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The Group of Thirty on Effective Governance

The Group of Thirty has published a report on governance of financial institutions that has interesting observations and recommendations applicable to all corporations. The following is quoted from the discussion of the role of the board of directors:

Boards control the three key factors that ultimately determine the success of a [corporation]: the choice of business model (strategy), the risk profile, and the choice of CEO—and by extension the quality of the top-management team. Boards that permit their time and attention to be diverted disproportionately into compliance and advisory activities at the expense of strategy, risk, and talent issues are making a critical mistake. Above all else, boards must take every step possible to protect against potentially fatal risks.

Well-functioning boards scrupulously discharge the following 10 essential tasks:

1. Fashion a leadership structure that allows the board to work effectively and collaboratively as a team, unified in support of the enterprise. Structures differ from one [corporation] to another. There is no ideal template. Boards with 8 to 12 members are best positioned to encourage candor and facilitate constructive debate.

2. Recruit members who collectively bring a balance of expertise, skills, experience, and perspectives and who exhibit irreproachable independence of thought and action. Members with experience in the CEO role, in finance, and in regulation are particularly valuable. Credentials notwithstanding, interpersonal chemistry is an essential determinant of a board's success.

3. Build, over time, a nuanced and broad understanding of all matters concerning the strategy, risk appetite, and conduct of the firm, and an understanding of the risks it faces and its resiliency. All board members should receive structured induction and ongoing training. The clear trend toward deeper engagement between directors and management and between directors and external constituents is to be applauded.

4. Appoint the CEO and gauge top talent in the firm, assuring that the CEO and top team possess the skills, values, attitudes, and energy essential to success. A very good CEO is preferable to a "star" CEO. The board must confirm the appointment of independent members of the executive team, including the chief risk officers (CROs) and head of internal audit, and should be consulted with respect to other very senior appointments. Boards should maintain a focus on talent development and succession planning, which are critical components of organizational stability.

5. Take a long-term view on strategy and performance, focusing on sustainable success. The board has an inviolable commitment to the long-term success of the firm, which should be viewed in a five-to-20 year time frame.

6. Respect the distinction between the board's responsibilities for direction setting, oversight, and control, and management's responsibilities to run the business. It is misguided and dangerous to conflate the responsibilities of management with those of the board. The board's primary responsibilities include: (a) reaching agreement on a strategy and risk appetite with management, (b) choosing a CEO capable of executing the strategy, (c) ensuring a high-quality leadership team is in place, (d) obtaining reasonable assurance of compliance with regulatory, legal, and ethical rules and guidelines and that appropriate and necessary risk control processes are in place, (e) ensuring all stakeholder interests are appropriately represented and considered, and (f) providing advice and support to management based on experience, expertise, and relationships.

7. Reach agreement with management on a strategy and champion management once decisions have been made. There is an important role for the board in strategy, but the real development and analysis is clearly an executive function. The board challenges and discusses the proposal with management, revisions are made, details are discussed, and eventually a strategy is hammered out to which all are fully committed.

8. Challenge management, vigorously and thoughtfully discussing all strategic proposals, key risk policies, and major operational issues. Effective challenge demands integrity on the part of both the board and management. Management must accept the board's prerogatives and respond positively rather than defensively. Boards must be careful not to undermine their own processes with disingenuous motives. Board members who challenge just to have their challenge recorded are not acting in the interest of the institution.

9. Ensure that rigorous and robust processes are in place to monitor organizational compliance with the agreed strategy and risk appetite and with all applicable laws and regulations. Proactively follow up on potential weaknesses or issues. Oversight and compliance are important functions of the board, but boards that permit their time and attention to be diverted disproportionately into compliance and advisory activities at the expense of strategy, risk governance, and talent issues make a critical mistake.

10. Assess the board's own effectiveness regularly, occasionally with the assistance of external advisers . . . . Boards should conduct periodic self-evaluations that include candid and constructive feedback on the performance of directors and committees . . . .

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