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NATIONAL ASSOCIATION OF CORPORATE DIRECTORS
NEW ENGLAND CHAPTER

New England
CHAPTER NEWS

Boards and the Future of Risk

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By Stephen M. Honig

Boards have a fiduciary duty to oversee risk management, insuring both an institutional commitment and effective mechanisms for implementation. Boards also must evaluate enterprise strategy, including management's evaluation of risks inherent in underlying assumptions. How did boards get to their current understanding of risk, what was the role of the SEC and how should boards deal with their fiduciary obligations?

Board understanding of risk started out modestly, the bailiwick of audit committees, defined in financial and regulatory terms and seldom understood as operational. Risk seldom appeared as a separate agenda item, and the New York Stock Exchange mandated audit committees establish policies to discuss "major financial risk exposures." The Sarbanes-Oxley Act began risk redefinition, requiring broad internal financial controls and CEO/CFO certification on an enterprise-wide basis; risk was now seen in wider terms.

Attorneys always understood risk broadly because they drafted "risk factors" in public securities offerings and in periodic reports under the Exchange Act. In 2009, the SEC by rulemaking formalized a broader definition of risk, in response to the perception that the economy could not have cratered absent fundamental failure in risk evaluation. New SEC rules require disclosing risks undertaken by executives to drive compensation, the board's role in risk oversight, the degree to which management reports risk to the board and how the board is otherwise informed of risk.

Risk and Strategy

Beyond broadened understanding of risk to include not only financial and regulatory matters but also operational matters, boards have strengthened their focus on the role of risk in strategy. Methodological quantification and evaluation of risk, driven by accounting firms and consultants, has led to a more disciplined evaluation of risk in strategic discussions.

The ultimate stage of risk assessment is not defensive but pro-active. Studies inform us that companies with maturing risk management practices positively affect profitability; inefficiencies are eliminated, information flows improve, supply lines strengthen and reputation for reliability is enhanced. A board that approaches risk management as a metric in strategic planning, and conveys that approach to management, will both meet its fiduciary obligations and drive profitability.

Action Items

What should boards be doing today?

Educate the board to facilitate top-down leadership and to communicate commitment to management. Review board and committee charters to make sure that risk assessment is institutionalized. Work with counsel to ensure regulatory and SEC disclosure compliance. Place risk on the agenda. Establish risk appetites for each business area. Evaluate all strategic initiatives in light of that risk appetite.

There are numerous sources for board education. Accounting firms and consultants have established robust training regimes. The NACD has issued a Blue Ribbon Commission report titled *Risk Governance: Balancing Risk and Reward* that contains specific implementation steps and sample reports.

Best practices also include establishing an appropriate "tone at the top," designating a chief risk officer or equivalent, ensuring that risk reporting is sufficiently robust to consolidate risk information from all parts of the enterprise, ensuring that changes in risk are monitored and placing risk on the agenda regularly.

Boards must ingrain risk management into the corporate culture. In that context, enterprise risk management becomes a powerful tool rather than a mere SEC reporting burden. ▲

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