Governance Insights Center
Risk Oversight Series

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How your board can decide if it needs a risk committee

Risk committees are often suggested as a good way to improve board oversight of risk. Whether they are the right answer for an individual company is another question.

Ongoing global economic and political uncertainty continue to put a spotlight on whether companies are prepared to both seize opportunities that emerge and protect themselves against threats. For their part, boards are reflecting on whether they have the right governance structures to oversee strategic risks like these effectively. Some are examining whether a risk committee makes sense. Barring a regulatory requirement for a risk committee, it's not as easy a decision as you might think.

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Risk committee: to have or have not?

There's a lot of interest in risk committees—particularly since the financial crisis. They are now required at large financial institutions. But risk committees are still relatively rare outside the financial services industry.

How rare? Only 14% of companies in the S&P 500 have risk committees—excluding financial services, that drops to only 5%.[1] These figures include companies that combine risk with another committee, like finance or audit. Only 8% of the S&P 500 have a standalone risk committee—and that number drops to only 1% when you exclude financial services companies.[2]

Here, we explore some questions that can help you decide if a risk committee makes sense for your board. If the answer's yes, we also describe considerations for establishing one.

A majority of directors see no need for a risk committee

55%

of directors *say their companies don't have a risk committee and don't need one.*

14%

of directors *say their board is considering adding a risk committee or that they should.*

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

Questions for the board to consider:

- How is the board currently overseeing risk? Would a risk committee increase the board's effectiveness?
- Does the board need to reassure investors or regulators that it is devoting enough attention to risk—and would a risk committee be an effective way to do that?
- How do the benefits of adding a risk committee compare with the drawbacks?
- What are some considerations when setting up a risk committee?

Establishing a risk committee is not the only way to respond to the challenges boards face related to risk oversight.

Throughout this paper, you'll see these thought bubbles. They provide other options—apart from establishing a permanent risk committee—that a board can use to address the challenges in overseeing risk.

[1] Based on PwC analysis of S&P 500 companies conducted using BoardEx data, October 2016.
[2] *Ibid.*

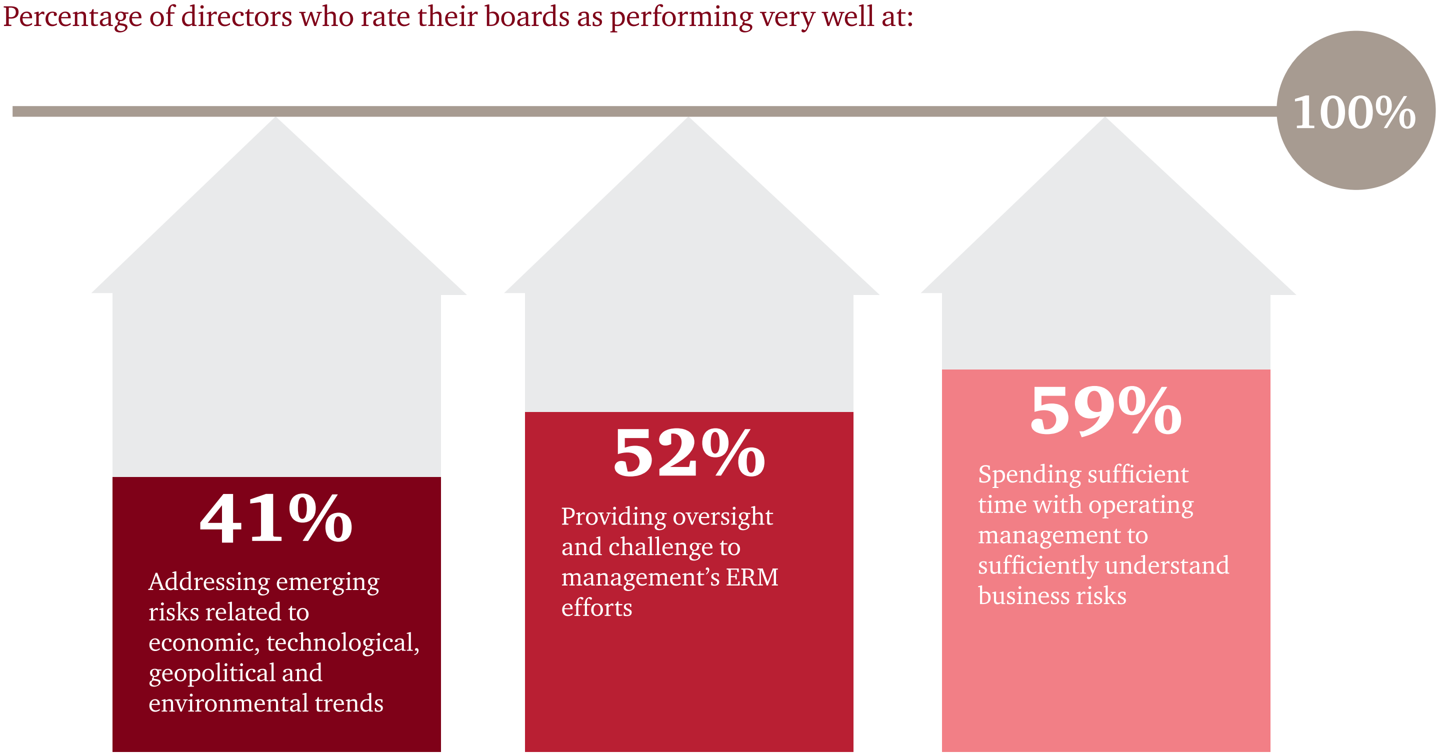
How is the board currently overseeing risk? Would a risk committee increase the board's effectiveness?

First off, if you're currently satisfied with the way your board handles and assigns risk oversight without a risk committee, you don't need to do anything. But some boards struggle with overseeing risk. For one thing, board and committee agendas are almost always short on time. It's not surprising that 47% of directors would like to see at least some more time and focus on risk assessments and risk management.[3]

Where and how to do that may be the biggest challenge. Most boards assign risk oversight to their audit committee, which already has significant demands on its time. Audit committees meet more frequently—almost nine times a year on average—and have longer meetings than any other committee.[4] In addition to time constraints, the audit committee may not be right for other reasons. Audit committee members are often selected because of their financial acumen, while risk discussions may require other types of expertise.

Directors believe there's room to improve their oversight of risk

Percentage of directors who rate their boards as performing very well at:



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

[3] PwC, *2016 Annual Corporate Directors Survey*, October 2016.
[4] National Association of Corporate Directors, *2016-2017 Public Company Governance Survey*, November 2016.

To a certain extent, audit committee focus on risk is inevitable under the current governance rules. The NYSE requires audit committees to discuss the company's policies "with respect to risk assessment and risk management."[5] Audit committees often also oversee how management addresses many of the company's key risks. So one of the first considerations is whether you could allocate some aspects of risk oversight to the full board or other committees, or create a risk committee. But recognize that even the creation of a risk committee doesn't absolve NYSE audit committees from the duty to oversee risk policies. When risk committees exist, we often see some duplicative management reporting to both committees, or the need for periodic joint meetings to cover similar responsibilities that appear in both charters.

Another challenge is that board discussions tend to focus on individual known risks. There's typically less board focus on the important question of how multiple risks interconnect. That may be a sign the company's risk management program isn't fully examining those connections, or at least not communicating them to the board.

There's also less board discussion about emerging or unknown risks—those that may be around the corner. Such risks often present the biggest challenges to meeting the company's strategic objectives. If audit committees are taking on the key responsibility for risk, they may focus primarily on how management is mitigating key financial and compliance risks. They may not approach risk with the mindset to think critically about unknown risks. Plus, assigning responsibility to the audit committee may prevent other directors with more diverse or strategic perspectives from adding to those discussions.

Having a risk committee helps ensure there's enough time devoted to this important responsibility. Risk committees can take responsibility for overseeing:

- **Key risk connections.** This includes whether they compound or offset one another.
- **Emerging risks.** In particular, a long-term focus on the industry and the external environment may help with a better understanding of industry-specific or growing exposures.
- **Culture and risk appetite.** Both help guide management's actions, and can even help companies take more risk as everyone understands and agrees on the parameters for risk taking.
- **Risk management processes.** Ongoing dialogue with the chief risk officer (CRO) can reveal how effectively the risk management program is working.
- **"Orphaned" key risks.** Prevents risks that don't fall squarely into the scope of the audit committee or another committee from falling through the cracks.

Risk committees can also coordinate risk oversight among committees and the full board. Cross-committee membership—as discussed later—is one way to ensure better coordination of risk oversight.

[5] NYSE rules in the Listed Companies Manual. Section 303A.07(b)(iii)(D).

Other options

Boards can convene an ad hoc risk committee for a period of time. This would allow a subset of directors to monitor management's efforts to upgrade risk management policies and practices. Once processes and reporting are effective and stable, the group can disband. Or an ad hoc risk committee can focus on one particular emerging risk or a significant risk, like cybersecurity.

If directors don't feel they're getting the risk reporting they need, they can insist that management provide more informative and detailed reports. Only half of directors believe their boards perform very well ensuring management's risk reporting to the board is informative and at the appropriate level of detail.[6]

Make room on the full board agenda for discussions that take into account aggregated risks across the company and the interdependence of risks. This may be more useful than discussing individual risks already covered in committee conversations.

[6] PwC, *2016 Annual Corporate Directors Survey*, October 2016.

Does the board need to reassure investors or regulators that it is devoting enough attention to risk—and would a risk committee be an effective way to do that?

If a company suffers a loss because risk hasn't been properly managed, investors, customers, employees and perhaps even regulators will want to understand why. Consider a cybersecurity breach that has compromised employee or customer information. That kind of event can erode confidence and may create a chilling effect on future business opportunities or attracting talent. Stakeholders are likely to ask, "Where was the board?"

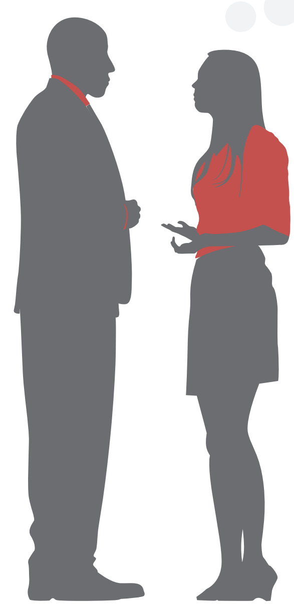
We know risk is a common topic when shareholders engage with companies. Although shareholders for the most part are satisfied discussing such items with management, they may want to discuss risk *oversight* with a director. A risk committee chair who understands the company's risk framework and can speak to key risks would be the ideal board member to engage in such dialogue. More than half of the directors (54%) responding to PwC's *2016 Annual Corporate Directors Survey* believe it is appropriate for directors to engage in direct communication with shareholders on risk oversight.

The board may decide that management needs to be more effective in assessing and managing risks. A risk committee would send a signal throughout the management team that risk will get more attention at the board level.

Other options

A board could signal its attention to risk by changing the title and duties of an existing committee. For example, we commonly see Audit & Risk, Finance & Risk, Compliance & Risk and Governance & Risk Committees.

Some boards assign oversight of certain key risks to separate committees, although they aren't called risk committees. Instead, an energy company might have an Environment, Health and Safety Committee to oversee workplace accident risks, or a health care company might have a Public Policy/Public Issues Committee to oversee possible regulatory challenges and opportunities.



How do the benefits of adding a risk committee compare with the drawbacks?

Benefits of risk committees

A risk committee may make sense if:

- The board simply cannot find enough time at the board level or on another committee to focus properly on risk.
- The board wants a central place to coordinate and monitor all risk discussions currently taking place in individual committees so that the governance of risk oversight is transparent to everyone.
- The board wants to send an important signal to shareholders and other key stakeholders, such as regulators.
- The board wants non-independent directors on the committee that oversees risk, which would rule out having the audit committee handle it.
- The board is concerned that the company doesn't have adequate capabilities to identify, assess and manage risks.

Other options

Ensure there's a clear allocation of risk oversight responsibilities between the board and committees. Re-examine agendas to ensure that they devote sufficient time to discussing how key risks across the company are interconnected.

Schedule sessions of the full board or other committees to discuss key risks with risk owners and the CRO.

Drawbacks of risk committees

There can also be downsides in terms of additional bureaucracy and possible confusion or duplication of effort in how you are overseeing risks. Many of these drawbacks are true of any additional committee a board might add.

- Additional committees bring additional costs and demands on the time of directors, and on the members of management who prepare materials and meet with the committee. Scheduling another committee meeting in the time already allocated to board meetings can also be a challenge.
- A separate committee may wall off important risk discussions from full board strategy discussions. PwC's *2016 Annual Corporate Directors Survey* shows that strategic/disruptive risks are among the most difficult for boards to oversee. But a risk committee cannot tackle these risks alone, since they fall squarely into the strategy oversight responsibility of the full board.
- Risk committee composition may be problematic. Because directors typically sit on multiple committees, getting the right people to serve on this committee may be a challenge. Your directors who bring strategic risk expertise may be tapped out.
- A risk committee may create unnecessary overlapping committee responsibilities, especially for NYSE-listed companies whose audit committees have some mandated responsibility to oversee risk policies. At a minimum, a risk committee creates additional communications demands to keep other committees, the full board and management apprised of its work.

What are some considerations when setting up a risk committee?

If a risk committee makes sense for your board, there are a number of issues to consider:

Committee composition

Which director backgrounds are ideal? Obviously someone with direct risk management experience, or an executive whose company has a reputation for effectively managing risk. Beyond that, a director with deep industry knowledge. For example, financial services risk committees often contain former financial services CROs and regulators. And some are adding directors with expertise managing specific risks, like regulatory or IT/cyber risk. Such a mix of risk, industry and subject area backgrounds allows the committee to understand competitive, environmental, technology and emerging risks—and to assess the effectiveness of the company's ERM program.

Overlapping membership with other key committees, such as audit and compensation, will contribute risk insights from those committees. Indeed, some companies choose to have all the chairs of other board committees on their risk committee.

What do risk committees look like today?

PwC reviewed publicly available information about the risk committees of 15 non-financial services companies. While the committee charters all require at least three directors, the actual committee size was between five and six members. (This is consistent with the size for financial services companies' risk committees.) Many require that all committee members meet NYSE or NASDAQ independence guidelines, while others mandate a minimum number of independent members. In terms of overlapping committee membership, 14 of the risk committees included members of the audit committee and 10 included members of the compensation committee.

Charter

Created thoughtfully, the charter can help avoid duplication of work either with the board or other committees. It should include membership requirements, meeting frequency, expected reporting (to the board, from executives) and the scope of its authority. It also should outline the committee's core responsibilities. Those typically include:

- Reviewing and discussing all enterprise risks, including how the company identifies and monitors those risks and the adequacy of risk mitigations
- Reviewing and discussing risks that can impact a company's strategy
- Reviewing and approving the risk appetite statement and overseeing culture
- Overseeing the company's risk management program, risk governance and risk framework

Some charters include oversight of specific risks, such as regulatory, compliance, third party or cyber risks.

Note: Financial services companies have different risk committee mandates (see page 10).

Reports

Work with the CRO to ensure the board gets the right risk reports, including key risk indicators linked to the company's risk appetite statements that may signal a change in the risk profile.

Communications

Coordinate risk oversight across committees, including those risks that are not assigned to other standing committees.

Financial services risk committees

Regulators play an important role in financial services companies. Even many financial services firms that aren't required to have risk committees have established them. While risk committees have focused on traditional market, credit and liquidity risks, there's recent evidence that their scope is expanding. Charters now point to oversight responsibilities for the risk framework, risk appetite, operational, cyber, ERM/compliance, funding and reputation risk.[7] Meanwhile insurance company directors indicate their risk committees should move beyond reviewing management risk reports and doing deep dives on specific risks to spend more time on emerging risks and strategy.[8]

Enhancing risk oversight for an existing risk committee

The good news is that most directors (84%) who are on boards that have risk committees think they're effective.[10] If you feel your risk committee needs a reboot, here are some hints:

- Revisit the charter and decide whether the scope of responsibilities should be revised.
- If the committee lacks risk management expertise, reconsider the composition.
- If the committee meets too infrequently to keep up with a changing risk profile, think about meeting frequency (keeping in mind the strain on everyone's schedule).
- If the information management provides isn't clear or concise, push for higher quality risk reports.

Most importantly, if you have been focused on legal, regulatory or compliance-type risks, you may be missing the most important threats and opportunities that the company faces with its strategy.

[7] PwC analysis of publicly available information for 12 financial services companies, July 2016.
[8] PwC, *The role and function of insurance company board of directors' risk committees,* 2015.
[9] PwC, *2016 Annual Corporate Directors Survey,* October 2016.

In conclusion...

Many boards can effectively oversee risk even without a separate risk committee. Indeed, many directors give their boards fairly high marks on how well they oversee risk, and see little need to add a risk committee. For other companies, a risk committee may increase the board's overall effectiveness at overseeing risk.

No matter what structure your board deems best for risk oversight, all committee insights about risk need to be part of robust risk discussions with the entire board.

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Other "Risk Oversight Series" topics include:

- *Why your board should take a fresh look at risk oversight: a practical guide for getting started*
- *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 be ready for crisis*

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