeholders, such that employees have a sense of ownership of risk management issues and that stakeholders may fully understand and become comfortable with a company's risk management practices and any existing exposures.

S&P notes that ERM is "generally in a nascent stage" and all companies need to continue to strive to integrate risk management into strategic decision-making. A focus on risk management and assessment is not limited to those companies seeking to obtain or maintain a credit rating, but instead is in the realm of all companies subject to the rules and regulations of the Securities and Exchange Commission or other corporate

governance bodies. The SEC and others now require certain disclosures and compliance measures with respect to risk assessment, oversight and management. As such, although a company may not have credit rating needs, the guidance with respect to ERM provided by S&P contains useful considerations for most companies, particularly those subject to the oversight of the SEC and other corporate governance bodies.

The summary above is intended to describe the current S&P guidance relating to ERM, as well as practical implications for companies managing risk. The full text of the S&P FAQs can be found [here](#). For a more comprehensive analysis of S&P's ERM initiative and its implications, or for further information about, or assistance with, your SEC or other compliance obligations regarding risk assessment and management, please contact the lawyer at Sullivan & Worcester LLP with whom you regularly consult, or the lawyers listed above.

July 2010