# NEXTLEVELSOLUTIONS RISK AND REGULATORY INSIGHTS

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## BANK /COMPANY BOARD & RISK GOVERNANCE EVALUATION

Organizations that fail to maintain effective boards are likely to fail, suffer losses or underperform full potential. *The ongoing and systematic evaluation of the corporate governance process is fundamental to the effectiveness of the oversight of the entity*. The evaluation of board is critical and foundational to excellence in performance. Boards focused on its performance and holding itself accountable tends to be more effective at building robust risk cultures, directing effective regimes for governance and risk management and creating shareholders value. *Directors and Executives focused on growing shareholders value, understand their roles and committed to effectively discharging their fiduciary responsibilities are more likely to accept the discipline imposed thorough a well-developed and executed evaluation process*. These corporate leaders understand that the output, used appropriately will make individual directors more competent, the board more capable and give the organization greater capacity to achieve its business objectives.

*"At least annually, the Board, utilizing the advice of management, should assess and document whether the corporate governance process that it has implemented successfully achieves its objectives and, consequently, whether the Board itself is fulfilling its own responsibilities. The Board should also regularly assess the effectiveness of its overall governance process and make changes, as necessary".* This excerpt from the Central Bank of The Bahamas Guidelines on Corporate Governance clearly delineates the need for an assessment of a financial institution's governance regime. *It represents capital best practice not only for banks or financial institutions but also for all organizations regardless of nature or size*. Practically, the approach to assessment will differ depending on size and complexity but the underlying principles of testing directors' performance; understanding the effectiveness of risk management; and challenging the governance arrangements, should remain the same.

A board evaluation process should be done regularly and should be targeted at identifying weaknesses and creating opportunities for improvements. *Anticipating these periodic assessments, the board, through the chair, working with executive management, should ensure that there are mechanisms and standards in place for the ongoing assessment of directors' participation contribution and performance*. Too often one get the sense that organizations views these processes as needing to have perfect outcomes. Consequently, the processes employed are often not sufficiently rigorous and are seemingly "designed" to create positive results. Full and comprehensive assessment of the board as a whole, its committees and the performance of individual directors are critical to this process. Understanding the effectiveness of the various lines of defense and how governance principles are observed, and the effectiveness of the board's oversight is paramount.

Our fifth issue of the **Risk and Regulatory Insights** considers the important issue of evaluating the effectiveness of the board of directors. For organizations this is fundamental to understanding how engaged your board is in discharging its oversight *and appreciating that this oversight is built largely on the efficacy of the organization's risk governance*. In this issue, we leveraged material from the International Financial Corporation's (a member of the World Bank Group) publication, "*Risk Culture, Risk Governance, and Balanced Incentives - Recommendations for Strengthening Risk Management in Emerging Market Banks*". What follows is a direct excerpt from that document, with minor edits, presented to provide insight into how an organization's can compare its maturity against certain risk governance best practices. The extent to which an organization is either below standard, standard or above standard in its risk governance is indicative board performance. While the focus of the material is on banks or, understand that while some of the risk differs the general principles for risk management and corporate governance remain the same and therefore this material can be applied to any type of organization.

At **NextLevelSolutions**, we focus on strategically leveraging risk and governance for organizational gains and welcome opportunities to discuss these issues with your boards, executive and senior management.

According to International Financial Corporation's publication - "*Risk Culture, Risk Governance, and Balanced Incentives,* "board evaluation is a process by which the bank gauges how well it's Board is achieving the targets set. The main objective of the evaluation exercise is to improve the effectiveness of the Board's activities. The following practices ensure that a bank's Board evaluation meets its risk management objectives:

- There should be regular assessment of the Board's performance on risk management oversight, Board composition, experiences, knowledge and skills which should inform better ways as to how the Board should effectively deliver on its mandate.

- The areas of evaluation of the Board Risk Committee, in particular, should include:

  - The breadth and depth of the Board Risk Committee's knowledge of risk and risk governance and management (including ongoing education);

  - The independence of the risk committee members from management;

  - The performance of the chair of the committee and his or her relations with management and the CRO and with the committee;

  - The clarity of communications with management about risk, and the degree to which these communications have been understood and acted upon;

  - The quality of Board, risk committee, and management responses to potential or actual financial, operational, regulatory, or other risk events; and

  - The effectiveness of the information received and reporting about risk by management.

- During performance evaluation, the Board should consider the following process:

  - Select a coordinator and establish a timeline for the evaluation process;

  - In addition to risk committee members completing the form as a self-evaluation, ask individuals who interact with the risk committee members to provide feedback;

  - Ask each risk committee member to complete an evaluation by selecting the appropriate rating that most closely reflects the risk committee's performance related to each practice; and

  - Consolidate the results of such inquiry and evaluation into a summarized document for discussion and review by the committee.

- In addition to self-assessment, commissioning an independent external review of a bank's risk governance policies, procedures, and performance can yield useful benchmarking information and shed light on leading risk governance practices.

- The Board should assess the adequacy of the disclosure of the risks facing the bank [the organization] in a clearly documented disclosure policy. A disclosure of material circumstances, an annual report, or other disclosures should document the risks affecting the bank's [the organization's] performance and meet the minimum requirements set out by regulatory bodies.

- The bank [the organization] should have an integrated and detailed program for incorporating feedback from the performance review initiatives and show improvement on implementation of such recommendations."

"The table lists criteria that can be used to assess a bank's [organization's] maturity against each one of the risk governance best practices. The following key risk governance indicators can be used by banks [organizations] to undertake a self-assessment and benchmark their risk governance structures against the recommended best practices."

## Risk Governance Maturity Rating Scale

| Component | Below Standard | Standard | Above Standard |
|---|---|---|---|
| **Risk Governance Structure** | Lack of a defined governance structure to oversee enterprise wide risk management. Roles and responsibilities of the Board, CRO and senior management are not defined. | The Board has documented and approved governance structures and guidelines and its committees have charters that explicitly include their risk management roles and responsibilities. These guidelines have not been communicated throughout the bank [the organization]. | The Board-approved risk governance structures and guidelines are well understood throughout the bank [the organization], and risk management initiatives are continually sustained and strengthened by all key stakeholders who include the Board, senior management, and employees. |
| | A risk appetite statement is not established. | Risk appetite is mentioned in connection with critical topics such as strategy discussions. | A Board-approved risk appetite statement is leveraged across the bank [the organization], to inform all business decisions and supports the enterprise-wide risk management practices. |
| | The risk management functions are not in existence or do not have adequate resources and support to play their role in risk governance as a second line of defense. | | The risk management function is integrated as part of the second line of defense in the risk governance structure. |
| | The bank [the organization], does not have an internal audit function, and even where there is one, it lacks independence and/ or adequate resources to play its role in providing assurance on risk governance as a third line of defense. | There is an internal audit function and/or a risk management function, but their recommendations are not positively received and implemented. | The internal audit function is integrated into the risk governance framework as a third line of defense. |
| | Individuals or groups tasked with responsibilities for risk governance lack the appropriate independence. | The individuals or groups tasked with responsibilities for risk governance report to the CEO or equivalent but have no reporting line to the Risk Management Committee or Board. | The individuals or groups tasked with responsibilities for risk governance have appropriate independence and report directly |
| | | | |
| **Risk Management Framework** | Lack of a defined risk management framework that defines the bank's [the organization's] risk management processes, functions such as risk identification, assessment, measurement, control design and reporting. | Though the bank [the organization] has a risk management framework which identifies risk management processes such as risk identification, measurement, and control design and reporting, these practices have not been embedded in the risk culture of the bank [the organization], and are not followed consistently in the day-to-day activities. | A risk management framework is understood across the bank [the organization], and leveraged upon by all the risk management stakeholders' to drive the risk management programs in the bank [the organization]. |
| | Due to lack of a risk framework, the bank's [the organization's] risk appetite levels are not clearly defined. | | |

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|---|---|---|---|
| | Lack of a clearly defined taxonomy for the explicit and implicit risks covered by the bank's [the organization's] risk management program. | Each business unit has its own taxonomy of the risks it faces. There is lack of a unified bank [the organization] risk profile. | The bank [the organization] has a unified classification of risks, and those charged with risk oversight have a unified view of the risks facing the bank [the organization]. |
| | Lack of tools and/or methodologies needed to adequately quantify risk(s). | Different risk management toolkits are used by the bank [the organization] in managing the different risks, or each business unit has its own toolkit. | A single risk management toolkit is used, and is accessible to all those charged with risk oversight in the bank [the organization] to aid in the quantification of risks. |
| **Qualifications & Experience** | The Board, CRO, internal audit functions and other persons charged with the responsibility for risk governance do not have the requisite skills and experience. | Some members of the Board have good backgrounds in finance, banking, and audit or risk management. | A significant number of Board members have a strong finance, audit, and/or risk background. |
| | | Employees in the Risk Management function and the Internal Audit function have good formal education, credentials and training but skills gaps exist. | The majority of the Board members and the CRO and his team have excellent formal education and significant industry experience. |
| | | | The Internal audit team has the requisite skills to enable them to play the risk governance role as a third line of defense. |
| **Training and Capacity Building** | The Board and pertinent individuals do not receive training to understand and execute their required responsibilities for risk management. | The Board and risk management function receive occasional training to understand and execute their required roles and responsibilities for effective risk management. | The Board and all functions receive regular and focused training to understand and execute their risk management responsibilities. |
| **Board Evaluation** | Risk management is not included in performance management systems. | Risk management is included in performance management systems for management and not at lower levels | Risk management is integrated with performance management systems and continually adapted based on feedback and changing bank [organization] needs. |
| | There are minimal improvement initiatives resulting from risk management and/or internal audit activities, such as internal reviews, internal or external assessments, user feedback, complaints, and other issues. | There is a high-level program for improvement resulting from activities such as internal reviews, internal or external assessments, user feedback, complaints, and other issues, but this is only deployed superficially. | There is an integrated and detailed program for improvement resulting from activities such as internal reviews, internal or external assessments, user feedback, complaints, and other issues. |

**Table taken from Risk Culture, Risk Governance and Balanced Incentives Page 43**

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## NEXTLEVELSOLUTIONS.

***We assist financial institutions, companies and organisations in understanding and strategically resolving governance, risk, compliance and operational challenges, maximise performance and grow!***

**RISK | INTERNAL CONTROLS | COMPLIANCE | GOVERNANCE | FINANCE | STRATEGY | TRAINING**