

**STANDARD  
& POOR'S**

*Setting the Standard*



## **ERM in Light of Good Corporate Governance**

**Enterprise Risk Management Symposium**

**Chicago**

**23-25 April 2006**

**George Dallas**

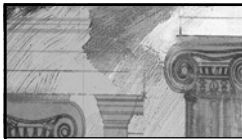
**Managing Director and Global Practice Leader**

**Corporate Governance**

**Standard & Poor's**

**London**

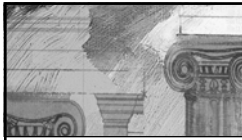
*The McGraw-Hill Companies*



## ***Corporate Governance and ERM***

### **Agenda**

- **Governance as a risk factor**
- **Standard & Poor's Enhanced Analytics Initiative**
- **Corporate Governance Analytical Framework**
- **Linkage of Corporate Governance to ERM**



## *Governance as a Risk Factor*

### 20<sup>th</sup> Century

**“Man's capacity for justice makes democracy possible, but man's inclination to injustice makes democracy necessary.”**

**Reinhold Niebuhr, German theologian (20<sup>th</sup> Century)**

### 19<sup>th</sup> Century

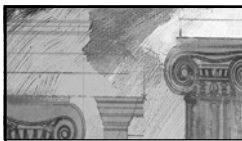
**“I can resist anything but temptation.”**

**Oscar Wilde, *Lady Windemere's Fan* (19<sup>th</sup> Century)**

### 18<sup>th</sup> Century

**“If men were angels no government would be necessary.”**

**James Madison, *US Federalist Papers* (18<sup>th</sup> Century)**



## *Law, Regulation and Market Forces: “Top down” versus “bottom up” initiatives*

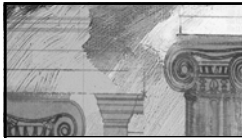
### Legislation and codes of best practice: instruments of policy and reform

- Laws, codes are listing rules have their limits
- Cannot assume that compliance means good governance or that all companies who comply to laws and listing rules have the same governance standards
- Compliance is baseline: potential for windowdressing or “box ticking”

### Market based solutions: systematic evaluation of governance risks in individual firms

- Complements top down efforts by regulators and exchanges
- Tool for investors, companies and regulators

Process of measuring corporate governance provides greater transparency for investors and a positive incentive for companies to improve their governance standards



## *What Standard & Poor's is doing*

### **Enhanced Analytical Initiative for S&P credit ratings:**

#### **“3 pronged” approach**

- **Accounting**
  - **Enterprise Risk Management**
  - **Corporate governance**
- **These three areas are interlinked, supported by specialist analysts in each discipline**

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## *What Standard & Poor's is doing*

### ***Accounting***

- Drive analytic rigor and ensure that all analysts achieve a robust proficiency in accounting and financial reporting analysis
- Provide greater transparency in our ratings through enhanced financial reporting analysis
- An analytic, rather than forensic, approach to accounting and financial reporting

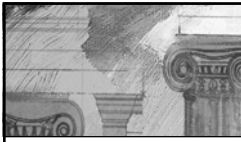
### ***Enterprise Risk Management***

- Key sectors: banks, insurance companies, energy (trading emphasis)
- Gradual roll out to other sectors
- Criteria emphasizes “PIMS”: process, infrastructure, methodology and systems

### ***Corporate Governance***

- Rated companies screened to assess management behaviors and identify cases where enhanced governance analysis could help for a more robust credit rating opinion
- Tools include our “GMA filter” and software technology designed to screen public documents for word strings which might indicate potential governance anomalies

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## Standard & Poor's Corporate Governance Analytical Criteria Framework

### Ownership Structure & External Influences

- Transparency of Ownership
- Concentration and influence of ownership
- Influence of external stakeholders

### Shareholder Rights and Stakeholder Relations

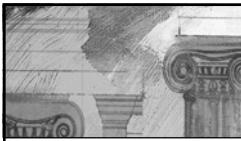
- Voting and shareholder meeting procedures
- Ownership rights and takeover defenses
- Stakeholder Relations

### Transparency, Disclosure and Audit

- Content of public disclosure
- Timing of, and access to, public disclosure
- **The audit process**

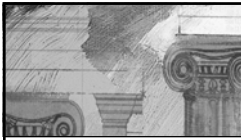
### Board Structure & Effectiveness

- Board structure and independence
- **Role and effectiveness of board**
- Board/executive compensation



## Major factors S&P considers in evaluating credit risk and assigning ratings

BUSINESS RISK	FINANCIAL RISK
• Country Risk	• Accounting
• Industry Risk	• Financial Policies and Governance/Risk Appetite
• Company Competitive Position	• Cash Flow Adequacy/Volatility
• Product Portfolio/Marketing	• Leverage/Capital Structure and Flexibility/Asset Protection
• Technology	• Liquidity/short term factors
• Productivity/Cost Efficiency	• Contingent Liabilities and Triggers
• Strategic and Operational Management Competence	
• Profitability	
• Growth Strategy & Risk Appetite, Management Culture and Governance	



## Corporate Governance Criteria Relevant to Risk Management

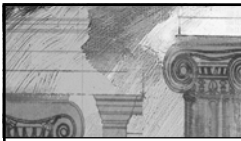
### Focus on the Audit Process and Internal Controls

- Internal control department: resources, purview and reporting lines
- Financial performance: financial risk management
- Non financial performance: operational risks
- Information/tracking systems
- Early warning systems/whistleblowing

### Focus on Board Effectiveness

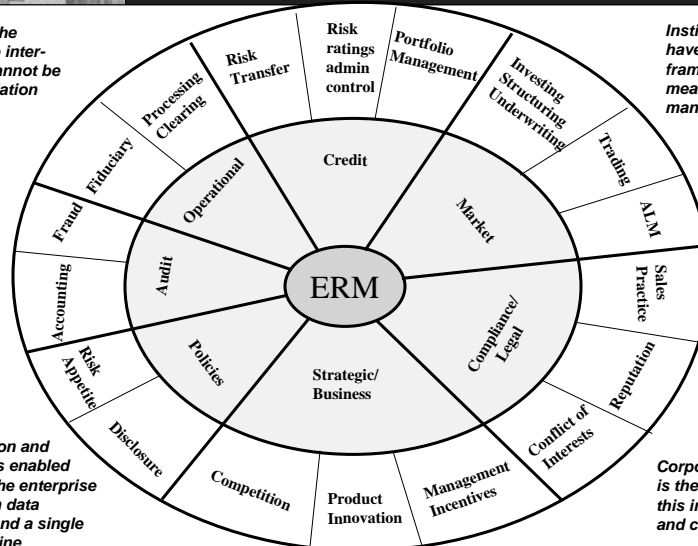
- Corporate culture/tone
- Board/audit committee oversight and engagement
- Skill sets: risk management expertise?

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## ERM approach of the risk function in the future

*Risks within the enterprise are inter-related and cannot be viewed in isolation*

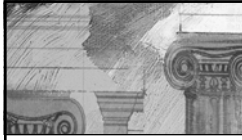


*Institutions will have a unified framework for measuring and managing risks*

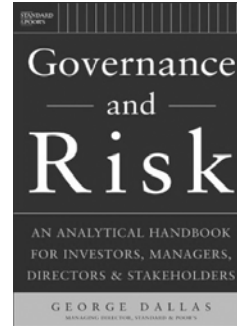
*Risk integration and aggregation is enabled through-out the enterprise via a common data architecture and a single valuation engine*

*Corporate governance is the glue that binds this into a consistent and coherent structure*

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Detailed expositions of our criteria & methodology, examples, and a wide discussion of corporate governance issues are available in *Governance & Risk* (McGraw-Hill) written by members of the S&P Governance Services group and distinguished guest contributors. Our criteria and published governance evaluations are also available on our website: [www.governance.standardandpoors.com](http://www.governance.standardandpoors.com)