A conversation about risk committees

KPMG Board Leadership Centre

With risk high on the board agenda, should boards be thinking about having a separate risk committee in addition to the audit committee? Chris Burt and Bryan Foss from the Risk Coalition joined our Board Leadership Centre FTSE350 discussion to help weigh up the pros and the cons.

The risk landscape has become ever harder to navigate in recent times, with COVI D-19 spawning new threats and opportunities for companies and boards. Is the time now right for more boards to have a standalone risk committee? Such committees are *de rigueur* across the financial services sector but relatively rare in other sectors.

Guidance for risk committees

The Risk Coalition - a network of not-for-profit and membership organisations committed to raising standards of risk management in the UK - launched Raising the Bar in late 2019. This Principles-based guidance for board risk committees and risk functions has, in many ways, become the 'go-to' guidance for risk committees within the financial services sector. However, because it is principles-based, it can be applied to risk committees in any sector.

"We wrote 'Raising the Bar' because we realised that there was an absence of guidance for second line risk functions around best practice," Chris says. "There is only one passing reference to risk committees in the FRC's Corporate Governance Code, so we felt that there was a gap that needed filling. We also felt that risk committees in financial services businesses had tended to have a focus on market risk and credit risk but somewhat less on operational risk. But it's operational risk issues that have often had the biggest impacts. The guide is intended to help Boards and those connected with risk management to think carefully about how best to cover all material areas of risk and ensure that key responsibilities are clearly allocated."

Likewise, there are only four references to risk committees in the HKEX's Corporate Governance Code without concrete specifications.

The case for risk committees

How strong is the case for separate board risk committees outside the financial sector? The Brydon Review placed a strong emphasis on business resilience and in Bryan's view this does help open the conversation on having a risk committee, given that resilience inherently stems from addressing current and future risks.

A further important driver is likely to be ESG. With carbon-neutral targets brought forward from 2050 to 2030, Bryan observed that Boards will be looking for particular assurance that they will be able to meet the commitments they make to stakeholders. "There will be no second chances. Organisations will have to get it right and for that they need to be managing the risks throughout the journey."

While there is no empirical evidence that having two separate committees drives better outcomes, Chris pointed to a review of FTSE350 corporate reporting which suggested that there was better quality risk reporting from businesses with a separate risk committee. He also believes that following the guidance in 'Raising the Bar' helps create greater strategic alignment within an organisation, better linking risk management to corporate purpose, values and performance.

Composition of the committee

What does best practice look like in terms of composition and operation?

Chris and Bryan both noted that, for many boards, there may be some cross-membership between the audit committee and the risk committee. This can be a significant positive. As one attendee observed, "it provides a full 360-degree view and helps you see clearly the interface between audit and risk."

Moreover, it may also be the case that the two committees hold some shared/combined meetings. For example, a major IT project, which may have significant control and reporting implications.

Another attendee highlighted the issue of reserving in the insurance sector - something that is both an audit and a risk matter. "It emphasises that the relationship between the two areas is a complicated spectrum in which it is often hard to define where the line should be drawn between the two."

However, it was generally felt that it is preferable to have different chairmen on the two committees, to bring different perspectives and a wider view. One attendee observed that being chairman of both committees can be "an uncomfortable place."

Emerging risks

Alongside the 'Raising the Bar' guidance, the Risk Coalition has also developed GABI (Gap Analysis and Benchmarking Insights) - an online tool to help organisations assess how well they are meeting the guidance. A survey of GABI users found that over half of respondents are spending more time on emerging risks, driven by the pace of technological change and digital transformation. Businesses also operate in increasingly complex supply chain ecosystems - there is a whole value chain to manage, not just the organisation's own immediate perimeters.

Another critically important risk is cyber - a rapidly proliferating threat, and particularly relevant to the COVID-19 era which has seen mass migration to remote working and connectivity, creating a dramatically larger attack surface for cyber criminals.

This likely to be a key area of focus for risk committees and indeed governmental and regulatory bodies - and is also where we are seeing increasing numbers of advisers to committees being appointed.

New risks from COVID-19

The pandemic itself has also created new levels of risk and challenge, putting everyone on a learning curve. It has only served to increase the focus on resilience and third party risk.

As Chris sees it, the focus on resilience is an opportunity to think about risk in a different way. "Traditionally, you take a given risk and work forwards from that, thinking through what the impacts and implications would be.

But another approach is to start at the other end - with a worst case scenario, such as a pandemic - and work backwards to identify the risks it creates and the responses needed. We need a combination of both approaches in my view."

Objective led

It is important that risk oversight is objective led. The risk strategy and risk appetite should be consistent with the organisation's overall business model, including its purpose, values, risk culture expectations, corporate strategy and strategic objectives.

Strategy and risk are two sides of the same coin. Any discussion on strategy can be turned int a discussion on risk and vice versa. The two are so entwined its impossible to have a discussion about how to achieve the organisations strategic objectives without talking about the risks.

No set answers

Just as risk itself is complex and multi-layered, so there is no simple formula to the management of risk.

"Ultimately, it is down to each individual business to arrive at the model that best suits them," Bryan says. "But whether a company has a standalone risk committee in addition to an audit committee or not, what is key is to ensure there is clarity of responsibility across the organisation and that all risks - financial, operational, strategic - are being picked up, managed and mitigated.

"The recommendations from the Brydon Review are due to be published in the coming weeks and consulted on through to the summer - so this is the perfect time for executives and NEDs to be thinking about these issues.

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 kpmg.com/cn/boardleadership

Frank Mei
Partner, Head of Governance,
Risk and Compliance, China
+86 (10) 8508 7188
frank.mei@kpmg.com

Alva Lee
Partner, Head of Governance,
Risk and Compliance, Hong Kong
+852 2143 8764
alva.lee@kpmg.com

Johnson Li
Partner, Governance,
Risk and Compliance
KPMG China
+86 (10) 8508 5975
johnson.li@kpmg.com

Kelvin Leung
Partner, Governance,
Risk and Compliance
KPMG China
+86 (755) 2547 3338
kelvin.oc.leung@kpmg.com

kpmg.com/cn/socialmedia