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Why your board should take a fresh look at risk oversight: a practical guide for getting started

Boards play a critical role in overseeing company risk. Ongoing and evolving challenges call for a fresh approach to the task.

A thoughtful approach to risk oversight can bring real value to a company and its shareholders. The right approach delivers transparency on the board's activities to investors; engages a diverse set of directors with the right skill sets; allocates risk effectively at the board level; and provides time for strategic risk discussions. So how can your board refresh its risk approach to be more effective?





A renewed focus on effective risk oversight

Boards have a critical role in overseeing a company's key risks—whether those risks fall into strategic, financial or operational buckets, or relate to regulatory compliance or other corporate obligations. Directors who thoughtfully define and agree on their board's approach to overseeing risk can bring real value to a company and its shareholders. The board's role in overseeing risk

also continues to attract the attention of investors, regulators and other stakeholders, prompting calls for greater transparency.

To respond to the following challenges in overseeing risk, boards should consider ways to refresh their current approach.

Addressing the key challenges for directors



How can a board reassure investors that it is overseeing risk effectively?



Board action: Enhance proxy disclosures to better describe risk oversight, so shareholders can better understand what your board does and how.



Do directors' backgrounds support effective risk oversight?



Board action: Rethink board composition. Ensure directors bring diverse perspectives to risk discussions.



Are any key risks falling through the cracks and not being overseen anywhere at the board level?



Board action: Clearly allocate risk oversight among the board and its committees. Ensure that the chairs share their committees' insights about those risks with the full board.



Is too much of the board-level effort on risk focusing on compliance and regulatory matters?



Board action: Preserve agenda time to focus on key risks, including big picture strategic risks.



Challenge: How can a board reassure investors that it is overseeing risk effectively?

Shareholders have pushed for more meaningful and transparent disclosures on boards' activities and performance in recent years. Investors' focus on the oversight of risks is no exception, particularly as more companies have experienced cyberattacks, supply chain disruptions, allegations of wrongdoing, and other challenges that damage both reputations and bottom lines. When investors witness such damaging incidents, they may even consider voting against re-electing directors.

Starting in 2010, public companies were required to include in their proxy statements disclosures about the board's role in risk oversight. Initially, many companies disclosed little beyond the fact that the board had overall responsibility for overseeing risk, the audit committee oversaw financial-related risks, the governance committee oversaw governance-related risks and the compensation committee oversaw compensation-related risks.

Such basic disclosures didn't give shareholders much confidence that the board was actively overseeing the risks that matter.

Today, some companies have significantly expanded their disclosure on how their board oversees risk. According to our 2016 survey, 30% of directors indicated that their board has taken action to enhance proxy disclosures related to risk oversight.¹

¹ PwC, 2016 Annual Corporate Directors Survey, October 2016.

How robust are your risk oversight disclosures?

We reviewed the proxy statements of over 50 companies from the S&P 500, representing multiple industries. Some of the more robust disclosures we reviewed:

- Made it clear the **full board is engaged** in discussing all risks, even if specific committees are described as overseeing the risk assessment process or overseeing specific risks. Some of the advantages noted of full board involvement included allowing directors to collectively provide input on key risks, assessing the interplay among risks, making informed cost-benefit decisions and providing views on the adequacy of risk mitigation.
- Described **how the board oversees key risks**. In addition to describing which committees oversee which risks, many explain the full board's role. Some boards dedicated a portion of several board meetings a year to discussing specific risks in greater detail while others covered each risk on a rotating basis at regular board meetings. Additionally, some disclosures identified which board meetings were focused on risk discussions; listed which risks are regularly reported on to the board; or specified which risks the board focused on during the prior year.
- Described the board's **approach to allocating risk oversight**. Sometimes they indicated whether the full board or a specific committee (e.g., the audit or risk committee) does the allocation. We also saw proxies that described the board's awareness of the need to coordinate the oversight allocation, particularly for risks that impact multiple committees, and the governance committee's role in ensuring all significant risk categories are addressed by at least one committee.
- Described the **nature and frequency of reporting** to the board, including which specific executives lead the discussion; which committees receive reports; and whether the entire board receives regular reports. Some disclose how risk discussions are woven into other management presentations about strategy, business unit performance or proposed significant transactions.



Many of the proxy statements also discussed management’s role, describing how management supports the board and how the enterprise risk management (ERM) process works.

Proxy disclosures are detailing management’s role in risk

Some of the more robust disclosures included:

- Which executives (from the C-Suite, business and functional units or regional operations) make up the management-level risk committee, and how any subcommittee structure works
- What role the chief risk officer plays
- How risk management is coordinated across the company and how management remains alert to emerging risks
- The ERM process, including the use of common frameworks; agreed-upon risk definitions; the categories of risk being assessed; techniques used to capture risks across the organization (e.g., surveys); and whether third parties helped with the assessment. Some also noted that they identify risk owners as part of the process and that there is a centralized assessment of the adequacy of risk mitigation.



Board action: Enhance proxy disclosures to better describe risk oversight, so shareholders can better understand what your board does and how.

To improve descriptions of the board’s risk oversight, directors can:

- Have management benchmark the company’s disclosure about the board’s oversight of risk with those of peers and competitors
- Ask those who prepare the proxy statement to draft a sample disclosure that includes additional information on the board’s practices; considers insights drawn from management’s review of other companies’ disclosures; and incorporates the elements of robust disclosures described earlier

With this information, your board can critically evaluate whether you should enhance your disclosures so investors can better understand the board’s activities. This exercise may also identify changes that could improve the board’s underlying practices. For example, it may point to the need to devote more board time to risk management. It may also point to gaps in management’s processes.



Challenge: Do directors' backgrounds support effective risk oversight?

Boards may not be as effective at overseeing risk if directors don't have industry expertise or sufficiently diverse backgrounds that allow them to bring different perspectives to the discussion. Many of the key risks a company faces are linked to its strategy and industry. Yet antitrust regulations make it a challenge to have many directors with deep industry knowledge on a company's board. This can make it harder for boards to have in-depth understanding of the key risks or spot risks that management hasn't already identified. The challenge may be more evident in highly specialized or regulated industries. For example, a director who has services or general manufacturing experience may not be familiar with the more unique risks at insurance or pharmaceutical/biotech companies.

Having diverse skills, backgrounds and experiences on a board is vital to understanding the broad range of risks a company can face. Directors who have risk management expertise can also bring real value.

While consensus is that it's an important skill, the definition of what qualifies as "risk management expertise" is broad. The Dodd-Frank rules require large financial institutions to have at least one risk management expert on their risk committees. The definition says that person is to have experience identifying, assessing and managing risk exposures of large, complex firms.

Based on our review of a sample of 2016 proxy statements, over half of the companies (52%), including many companies that are not in financial services, specifically disclose that certain board members have skills or experience in risk management.² Those individuals had varying backgrounds, serving as chief executive officer (CEO), chief financial officer (CFO), or general counsel; being directors of other public companies; or having operational experience. A few companies even specified that "risk management" was a director skill they need on their board in their skill matrices, and then identified which directors possess this attribute.

Risk management expertise is important to board composition

63%

of directors rate risk management expertise as very important to have on their boards—placing it fourth in a long list of attributes.



79%

of investors said it's a very important attribute to be represented on boards—rating it as the second most important attribute.



Sources: PwC, 2016 Annual Corporate Directors Survey, October 2016; PwC, *What matters in the boardroom? Director and investor views on trends shaping governance and the board of the future*, 2014.

² Based on PwC analysis of 2016 proxy statements of 100 S&P 500 companies, judgmentally selected to represent multiple sectors, April 2016.



Board action: Rethink board composition. Ensure directors bring diverse perspectives to risk discussions.

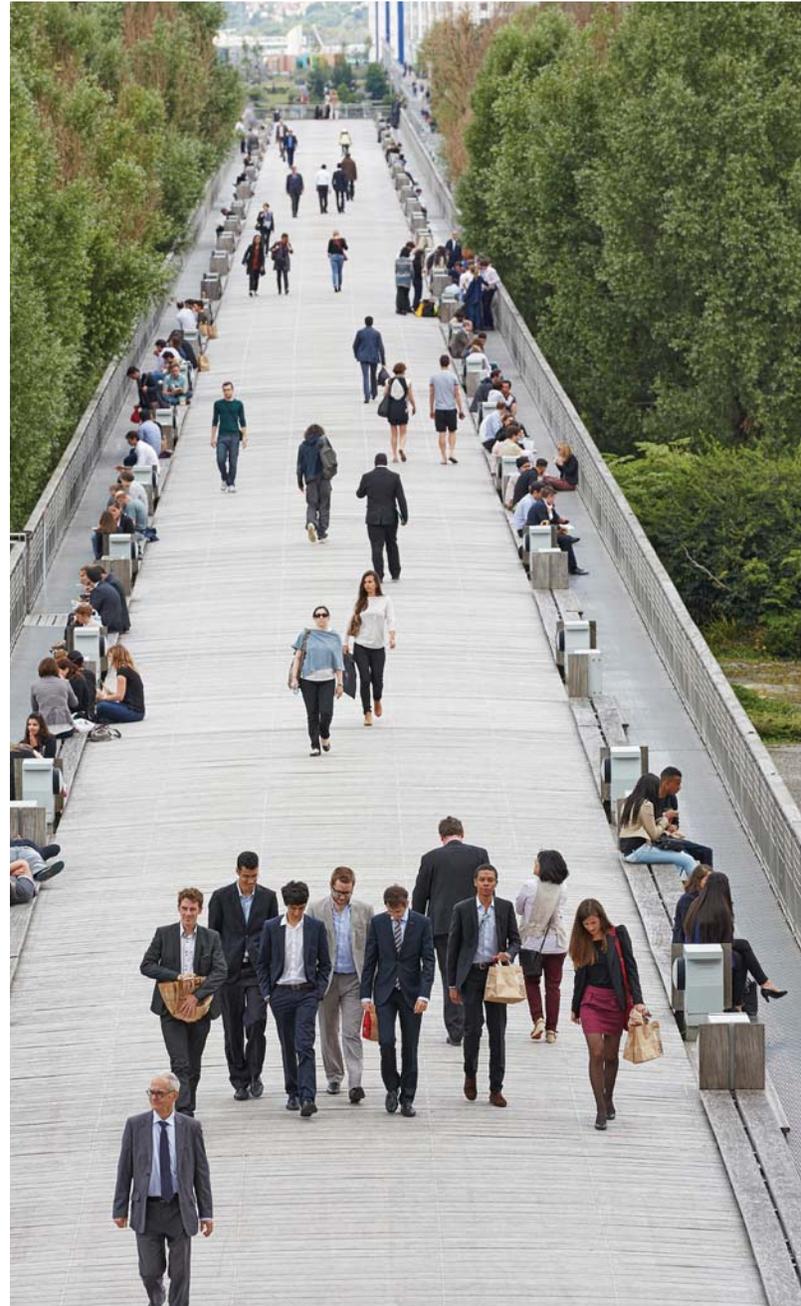
Boards need the right composition to oversee risk effectively:

- 1** A sophisticated understanding of the company's industry to help with assessing risks and their implications. This may involve having or adding directors from non-competitors in the industry or adjacent industries or even a retired industry executive.
- 2** A broad diversity of backgrounds among directors to help better understand the different risks that could impact the company. A company's changing strategy may drive the need to add a director with specific expertise; some boards have added directors with digital or IT expertise for this reason.
- 3** Perhaps even **one or more directors with risk management expertise** who understand the company's processes and results.

The right board composition allows you to drive more effective discussions and helps ensure management has identified all relevant risks.

Additionally, boards can:

- Highlight in the proxy statement which directors bring risk management experience, given investors' interest in this director attribute
- Ensure new directors receive robust orientation and all directors get continuing education that focuses on changes in the industry and its implications on risk





Challenge: Are any key risks falling through the cracks and not being overseen anywhere at the board level?

With the various key risks that a company faces, there can be confusion over who is ultimately responsible for which risks and where they are overseen at the board level. In particular, directors might believe another board committee is covering a risk when it's not.

The good news is that most directors (83%) believe their board's performance is good or excellent when it comes to mapping specific risks to the board and its committees.³



Board action: *Clearly allocate risk oversight among the board and its committees. Ensure that the chairs share their committees' insights about those risks with the full board.*

It's helpful for the board and committee chairs to work together to ensure all key risks are subject to board-level oversight. Some boards find it helpful to use a risk allocation matrix, which extends the key risk summary that many

boards currently receive. Some companies even show overall risk allocation graphically in their proxy statements.⁴

When individual committees take the lead in overseeing key risks, the committee chairs need to provide robust reporting back to the full board so other directors get a sense of how well the company is managing critical risks. Regardless of which board committees may have responsibilities for specific risks, the entire board should discuss the cross-enterprise risks.

Things get more complicated, though, when a key risk overlaps multiple committees. For example, the risk of incentive compensation promoting risky behavior impacts both the audit and compensation committees. Different boards take different approaches to such situations. The committee chairs could simply discuss the risks, attend the other committee's meetings or even periodically hold joint committee meetings. Some boards embrace cross-committee memberships to promote knowledge sharing.

A risk allocation matrix can be useful

Key risks (illustrative only)	Executive responsible	Board oversight	Frequency	Source of assurance
Breaches in IT security	Chief information officer	Audit committee	Biannually	Internal audit IT security consultant
Unreliable supply chain	Chief procurement officer or chief operating officer	Board	Annually	Internal audit
Integrating new acquisitions	Chief executive officer	Board	Annually	Internal audit

³ PwC, 2015 Annual Corporate Directors Survey, October 2015.

⁴ For examples of overall risk allocation graphics, see [Walmart's](#) (page 31) and [GE's](#) 2016 proxy statements.



Challenge: Is too much of the board-level effort on risk focusing on compliance and regulatory matters?

It may be easy for directors—whether as part of the full board, an audit committee, a risk committee or another committee—to get bogged down in risk discussions that overly focus on regulatory and compliance risks. This isn't surprising given today's heightened enforcement environment and the proliferation of regulations facing companies.

Another factor is that many boards assign risk oversight responsibilities disproportionately to audit committees. Audit committee members typically have some form of financial reporting experience. Such background may have given them little opportunity to think creatively about risks other than financial and compliance risks. And so an audit committee may not be the best venue to discuss whether management is appropriately identifying emerging risks, disruptors or broader strategic risks.

Plus, with already full meeting agendas—for both boards and committees—it's challenging to make time for robust discussions that range beyond compliance to strategic and operational risks.



Board action: Preserve agenda time to focus on key risks, including big picture strategic risks.

Boards should evaluate their current approach to overseeing risk and assess whether too much time is focused on compliance risks versus strategic risks. Do your discussions about company strategy or proposed transactions consider the related risks? Is there a focus on predicting the impact of emerging disruptive forces? If not, consider adding risk as a required topic to the reports from management supporting such discussions. You can also use a facilitator or third party to drive the discussion or add insights about how broader economic, business or industry trends impact risk. Finally, an unstructured, free-flowing session to brainstorm about risks with management is another way to move beyond compliance risks and encourage out-of-the-box thinking. It may also help directors understand how risks are interconnected.

Boards want to focus more on risk

47%

of directors would like to see their boards devote at least some additional time and focus to risk assessments and risk management

59%

of directors want at least some additional time and focus on IT risks



Source: PwC, 2016 Annual Corporate Directors Survey, October 2016.



An evaluation may also determine that the full board needs to spend more time discussing risk. Dedicating time during strategy retreats or regular board meetings can help. Plus, if management highlights key issues in the pre-reading materials, boards can focus their discussion appropriately. They may also be able to free up agenda time by handling routine requirements differently.

Audit committees and risk committees already tend to have packed agendas. So you may need to update your committee structure and/or responsibility allocations.

In conclusion...

At a well-run company, boards play a crucial role in risk oversight. Boards thinking proactively about their risk oversight should consider enhancing proxy disclosure, bringing more diverse viewpoints into the boardroom, rethinking the allocation of risk oversight duties, and ensuring the topic has necessary agenda time at meetings of both committees and the full board. By examining and refining its approach to risk oversight, a board can deliver enhanced value to the company and its shareholders.

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Other “Risk Oversight Series” topics include:

- *How your board can influence culture and risk appetite*
- *How your board can ensure enterprise risk management connects with strategy*
- *Why your board should refocus on key risks*
- *How your board can decide if it needs a risk committee*
- *How your board can be ready for crisis*

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