BRC
BOARD RISK COMMITTEE

BOARD RISK REPORT

January 27, 2023

Dear Fellow Board Members, Chief Risk Officers, and friends of the BRC:

Happy New Year and we hope it is off to a good start for you. This month's Board Risk Report, as our tradition, will focus on emerging risks that boards should pay attention to in 2023. We have also added a section on best practices for Board Risk Committees in response to questions raised throughout 2022.

We welcome our newest staff member to the BRC, Susan C. Keating, former CEO of Women Corporate Directors and board director herself. Susan joins the BRC as the Chief Partnership Officer. Many of you already know her, but she will be reaching out to get to know more of you and develop new collaborations.

In 2023 we look forward to further developing partnerships and moving to a formal membership organization as we continue to add value through peer councils, thought leadership and programming critical to addressing risk.

Thank you for your continued support of the BRC as a non-competitive, trusted place for the exchange of ideas, strategies, and best practices in enterprise risk oversight.

Sincerely,
Catherine A. Allen
BRC Founder and Chair of the Board

THE 2023 RISK LANDSCAPE:
Planning for the Smart Pivot Against a Cavalcade of Risks

By Catherine A. Allen and Gary S. Roboff

2023 promises to be a year where carefully considered risk expectations are shattered with regularity. If there was ever a time for redoubled scenario-based risk planning, this is it.

In this report we'll explore five interrelated topics that will be important for boards in 2023: economic risk; political divergence in the United States; climate risks, international geo-political risks and continued pandemic risks.

1. Economic risk was high on most board agendas even before the potential impact of new rules in the House of Representatives became clear. Now, for more boards, it's moving higher. Congressional debt limit brinksmanship is close to a sure thing for the first half of 2023, and it's worth remembering that the

United States saw its credit rating fall from AAA to AA+ in 2011 [1] even without a default. Amid slightly moderating inflation numbers many observers see a mild recession and a brighter outlook during the second half of 2023 [2] while others are less sure. **Economic volatility reflecting political fracturing in the U. S. and elsewhere, continuing global conflicts and reinvigorated COVID strains should be square in our line of sight in the new year.**

2. In the United States climate change and other ESG issues are now polarizing issues while other countries are moving forward aggressively with a wide range of sustainability measures. In late 2022 the EU finalized coherent human rights and climate due diligence and reporting directives while the UK, Canada and others moved forward with TCFD-aligned climate requirements. Meanwhile, in the United States, we can expect a deluge of lawsuits within days of an expected SEC climate change reporting rule. **Regulatory risks will increase significantly as a function of ESG divergence during the next two years if firms operating internationally are not preparing to be compliant with sharply heightened ESG expectations outside of the United States.**

3. In the United States, as elsewhere, we've seen the catastrophic impact of extreme weather events likely associated with climate change: fires spanning tens of thousands of acres are now the norm (the five largest fires since 1872 have occurred since 2017) [3]; hurricanes - such as Ian and Nicole - devastating coastal communities; extreme drought creating a harbinger of water crises in Arizona that may in time span the American Southwest. The notion that water is becoming the next oil is not a new one [4], but headline readers will have noted that 80% of the recent torrential rains in Los Angeles were discharged straight into the Pacific Ocean. Reports [5] suggest that efforts to resolve the situation will take at least three to five decades. Businesses and municipalities can work together to achieve impressive resilience improvements much sooner – witness Babcock Ranch, only 12 miles northeast of Fort Myers, which was virtually unscathed amid a sea of devastation left by Hurricane Ian [6]. A 2021 report suggested that $1.26 trillion in business revenue losses is likely within the next five years [7]. **Boards have a responsibility to make sure that, despite political pushback, climate risks remain a priority on corporate agendas.**

4. After a year of hybrid war in the Ukraine, severe supply chain disruptions, a prolonged pandemic and sharply increasing economic pressures, expectations for a changing geo-political map are slowly coming into focus. The relationship between the U.S. and China, at the top of everyone's watch list, is now joined by India, coming into its own as a potent power, and others. **The evolution of these blocks will be critical to businesses as data processing, trade restrictions, and other policies evolve. Scenario planning around the evolution of these blocks should be an important exercise for many.**

5. The COVID environment has improved in many parts of the world, but in China, the situation is more complex. Some health organizations project that China's COVID related deaths could top 1 million by the close of 2023 [8] and spillover effects outside the mainland are unclear. Also still unclear are the true impacts of long term COVID. At Davos last week former U.S. Treasury Secretary Larry Summers suggested that the world is "utterly unprepared" for another pandemic [9], the odds of which he placed at more than 50% during the next 15 years. **In the current environment it's easy to develop a sense of post-COVID complacency (COVID was already low on this year's Davos agenda), but it's the board's obligation to make sure that pandemic preparedness remains high on corporate agendas.**

Questions for Board Members:

- How would your organization rank these risks?
- Is robust scenario planning a standard practice when assessing material risks?

- How and when are these risks discussed and in what committees?
- How is your organization monitoring these risks?
- Are there other risks not listed above that you feel should be added?

BEST PRACTICES IN SETTING UP AND RUNNING A RISK COMMITTEE OF THE BOARD

Below are some best practices for setting up, and running, Board Risk Committees. The BRC is planning a webinar and peer exchange on this topic because of requests from many of you, and dates/time will be communicated soon.

- **Ensure that your organization understands and communicates its risk appetite.** Risk Matrices are an important tool to identify and codify your organization's risk appetite. Risk appetites (and the matrices on which they are based) should be updated annually as a part of board strategy discussions and include all significant identified and potential risks your organization might face. This BRC Report should help with that. Identify high, medium, and low risks and the probability of them happening, including those that would be catastrophic. Then ensure the risks are assigned to the appropriate committees of the board or the board as a whole. Identify all the potential risks beyond financial for monitoring: cybersecurity, operational, compliance, regulatory, privacy, emerging technologies such as AI, Web 3, and quantum computing.

- **Create a Risk Committee of the Board.** Many organizations have management level risk committees but as risk issues become more diverse and complex experience shows that boards need a place where deeper discussions can take place. Risks such as geopolitical, reputational, DEI, ESG, supply chain, climate change, talent management, pandemics, and third/Nth party risk require a degree of attention best structured within a dedicated board committee. The committee can take the lead with key executive managers in educating other board members on emerging risks that could have significant impacts on their organization. While Dodd-Frank mandated financial institutions to have risk committees of the board, many other sectors are adding them, sometimes with different names handling specific aspects of operational risk. Having a board level committee helps ensure an organization is properly and timely addressing all significant operational risks.

- **Have joint meetings of the Audit and Risk Committees each year and allocate risks between them.** The chairs of Audit and Risk should sit on each other's committees as well as the CEO, CFO, CRO and other appropriate executives. Audit appropriately looks at risks and how rules were followed. An effective Risk Committee focuses a company on what could or will happen in the future with a keen eye on emerging risks. Note that Audit committees can and should play an important role in reporting on areas outside of traditional financial subjects. Climate and human rights related required reporting are good examples. Governments internationally are imposing strict, standards-based reporting requirements, often including independent testing and verification requirements. As others [10] have noted, audit committees have an important role in overseeing management's development and ongoing implementation of investor-grade ESG disclosures.

- **Risk Committees should meet at least four times a year, and more, if needed.** The Committee Chair should report to the full board the topics, exceptions, and recommendations of the Risk Committee.

- **Narratives are as important as dashboards in addressing the risks, especially at full board meetings.** It is not enough to rank risks and document steps to mitigate them. There should be case studies, comparisons to competitors, comments on news reports, and increasingly utilized tabletop exercises so the board directors understand context and gravity of key risk/issues. Best practices evaluations should be included.

- **Hold separate meetings or retreats with experts.** Many of the emerging risks are topics not as well known to the board such as specific cybersecurity threats, AI, reputational risks, geopolitical and climate change risks. This is where outside expertise to provide knowledge and context is critical. Expert resources can sometimes more effectively lead board discussions to focus on issues which may have outsized impact in future years.

- **Rotate members of the committee.** It is important to keep knowledgeable directors on the risk committee, but committee participation is also a chance to better educate board members, so rotation is key. Include management with responsibilities for each of the risk areas on the committee as well as the directors or have them present at each meeting.

- **Have board directors participate in industry conferences and educational events to learn more about potential risks.** NACD, WCD, ODX and the BRC are some examples of organizations that address boards on risks. Share with the directors important studies, articles and educational materials. Have an educational budget for the directors.

- **Adhere to industry best practices.** Hold regular emerging risk discussions and include the right C-level executives in these conversations. Ensure that the CRO and CISO report to the board on a regular basis without other executives at the table. Encourage having board directors with cyber, risk and technology backgrounds.

- **Set up other risk related sub-committees if needed such as Cybersecurity, Innovation, Strategy, ESG and Talent Management.** It depends on the industry and threats to it.

Questions for Board Members:

- Does your board have a Risk Committee, and if not, why not?
- Does your management team have a risk committee?
- Do you have a Chief Risk Officer, and why not?
- What other best practices might there be?
- Does your board provide educational funds for members?

REFERENCES

[1] S.& P. Downgrades Debt Rating of U.S. for the First Time - The New York Times (nytimes.com)
[2] See for example https://www.nytimes.com/2023/01/12/business/imf-global-economy-recession.html
[3] 15 Largest Wildfires in US History | Earth.Org
[4] See, for example, Is water the new oil? | Water | The Guardian
[5] L.A. lets rain flow into the Pacific Ocean, wasting a vital resource. Can we do better? (yahoo.com)
[6] Florida solar community endured Hurricane Ian with no loss of power and minimal damage - CBS Miami (cbsnews.com)
[7] Climate Change Will Cost Companies $1.3 Trillion By 2026 (forbes.com)
[8] China's COVID-19 Surge Could Cause 1 Million Deaths By 2023: IHME (ibtimes.com)
[9] 'Covid-scale problem in next 15 years': Larry Summers on his top risks (cnbc.com)
[10] See, for example, https://www.pwc.com/us/en/governance-insights-center/publications/assets/pwc-the-audit-committees-role-in-sustainability-esg-oversight.pdf

ABOUT THE AUTHORS

Catherine A. Allen
BRC Founder and Chair of the Board

Catherine sits on a number of corporate, university and nonprofit boards, including, in the past, Synovus Financial, El Paso Electric Company, Stewart Information Services, RiskSense and NBS Technologies where she set up, chaired, and sat on a number of Risk Committees. She currently sits on the boards of CRI Advantage, the Belief Agency, PocketPatient MD and Supply Wisdom. She also serves on the New Mexico State Investment Council and the New York Institute of Technology Board of Trustees. She is on the Advisory Boards of Women Corporate Directors and the Executive Women's Forum. She was named one of the NACD 100 Most Influential Directors in 2018. She speaks to Board Directors and writes often on the topics of emerging technologies, cybersecurity, third party risk management, and the need for Risk Committees. In 2020 she founded the Board Risk Committee, a nonprofit aiming to foster more effective enterprise risk management and board oversight.

Gary S. Roboff
BRC Board Member; Shared Assessments Senior Advisor

Gary has more than four decades of experience in financial services sector planning and management, including 25 years at JPMorgan Chase where he retired as Senior Vice President of Electronic Commerce. Gary has served on the Board of Directors at multiple companies and organizations including ISTPA, the NYCE network, and the Electronic Funds Transfer Association. Gary served on the Board of Trustees at Clark University for 12 years, nine of them as Board Vice Chair and Chair of the Board's Strategic and Financial Oversight Committee.

UPCOMING EVENT

16th Annual Shared Assessments Third Party Risk Summit
March 15-16, 2023
Orlando World Center Marriott, Orlando, FL

The Shared Assessments Third Party Risk Summit is the premier global, multi-industry event to shed light on processes, technologies and efficiencies in third party risk management. Join leading experts in risk management to identify trends, leverage new technologies, and share best practices. ****The BRC will lead a breakout session to address topics important to board risk governance on Day Two of the Summit.***

__The Board Risk Report__ is the periodic publication of the BRC. __SUBSCRIBE NOW__ to receive complimentary world-class risk management practices delivered directly to your inbox.

WHO WE ARE

The Board Risk Committee (BRC) is the foremost thought leadership peer council for board risk committee members and chief risk officers. The BRC is a nonprofit, non-competitive, trusted place for the exchange of ideas, strategies, and best practices in enterprise risk oversight. We advocate for having risk committees of boards, where appropriate, and for educating board directors about enterprise risk. The BRC aims to foster more effective risk management and board oversight. The BRC works in partnership with The Santa Fe Group (SFG) and Shared Assessments (SA). SFG is a strategic advisory company providing expertise to leading corporations and other critical infrastructure organizations in the area of risk management. SA is the thought leader and provider of tools, education and certifications in the third party risk management space. *The Board Risk Report is the periodic publication of the BRC.*

BRC Contacts:
Catherine A. Allen, Founder and Chair of the Board, cathy@boardriskcommittee.org
Ellen Dube, Executive Director, ellen@boardriskcommittee.org
Susan C. Keating, Chief Partnership Officer, susan@boardriskcommittee.org