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THE UNTHINKABLE

10 Elements of Post-pandemic Risk Oversight Essential to Boards Today

For many businesses, the pandemic, and events resulting from it, exposed monumental gaps in risk management. The shutdown of the entire global economy and much of society – within a matter of a few weeks – had been unimaginable to contemplate.

Prior to COVID-19, even corporate business continuity and resiliency plans and scenario-planning that incorporated the impact of a pandemic such as SARS, did not fully anticipate the extreme scope of our current crisis and the likely permanent impact for decades to come. While SARS was limited to a few countries and 774 deaths, it did not have the global impact on supply chains, services businesses and the large number of countries that COVID-19 has had.

With the unprecedented complexity brought by a pandemic-level threat, managing risk has become as important as other key duties of the board and places additional burden on the Audit committee. Succession planning, strategy, and fiduciary responsibility are all top responsibilities for the board as is effective risk oversight.

Moreover, as boards carry out these key responsibilities during this challenging time, we are seeing a wave of regulatory activity placing additional pressures on companies and boards. Regulations around everything from workplace safety, Paycheck Protection Program rules and greater oversight of tech giants, keep boards and companies at a much higher level of regulatory risk.

The murder of George Floyd and subsequent social unrest led boards to focus more on their organization's diversity, equity, and inclusion policies and practices. Leaders like Larry Fink, chairman and CEO of BlackRock, and executives in the Biden Administration are getting boards' attention on human capital management as well as ways to address climate change, placing greater emphasis on Environmental, Social and Goverance (ESG) metrics and reporting requirements.

As the pandemic crisis and lingering economic and social volatility—as well as other risks—increasingly threaten businesses and recovery globally, some companies are considering establishing a stand-alone board Risk committee. It is important to note that the Dodd-Frank Act required large financial institutions to establish a Risk committee on the board after the last financial crisis.

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According to **Susan C. Keating**, CEO of Women Corporate Directors (WCD), creating a dedicated Risk committee is just one way boards are arming themselves given the current environment.

"While risk oversight is the responsibility of the full board, some companies are opting to form dedicated committees to drill down on newer risks and make recommendations to the full board on mitigation strategies," says Keating. "Risk has become an integral part of strategy development and oversight, as companies have seen what happens when the unthinkable actually comes to pass—from the collapse of the global supply chain to a health crisis that spans every country in the world."

WCD teamed with the Board Risk Committee (BRC), C-level executives, and board members to offer perspectives on how boards should approach risk today.

Complex Risks – Measurable and Immeasurable

- Ongoing impact of Covid-19 on families and healthcare
- Uncertainty around availablity and long-term efficacy of vaccines and threat of new strains
- Worldwide unemployment despite select stock market gains
- Social movement demanding accountability from organizations for racial inequities
- Reputation risk on social media
- Hyper-charged political and social environment
- Cyberwarfare attacks
- Escalating climate change
- Emerging technologies (5G, AI, robotics)
- U.S. domestic terror threats

Panelists included:

Catherine Allen, chairman, Board Risk Committee and interim CEO, Shared Assessments

Christopher Burt: co-founder and director of the U.K. Risk Coalition; principal, Halex Consulting; director, Risk Coalition Research Company

Jackie Daylor: Audit partner, KPMG LLP

Agnes Bundy Scanlan, Esq., CIPP: president, The Cambridge Group LLC; director, Truist Financial Corporation, NewTower Trust Company, AppFolio, Inc. and R1 RCM, Inc.; member, WCD Boston

1 Consider creating a Risk committee.

The complexities of risk today spread far and wide into operations that may test the content knowledge of board members whose technical expertise is more focused on financial and compliance issues. As the Audit committee helps navigate both the challenging financial realities and increasing regulatory requirements, companies are grappling with having to broaden the committee's scope beyond these focus areas. In an effort not to spread the Audit committee too thin, some companies are carefully weighing the pros and cons of establishing a separate committee dedicated to looking at risk from all respects, especially operational risks.

"A Risk committee provides the opportunity to include members with experience in areas such as cybersecurity, IT, compliance, third-party risk management, privacy, and reputational risk," says **Catherine Allen**. "With this knowledge and expertise, the Risk committee can evaluate the significance of risk profiles for each business and establish metrics. The Audit committee often does not have the time or expertise to address these growing operational and reputation risks."

2 Don't spend too much time on risks you already know.

Boards tend to focus too much on known risks that already have mitigation plans in place or risks they feel they can address. For example, in the banking and financial sector, risk maturity around financial and operational risks such as credit, market or liquidity, is typically well addressed. However, risk maturity around more qualitative risks such as conduct and culture, are less advanced as these areas are more complicated to define and measure. As a result, these more complex issues are less frequently discussed by the board and therefore may feel out of their control. It is imperative that boards explore these risks—geopolitical, culture, conduct—in more depth to adequately assess and mitigate against them.

> "The real value is focusing on new and emerging risks where you may need to develop a solution or process to reduce or control a potential threat," said **Chris Burt**. "An important quality to look for in a board Risk committee member or a Chief Risk Officer is imagination."

3 Keep an eye on what can go very wrong, very quickly.

"The liquidity crisis stemming from the COVID-19 shutdown put many companies in a dangerous financial position virtually overnight. Many of these businesses had seen a liquidity crunch 12 years earlier during the 2008 financial crisis—where the cascading consequences affected individual firms and then the entire financial sector. These kinds of existential threats are where Risk committees must not get complacent," said Burt. "Pay attention to risks that are currently under control but have the potential to go very wrong, very quickly."

Other examples along this vein include cyber attacks on critical infrastructure such as water and electric, rapid flooding caused by climate change, and social unrest due to employee and customer boycotts and demonstrations that impact business continuity. Boards need to push past the top three or five risks on the list. Although some risks may be deemed low probability, mitigation plans are crucial if the risk could give rise to a significant operational or financial impact.

4 Reputational risk can stem from multiple other risks.

Reputation risk is aligned with other key business risks. Consequently, protecting a company's reputation and brand is a challenge. When contemplating new business strategies, key stakeholders must consider the impact of the strategy on the company's reputation. "A Risk committee often has to handle reputational repercussions that happen as a result of other matters under their oversight going awry," said **Agnes Bundy Scanlan**. "Everything from regulatory issues to an ESG failure to a customer data breach can carry significant reputational consequences that require a level of risk management beyond the initial incident." Today, the board discusses reputational risk factors such as cybersecurity, data breach incidents, nefarious employee acts, and corporate social responsibility.

5 Risk management doesn't mean being afraid to pull the trigger.

There can be a tendency when making strategic decisions, especially with certain boards in financial services, to keep asking for more data and not move forward. "Don't paralyze the organization by always asking for more data and refusing to act," said Burt. "At some point, you have to make a decision." The 2020 WCD Thought Leadership Commission report co-authored by Pearl Meyer, *Work Has Changed*, found that two of the five attributes needed in new leadership included the ability to pivot the company and strategy quickly and to make decisions in environments that are ambiguous.

It is important that board members maintain the perspective that, while data and situational information is vital, risk discussions ultimately come down to a judgment on behalf of the directors based on the interpretation of the data and professional experience of individual board members. "Risks are uncertain, future events—the board can prepare for and mitigate against those risks but cannot predict the future. There are often several potential outcomes that may result from a single risk in enterprise management, making it very difficult to predict the outcome. Therefore, it is key that senior executives and board members accept this ambiguity and exhibit good judgment in the absence of good data," said Burt.

6 Leverage a strong risk culture.

"Looking at the events of the pandemic, the economic collapse and the social unrest – the institutions that came into this past year with a strong culture are managing better," said Bundy Scanlan. "Organizations that have addressed risk in the past, in a strategic way, have been able to tap into this culture and adapt. These companies are better at working remotely – they are not as disrupted by these kinds of changes that drag down the performance of those who can't adapt."

"Tone from the top' is a phrase that one might say is overly used. I disagree. The risk culture supported by the board and executive management must permeate from the top, throughout, and to the lower ranks within a company. Ensuring awareness of the risk culture is paramount, thus communications and training must also occur."

7 Make sure compensation and performance aren't being driven by bad culture.

"What are the cultural elements—the tone at the top, the incentives, the pressures—that could create risk in an organization?" asked **Jackie Daylor**. "It's important to look at the behaviors that are driving results and the culture that's developing around the bottom line." Resetting incentives and ensuring that they are driving the culture and values that you aspire to is even more important in today's flexible work environment. Fraud risks can emerge when companies are under financial and operational stress. Leaning into those risks and understanding where opportunities or behaviors may emerge is critical to managing overall risk. Communication from the top is challenged in a flexible work environment, so messaging on culture and values must be clear and reach the broadest level of the organization.

Following COVID-19, companies are reassessing, enhancing, or establishing internal controls to mitigate against risk. KPMG's 2020 Audit committee pulse survey, **Challenges Presented by COVID-19** found:

- 26% of those surveyed cited ethics, compliance, and corporate culture as areas in which COVID-19 caused the company to evaluate internal controls.
- 40% of those surveyed cited assessing incremental fraud risks as one of the ways their company's internal audit function adjusted its focus and activities in response to the pandemic.

"Best practices for corporations to manage risks start at the top," said Allen. "They include having a robust risk profile and appetite by business, a Risk committee of the board, a Risk Operations Center, an Enterprise Risk Management (ERM) system and members of the board with risk or technology backgrounds."

8 Don't devote all attention to today's headline crisis.

"Risk committees tend to focus on the current threat in the news, whether it's a cyber attack or COVID," said Burt. "They always need to look at the risks as a whole—the ongoing threats that are always there—and not ignore any of them."

Assessing and ensuring proper mitigation plans are in place for individual risks and understanding the organization's overall risk profile are the main focus of the Risk committee agenda. However, boards and executives should not look at risk management as a process that stifles innovation, but instead as a process that supports innovation.

> "Risk management isn't just about preventing bad things from happening; it's also about analyzing opportunities to help good things happen."
>
> \- **Christopher Burt**, UK Risk Coalition

> "I suggest that companies adopt an innovation objective and identify the key risks that might undermine its achievement, like lack of organizational agility, unwillingness to risk losing public money, or being insufficiently entrepreneurial," says **Bundy Scanlan**. "That will help ensure that each project challenges the business case, the key risks are understood, bureaucracy and 'standard processes' are minimized, and that they learn to fail fast—but also learn from the experience and try again."

9 Keep strategic objectives top of mind.

"Strategy and risk are intertwined," says Daylor. "It's essential to have a strategic approach to risk management. Companies need organizational resilience to withstand black swan events, such as the current pandemic, so that their people and processes are prepared to respond in the right way."

"The crises of 2020 have clearly been wake-up calls to take a fresh look at companies' ERM processes, crisis readiness, and risk mindset—and how all of that connects to strategy," says Daylor.

It is also important to consider the role of the Chief Risk Officer. "We see the Chief Risk Officer playing a key role in the board's discussions on strategy, challenging both the executives and directors on risk, while also providing advice and guidance on how the organization can achieve its aims in a risk-controlled way," said Bundy Scanlan.

"An important role for the board is to help ensure the organization understands, and is leveraging, the strategic value of risk management activities," says Daylor. "The challenge is to continually refine and focus the decision-making process on taking profitable risks, consistent with the mission of the organization and the expectations of its stakeholders."

10 Plan for risk challenges and be prepared.

Risk management as a defensive function—to identify, monitor, and manage critical risks to the organization and its stakeholders—continues to be essential, Daylor notes. "But an increasingly competitive, disruptive, and uncertain environment calls for ever-smarter risk taking. This may require a significant shift in mindset and culture, particularly for organizations focused intensely on regulatory compliance and risk-mitigation."

How diversity helps address complexity.

"Diversity plays a huge part in reducing management's blind spots when it comes to risk," says Daylor. "Diversity of experience and social diversity help with problem solving, whether it's COVID-19-related health and safety concerns, managing flexible workforces, or the acceleration of digital transformation that comes along with a remote workforce."

Considerations for Boards

- Does the company have a complete inventory of its critical risks?
- Do the company's risk management activities result in a consistent, enterprise-wide view of the top risks? Are less likely risks with high potential organizational impact addressed?
- How do we think about risk and reward?
- What risks are acceptable, and how do they align with the business strategy?
- Are crisis readiness plans linked to risk management and are we prepared for a worst-case scenario?
- What are the black-line issues where we don't compromise, no matter how low the probability?
- Does the organization have a common "risk language?"
- How is leadership – in the C-suite and the boardroom – keeping pace with developments in the operating environment to ensure robust discussions about existential threats, competitive advantages, and where the organization is placing its bets?
- Does the board's existing membership and committee structure bring the right focus to the company's risks and crisis readiness?

The value of diversity is especially critical as risks grow in complexity. “On your Risk committee and for your board as a whole,” says Keating, “you want to make sure the diversity of the team is broad enough to address the wide spectrum of risks that are multiplying quickly each day.”

> “Diversity plays a huge part in reducing management’s blind spots.”
>
> - Jackie Daylor, KPMG

Resources – Boards and Risk

KPMG: “Getting Better at Seeing Ahead”
KPMG: “Challanges Presented by COVID-19”
HALEX Consulting: “The Risks of Risk Management”
The Risk Coalition: Raising the Bar Guidance

Contributors

Catherine Allen is chairman of the Board Risk Committee and interim CEO of Shared Assessments. She is on the corporate boards of RiskSense, Belief Agency, CRI Advantage, and PocketPatient MD, as well as the New Mexico State Investment Council. She formerly served as a public board member for Synovus Financial Corporation, Stewart Information Systems, El Paso Electric Company and NBS Technologies. She has set up, chaired, or served on numerous Risk committees. Catherine is co-chair of the New Mexico chapter of Women Corporate Directors.

Christopher Burt is the Co-founder and Director of the U.K. Risk Coalition, who instigated, chaired and is the principal author for the Risk Coalition’s “Raising the Bar – principles-based guidance for board risk committees and risk functions in the U.K. financial services sector.” He is the principal for Halex Consulting and director for the Risk Coalition Research Company. He is an independent consultant with over 25 years of risk consultancy experience.

Jackie Daylor is the former national managing partner for Audit Quality and Professional Practice at KPMG LLP. In that role, she was responsible for the strategic oversight of audit quality control and technical accounting and auditing leadership of the Audit practice for both KPMG LLP and KPMG Americas Ltd. Over her 30-year career at KPMG, Jackie has served as lead Audit engagement partner, SEC reviewing partner or account executive for a variety of large global clients, both public and private and was a member of the boards of KPMG LLP and KPMG Americas Ltd.

Agnes Bundy Scanlan, Esq., CIPP, is a member of Women Corporate Directors and president of The Cambridge Group LLC, a strategy and risk management advisory firm. The Cambridge Group provides regulatory risk consulting, operational expertise on financial services regulations, interim staff augmentation, training guidance, and more. Agnes currently serves on the Risk, Trust and Nomination and Governance committees of the board for Truist Financial Corporation; chairs the Audit and Compliance board committee for NewTower Trust Company, and chairs the Risk and Compliance oversight committee and is a member of the Audit committee of AppFolio, Inc. Recently, Agnes was senior advisor for Treliant and the northeast regional director for the Consumer Financial Protection Bureau.

About WCD

Women Corporate Directors Education and Development Foundation, Inc.

The Women Corporate Directors Education and Development Foundation, Inc. (WCD) is the only global membership organization and community of women corporate directors. WCD members serve on numerous boards of large private and family-run companies globally. A 501(c)(3) not-for-profit organization, WCD has multiple chapters around the world. For more information visit www.womencorporatedirectors.org or follow us on Twitter @WomenCorpDirs, #WCDboards.

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BRC
BOARD RISK COMMITTEE

Board Risk Committee

The Board Risk Committee (BRC) is a nonprofit, non-competitive, thought leadership peer forum dedicated to Board Risk Committee members and Chief Risk Officers (CROs). The BRC is a trusted place for the exchange of ideas, best practices, and topics of interest. Central to this exchange are discussions of current and emerging risks facilitated by horizon scanning that provides a real-time and forward-thinking perspective. Experience shows that correctly structured and staffed Board Risk Committees are an effective way to mitigate risk exposure. Visit www.boardriskcommittee.org for more information.

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