KPMG

Raising the bar

Principles based guidance for risk committees

KPMG Board Leadership Centre

On Wednesday 4 December The Risk Coalition launched 'Raising the Bar' - principles based guidance for board risk committees and risk functions in the UK Financial Services Sector. In an effort to meet the need for coherent, good practice guidance for board risk committees and risk functions, the guidance provides a long awaited, commonly agreed benchmark for 'what good looks like'.

Overview

The guidance, developed through industry, academic and regulatory consultation is intended to be evolutionary in nature. Organisations are encouraged to apply the guidance proportionately, and to continually challenge whether application achieved the appropriate outcomes.

While voluntary, adoption of the guidance is a matter of good business practice in line with the 2018 Corporate Governance Code.

> *Companies that our membership base seeks to invest in will be strengthened by an increased focus on some of the principles described in the draft guidance"*
>
> The investment association

Applicability

Although designed specifically for the Financial Services Sector where risk compliance is regulated, the guidance forms a useful reference for other sectors looking to formalise their risk processes.

Further, as discussions continue around the possible introduction of a UK SOX style framework, this would set a strong base for companies when measuring and reporting on the quality of controls around their risk process.

Structure

The guidance identifies eight 'apply or explain' principles for mature risk committees and offers supporting guidance on how to apply them. It is not intended to be prescriptive, but rather to provide good practice principles which can be applied by all organisations regardless of their risk profile and appetite.

This is complemented by nine risk function principles designed to help define the roles and responsibilities of the CRO and the second line risk function.

> *We welcome the initiative and particularly support your emphasis on improving standards of accountability of the Board and its committees on risk."*
>
> Financial Reporting Council

Eight board risk committee principles

Board accountability – this first principle clarifies the role of the committee as advisory, designed to facilitate focussed and informed board discussions around risk.

The remaining seven principles define the specific obligations of the committee in light of their role as advisor to the board.

Composition and membership – to comply with the Code guidance on chair, composition, succession and evaluation criteria

Risk strategy and appetite – to act as independent advisor to the board on the appropriateness of the risk strategy and appetite as set by the board

Principal risks and continued viability – to advise the board on risks and how they interact with the company's strategic objectives and business model

Risk management and internal control systems – to report on the suitability of the risk management and control systems

Risk information and reporting – to assess and report on the quality of the risk information and reporting

Risk culture and remuneration – to consider whether the culture of the business is aligned to the board approved risk strategy and appetite

CRO and risk function independence and objectivity – to safeguard the objectivity of the CRO and any second line risk function

The guidance is fundamentally designed to reduce shareholders exposure to the downsides of risk in the capital markets by helping businesses better manage their own appetite. The coalition invite businesses, both within and outside of the Financial Services Sector, to challenge themselves on a number of areas.

What are our principal risks?

While control frameworks and activity is generally focussed on financial reporting processes, bar in some specific cases such as Patisserie Valerie, the quality of reporting is not a major risk to the investor community. Rather, it is the non-identification or mismeasurement of principal risks which create the most exposure. It is only when risks are correctly identified and understood that appropriate mitigations and actions can be delivered.

Are responsibilities clear and not duplicative?

Where a risk committee is in place it is essential to avoid duplication of effort – not only from an efficiency perspective but also to ensure quality – If both groups see themselves as only partly responsible then ownership is clouded. Ensure clarity of responsibility and that the result is aligned to the principle of board responsibility with the committee playing an advisory role.

How independent does the committee need to be?

The UK Corporate Governance Code expects board risk committees to be composed of independent non-executive directors. Also think about the CRO role. What are the reporting lines between the CEO and the CRO? Do they have an executive position in the business?

How do we stay out of the weeds?

Risk committees – like other groups - can lack a diversity of thinking. Risk professionals are prone to digging for solutions but stepping back and consulting is key. Detailed analysis is useful, and a strong process will create a framework for control, but in terms of managing an effective, robust and adaptable risk profile there is no substitute for wisdom and judgement.

Do we have the right culture?

In light of the Fishmongers Hall attack in November 2019 can all businesses be confident that their front line people would act in such an empowered and brave way to protect the business and what it stood for, When we talk about promoting the right culture in the business do we mean it? Do front line staff really want the business to succeed?

How do we rebalance the equation between the risk management process and risk identification?

For too long the risk focus was on management and mitigation. Companies must find a way to be more robust in the annual risk assessment process. As the World, politically, socially and environmentally, evolves at exponential pace, businesses must expect a dramatic shift within their risk matrices. On this journey fresh thinking is essential – companies must be prepared to answer the 'that won't work for me' line as they push people to step outside of their comfort zone.

Are our corporate behaviours embedded into the risk process?

By embedding the right values at every step of the way companies can endeavour to drive the behaviours that they aspire to into the risk process. Are people empowered? Are they challenged to be understanding? Are they forced to asses the ethical consequences of their decisions? Embedding these elements into a risk process will drive new thought processes and new outcomes

Are the risk committee members empowered to call out what they see?

So often toxic behaviours and outcomes reach the board long before they irreparably damage the business but too often they are excused away with rectification and improvements promised and not delivered. Is your risk committee empowered to call out unacceptable behaviours as they see them? Is their advice taken and acted upon to close down toxic business activities even when they appear valuable in the short term?

The KPMG Board Leadership Centre

The KPMG Board Leadership Centre offers support and guidance to non-executive directors, whether managing a portfolio non-executive career or embarking on a first appointment. Membership offers you a place within a community of board-level peers with access to topical and relevant seminars, invaluable resources and thought leadership, as well as lively and engaging networking opportunities. We equip you with the tools you need to be highly effective in your role, enabling you to focus on the issues that really matter to you and your business.

Learn more at www.kpmg.com/uk/blc.

Contact us

Timothy Copnell
Board Leadership Centre
T: +44 (0)20 7694 8082
E: tim.copnell@kpmg.co.uk