



ICGN

International Corporate Governance Network

ICGN Corporate Risk Oversight Guidelines

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About ICGN

The ICGN is a global membership organisation of around 500 leaders in corporate governance based in 50 countries with investors collectively representing funds under management of around US\$9.5 trillion. Our mission is to raise standards of corporate governance worldwide and the breadth and expertise of ICGN members from investment, business, the professions and policymaking extends across global capital markets. To join the ICGN and share your experiences with fellow decision-makers in corporate governance, contact the ICGN Secretariat by telephone: +44 (0) 207 612 7098 or email: Secretariat@icgn.org. For more information, visit www.icgn.org.

Preamble

The International Corporate Governance Network (ICGN), founded in 1995 at the instigation of major institutional investors¹, represents investors, companies, financial intermediaries, academics and other parties interested in the development of global corporate governance practices. One of its objectives is to facilitate international dialogue on issues of concern to investors. High standards of corporate governance, including effective dialogue between companies and their shareholders, the ICGN believes, are a prerequisite for companies to compete effectively and for economies to prosper. The ICGN also believes that it is in the public interest to encourage and enable the owners of corporations to participate in their governance.

For companies and investors alike, risk taking is an inseparable element of strategy and a crucial driver in achieving objectives, including optimising value over time. Risk is part of every decision a company makes. Strategy and risk are not new concepts, although it is recognised that risk is a subject of increasing attention and regulatory and legislative movements in many jurisdictions. The board's and investor's ability to gauge and respond to how a company is managing risk has broader relevance beyond the board and shareholders alone. It bears on the company's impact on all stakeholders including employees and the communities in which an enterprise does business, and in certain instances, national or international markets.

Financial stability and non-financial factors are both important determinants of corporate strategy. Risk and risk oversight must therefore be understood broadly. In this document risk is defined² as the effect of uncertainties on corporate objectives, recognising that the effect can be either positive or negative. Boards and investors need to consider material risks of which the effects are manageable within the organisation's sphere of influence including but not limited to financial, market, operational, environmental, ethical, fraud, legal and compliance, and reputational risks. Risk oversight is defined as the board's supervision of the risk management framework³ and risk management process⁴. Risk management is distinct from risk oversight, as it is a responsibility of a company's management team.

Boards and shareholders have a joint responsibility to engage in substantive and effective communication on corporate risk oversight. Communication models and methods for this should not be any different than for other corporate governance matters. However, the topic of corporate risk oversight is a subject on which boards and investors should specifically engage. Active, informed, constructive and periodic

¹ The term "institutional investor" has the same meaning as set forth in section 2.1 of the *ICGN Statement of Principles on Institutional Shareholder Responsibilities (2007)*, a professional investor who acts on behalf of beneficiaries.

² This definition, as other definitions in this document, is in line with the definition as stated in the ISO Guide 73. Risk oversight is not a defined term in ISO Guide 73. ISO Guide 73 is but one source of useful information that may be consulted for information on definitions and guidance related to risk management.

³ Risk management framework is defined in line with the ISO Guide 73 as set of components that provide the foundations and organizational arrangements for designing, implementing, monitoring (3.8.2.1), reviewing and continually improving risk management (2.1) throughout the organization. References between brackets refer to the ISO Guide 73.

⁴ Risk management process is defined in line with the ISO Guide 73 as the systematic application of management policies, procedures and practices to the activities of communicating, consulting, establishing the context, and identifying, analyzing, evaluating, treating, monitoring (3.8.2.1) and reviewing risk (1.1). References between brackets refer to the ISO Guide 73.

communication between board members and shareholders is crucial for a mutual understanding of corporate strategy, risk and risk oversight. Such dialogue should be founded upon an appropriate and comparable level of respect, trust, seniority, skill and professionalism between investors and companies.

The objective of these guidelines is to help investors assess how well a portfolio company's board either unitary or supervisory⁵ is effectively overseeing risk management. The guidelines are intended to be used by institutional investors who own stakes in corporations in all jurisdictions. Users need to exercise their judgement when applying the guidelines to specific jurisdictions, companies and circumstances. Further the targeted audience for this guidance is broader than just company boards and investors; it includes auditors, risk advisory and rating firms as well as provincial, national and international supervisory bodies.

These guidelines rest on the following assumptions about the architecture of risk governance and the sequence and distribution of responsibilities.

- The risk oversight process begins with the board. The unitary or supervisory board has an overarching responsibility for deciding the company's strategy and business model and understanding and agreeing on the level of risk that goes with it. The board has the task of overseeing management's implementation of strategic and operational risk management.
- Corporate management is responsible for developing and executing an enterprise's strategic and routine operational risk program, in line with the strategy set by the board and subject to its oversight.
- Shareholders, directly or through designated agents, have a responsibility to assess and monitor the effectiveness of boards in overseeing risk at the companies in which they invest, and to determine what level of resources they will dedicate to this task. Investors are not themselves responsible for risk oversight at corporations.

These guidelines specifically address the challenge investors have, directly or through agents, in addressing risk at specific portfolio companies. However, it is well recognised that investors need to address risks in other ways, too, that lie beyond the scope of this guidance. For instance, they should identify, understand

⁵ The principles are intended to apply to both a single-tier board and a two-tier board structure. When referring to the "full board" or "the board" it is intended that this be specific to the actions of the non-executive and other directors that may comprise the supervisory board in a two-tier system or the unitary board in a single-tier system.

and take responsibility for how risks are managed in indexed portfolios. And they should understand and take steps to manage their exposure to portfolio risks that could result from aggregation of investments which are exposed to similar events. In any case, ultimate investors should monitor and make conscious choices involving risk based on an evaluation of long-term effects on the interests of underlying fund beneficiaries and participants.

The guidelines do not in any way seek to eliminate or minimize risk taking. In a healthy dynamic market profits are largely sourced from risk taking. Companies and investors alike are aware of this and act accordingly. However, a sound risk management program should demonstrably identify and reduce the frequency of potentially large loss events. Such large loss events may be particularly likely to occur as a result of a failure to manage systemic risk, rather than as the result of the idiosyncratic risk arising in one investment.

These guidelines are divided into three sections. Section 1.1 sets guidance for the internal board and company process on corporate risk oversight; Section 1.2 follows with guidance on investor responsibility in the context of corporate risk oversight. Section 1.3 culminates with guidelines on board and company disclosure of the risk oversight process.

The document recommends guidelines and suggested practices, as opposed to prescriptive rules to be followed. Should any of the following guidelines conflict with or confound local laws or regulations, the guidelines should only be applied in such a manner as to not violate such laws or regulations, as they are intended to complement laws and regulations.

These ICGN Corporate Risk Oversight Guidelines are not written in isolation. These guidelines are part of a larger framework of ICGN statements and principles. Attention is drawn to the ICGN Global Corporate Governance Principles (2009), especially to the full Section 4 on Risk Management, Section 2.2 on Effective board behaviour, Section 2.3 dealing with Responsibilities of the board, and 3.7 that addresses whistle-blowing practices. Further, the ICGN Statement on Institutional Shareholder Responsibilities (2007) is of importance in this context, especially Section 3.2 on the appropriate level of resources, experience and skills required of portfolio managers and others in similar agency positions.

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