Evolutions in Risk Oversight

Lessons Learned for the Decade Ahead

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Foreword

The past 18 months have been marked by significant disruptive risks with the Covid-19 pandemic presenting an ongoing multi-dimensional crisis with health, economic, social, and cultural impacts. In addition, organizations have had to respond to a rising focus on environmental, social and governance issues, as well as a rapid acceleration of existing trends such as increased digitalization.

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The tumultuous events of 2020 and 2021 — including the COVID-19 pandemic, a growing focus on environmental, social, and governance (ESG) issues, supply chain disruptions, record levels of deal-making, and evolving cyberattacks — present unique challenges and risks for organizations. Unsurprisingly, in the Global Network of Directors [illegible]

But despite the expanding scale, pace, and scope of the risk environment, it is unlikely that there will be a signifcant increase in board-level risk committees as a mechanism to manage the growing board oversight role. Risk committees will remain concentrated in highly regulated industries such as fnancial services and health care, or capital-intensive industries such as the energy sector. In these sectors, the risk committee enables efective oversight of closely intertwined governance, risk, and compliance fram i

4. New board committees are being developed to focus on evolving risks. Although few companies may adopt a board-level risk committee, a growing number of organizations are establishing committees focused on evolving or transformative issues that are closely linked to organizational strategy. Recent NACD data show that about 5.5 percent of boards have technology committees[5], about 2 percent have ESG committees, and 1.2 percent have cyber committees. One director observed that “a good board evaluates its committee structure every year and evaluates how it fits with the business model and whether there should be adjustments.”

New committees are established to ensure the issues receive regular and sufficient board input. In the future, we can expect to see risk oversight distributed across a broader range of board committees as boards structure themselves to reflect changing organizational needs. As one director noted, “There seems to be little consistency in committee structure and risk responsibilities across companies. My guiding principle would be ‘Do the least that buys you the most.’ This ensures the board is not hampered by processes that are not productive.”

5. The board must continuously revise committee charters to reflect evolving risks. Many organizations are also evolving the charters of existing and traditional board committees to reflect a necessary refocus of each committee’s mandate. In one case study, an organization transformed the audit committee into the audit and risk committee and codified a broader set of responsibilities, including conducting a forward-looking risk assessment, for

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In the face of COVID-19, the ransomware epidemic, and climate threats, organizations have experienced increasing calls to become more resilient. But what does “being risk resilient” actually mean and what are the implications for boards in terms of risk oversight said, “You need people with different sets of skills to actually rethink your basic business proposition and assumptions.”

It is also vital to consider whether the senior leaders responsible for organizational strategy are fully integrated into resiliency planning. This integration helps companies better identify risks and design and execute responses. Connecting risks to long-term strategy helps organizations move forward and mitigate their financial exposure, reputational damage, business interruption, and other losses.

Resilient organizations regularly assess the risk terrain and test whether they have the necessary resources to navigate it. Companies need an accurate view of organizational preparedness, as they often overestimate how quickly and effectively they will be able to respond to (and sustainably recover from) a given risk or they focus on actions around a short-term crisis.

Building risk resiliency and agility goes beyond having a crisis management plan in place. Scenario-based financial stress-testing and planning are vital

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Improving risk oversight has been a top-three area of focus[1] for most boards over the past decade, alongside improving risk information that management provides to the board. E f ective risk oversight is only possible when the board has comprehensive, clear visibility on risks the organization is facing and taking, as well as its steps to mitigate and manage them.

Organizations have made e f orts to improve their boards' risk information, with 60 percent of directors in a 2020 survey[2] agreeing that the quality of risk information had improved over the years. Yet, perennial challenges and frustrations remain. Directors are looking for risk-reporting improvements in terms of ease of interpretation and drawing conclusions; highlighting vulnerabilities, common risk drivers, and cumulative impacts on the organization; and capturing a forward-looking view.

Directors often face huge volumes of material —

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explore with management where and why there were areas of disagreement and spark more productive dialogue on critical matters.

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5. Adaptive Governance: Board Oversight of Disruptive Risks. (2018). Report of the National Association of Corporate Directors Blue Ribbon www.nacdonline.org/insights/blue_ribbon.cfm?itemnumber=61330

6 David Gillespie, Sean McGuire, and Martin Lehmann. Risk Functions at Banks and Insurers Must Become More Agile. (2020), Oliver Wyman www.oliverwyman.com/our-expertise/insights/2017/dec/risk-journal-vol-7

“You’re on mute.”

This must have been one of the most spoken phrases over the past 18 months as many organizations moved to online meetings and video conferences. The mobility restrictions associated with the COVID-19 pandemic created opportunities to innovate and, in many instances, offered a crash course in being agile — a critical requirement of boards.

As a result of the pandemic and other events of 2020, the scope and scale of issues on the board risk agenda have fundamentally changed, as have many aspects of governance processes. Going forward, boards must build their agility to enable organizations to navigate the new cadence of the business and risk environment.

As a previous article noted[1], an agile board can “identify and respond effectively to rapid and unexpected changes in the internal and external environment. It is characterized by a forward-looking and exploratory approach that challenges and nurtures both current and future business, enables quicker decision-making, and supports the organization to be more adaptable and innovative when confronted by change.”

While many directors agree that virtual board meetings are as e f ective as in-person meetings, there are serious challenges. In the future, boards need to explicitly implement approaches to ensure fully engaged directors in a virtual world. More than two-thirds of GNDI survey respondents (68 percent) noted the negative impact of reduced nonverbal communication among directors during virtual meetings. Board chairs may also need to take additional steps to ensure that minority views are represented, which may be more challenging virtually. Finally, boards may need to reconsider how to apply decision-making techniques such as “red teams” or “tenth man” (where at least one person is appointed to serve as the loyal disŸs€ R U p À F L À 0 4p 0 O P R D U G R ` Uh À D O H ð ÖX'H3_0 1 Tf 0.022 T

Agile boards embrace continuous learning in two key areas: organizational strategy and business model, and the expanding spectrum of events and trends driving changes in an organization's business environment.

Directors are more engaged and involved in robust dialogue across various levels of management than ever before — without impinging on management's operational role. This enables the board to actively debate and challenge management on their risk assessment, decision-making processes, and conclusions. Many directors noted that this process is vital to helping management "see around the corners."

Boards are also turning to directors from a range of professional backgrounds to increase cognitive diversity in the boardroom and to tap expertise on evolving issues such as cybersecurity, digitalization, and environmental, social, and governance (ESG) topics. Increased boardroom diversity across all vectors has many benefts. Still, onboarding a cybersecurity or an ESG expert does not relieve other board members from developing a robust understanding of the interaction between evolving risks and trends. Most boards have about 10 members, and as organizations face a widening array of issues, no board can have an expert on each topic. Since they cannot be "know-it-alls," boards must become "learn-it-alls."

Each director must commit to a boardroom culture of continuous le ≈ ¾ oeg

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As COVID-19 and its variants continue to disrupt society, business, and commerce, boards have expanded the scope of their risk oversight to include a broader, “people risks” agenda. Directors responded swiftly to the pandemic, supporting management teams as they faced new challenges to the health and well-being of their workforces. At the same time, there is a rising awareness on the role organizations play in addressing societal concerns at the board level. The intersection of these two issues is where the notion of creating “healthy societies” emerges.

The creation of a healthy society incorporates equitable access to a f ordable, quality health care, providing healthy environments to live and work, creating f nancial security and a more equitable workforce across race, ethnicity and gender. These aspects all play a role in our collective and individual health outcomes.

Boards that take on managing these “people risks” with the right balance of empathy and economics will be better positioned to secure the organizations’ future during this accelerated period of sustained change.

Before the pandemic, organizations and their boards framed the relationship with their employees through the lens of the workplace environment. Policies were created to help guide the organization and its employees in conducting the work relationship. Organizations often developed bene f ts, compensation, hiring, and workplace procedures from this perspective.

In just a few months in 2020, the pandemic shifted this paradigm. As many organizations went to remote work arrangements, the line between what happens inside the workplace and outside the workplace dissolved. This shift created a new level of oversight for boards as organizations needed to quickly develop strategic approaches to ensure the health and safety of their employees inside and outside of the workplace.

As boards continue to tackle the ongoing issues related to COVID-19 and its variants, health becomes a new driver in charting the future of an organization. The concept of “healthy societi

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2020-2021 Global Director Survey Report

Global Risks Report, 2021

Risk Resilience Report

Sustainable at the Core

Resetting the Future Of Work Agenda

Harnessing Technology Convergence

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