

Regulatory developments

As you might expect, there was a great deal of regulatory focus during 2009 related to the financial crisis.

In June, the US Department of the Treasury released its analysis of the causes contributing to the financial crisis. Two of these are the failure of companies' risk management systems to detect the risks inherent in new financial products and the growth in consumer debt that was accommodated by dramatically rising home prices. Treasury's proposed solutions include improving oversight of various financial markets and expanding the measures the government could take in reaction to situations that may pose a threat to the country's financial stability.

The SEC has also been active. Under the leadership of Mary Schapiro, it is developing new rules for the companies it regulates and focusing on changes in how it operates. Among these changes:

- Given the spotlight on the Bernard Madoff fraud, the SEC is placing a great deal of emphasis on its enforcement programs. The Division of Enforcement has a new director, Robert Khuzami, a longtime federal prosecutor. The division has hired more investigators and is reforming its policies and procedures to enable faster investigations through, among other things, a simpler subpoena process. It also is upgrading the systems used to track unusual activity and to analyze tips and complaints from whistleblowers.
- As discussed in our "Focus on governance initiatives" section, the SEC is seeking a package of measures designed to expand and improve the quality of information that companies provide to investors and to give shareholders new authority. One proposal would require companies to describe their controls over employee compensation policies so compensation doesn't incent behavior that might pose a material risk. Another would expand shareholders' power by allowing them to nominate directors.
- The SEC is proposing to improve the information that credit rating agencies provide. The agencies would have to disclose their methods of developing the credit ratings so that investors could better assess how much reliance to place on those ratings in making their investment decisions.
- The SEC is considering proposals related to hedge funds and derivatives to bring the oversight of hedge funds, other private pools of capital, and their related investment advisors under its regulatory umbrella.

While the SEC focuses much effort on the changes described above, it continues to concentrate on the quality of disclosures in companies' reports to shareholders. One such area is management's description of the various risks facing the business. The SEC doesn't want this discussion to be simply a listing of risks, but believes it should answer questions such as:

- What are the risks and the potential financial and operating impacts to the company if large customers or vendors go out of business?
- What are the risks if the company's lenders fail, and how would that impact the stability, growth, and operations of the business?
- What are the risks and the potential financial impacts if counterparties (including those on derivatives contracts) fail to meet their obligations?

The SEC believes this information is important for investors to make informed investment decisions. As companies begin to prepare their annual reports, management should consider what additional disclosures would allow investors to better assess the potential impacts from these and other risks.

Directors' action

Recognize this shift in regulators' emphasis toward enforcement activities, and discuss with management any issues that may cause concern for regulators.

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