NACD Texas TriCities Chapter Program
Constructive Failures
March 3, 2016 | Houston, TX
SPEAKER KEY TAKEAWAY CONSIDERATIONS

Panelist | James Lam, President, James Lam & Associates
Director and Chairman of the Risk Oversight Committee, E*TRADE Financial Corporation

Over the long term, the only alternative to crisis management is risk management, and crisis management is much more expensive, time consuming and embarrassing. The role of the board is critical during crises to ensure survival, but it is also important to put in place an effective enterprise risk management (ERM) program to prevent the next crisis.

The price of crude oil in 2016 has dropped from $100 to $30 in the past 18 months. Board members and executives at energy firms may be surprised by this rapid price drop, but they ***<u>should not</u>*** be surprised by its financial impact on their companies. One of the main objectives of risk management is to assess and quantify the potential impact of changes in key business and risk drivers. The board should have been informed of the company's risk profile.

The E*TRADE Financial case study shows how the board can work with management to manage through a crisis and put in place a best-practice ERM program by focusing on the fundamental requirements:

1. Establish a strong ***ERM agenda*** for the Risk Oversight Committee, including a focus on strategic, operational, and financial risks;

2. Strengthen ***independent risk oversight*** by formalizing the reporting relationships between the Board and the Chief Risk Officer and Chief Compliance Officer;

3. Enhance the process to review and approve risk policies, with a focus on the ***Risk Appetite Statement;***

4. Improve the quality and effectiveness of ***risk reports*** that go to the Board; and

5. Establish an ERM performance ***feedback loop*** by linking forward-looking earnings sensitivity analysis (from the CRO) and backward-looking earnings attribution analysis (from the CFO).

As a board member, ask yourself the following questions:

- Were we surprised by the business and financial impact of the recent drop in crude oil prices? What are the key lessons learned?

- Do we have an effective risk committee with the appropriate expertise? If not, should we establish one or should we expand the charter of the audit committee?

- Are our risk, compliance, and audit functions sufficiently independent of management to support the independent oversight role of the board?

- Do we have a robust set of risk policies, in particularly a risk appetite statement that establishes the types and levels of risk that we are willing to accept in pursue of our business strategy?

- How effective are the risk reports that go to the board? Are they forward-looking and highlight key risk exposures and trends? Do they focus the board's attention on key decision points?

- Do we have a performance feedback loop on risk management? How can the board be assured that risk management is working effectively in the organization?

Panelist | Michael Marquardt, Founder and CEO, Global Kompass Strategies, Inc. @advisorglobal; Director, Commonwealth Trust Company, Asia Assistance International, American Cancer Society's South Atlantic Division (Chairman), and ACS Cancer Action Network

The Volkswagen Disaster: Did the Company's Supervisory Board Supervise?

- The VW Board of Directors, although quite large at 20 members, only had one director who would be deemed independent under standard corporate governance guidelines.

- The corporate culture at VW, Germany's largest corporation, has been very deferential to senior management. Dissent is discouraged versus invited.

- VW "bet the company" on Diesel technology versus hybrid electric technology more than 10 years ago. When emissions standards tightened beyond technical capabilities, the options were down to pulling out of the lucrative U.S. market or attempting to cheat the system.

- Senior management followed a path that is very "Un-German": it didn't follow the rules.

For more in-depth analysis, see the speaker's "Director's Chair" article in the March/April issue of NACD's *Directorship*.

Moderator | Brian Kennedy, Senior Managing Director, Energy Sector Leader (Americas) – Strategic Communications, FTI Consulting

The public's level of trust and confidence in corporate and government leaders is at an all-time low, according to tracking polls. This trend, together with the incessant and ubiquitous scrutiny brought about by traditional, digital and social media outlets has created a whole new set of demands on corporate boards and management teams. As a result:

- Reputation is being tested every minute of every day; active and effective management of this intangible asset crucial, as stakeholders "look to reputation" during crises.
- Protecting and enhancing reputation and instilling confidence in key stakeholders in good times is essential to a company's ability to weather trying times.
- Effective planning can mean the difference between an incident or event and a full-blow crisis. As Dwight D. Eisenhower said, *plans* can be rendered useless by circumstances, but *planning* is indispensable.

Observations from recent corporate crises offer insight into the importance of effective communications during catastrophic events, when even some of the most well-known and highly valued brands are at put at risk. Demonstrating accountability, transparency, compassion, consistency, and commitment to effective mitigation/resolution are the pillars of effective communication during crises. The failure of companies to these key tenets can result in significant loss of enterprise value, not to mention brand investment, ongoing operations, reputation & long-term viability. Common missteps include, but may not be limited to:

- Failure to disclose the facts promptly.
- Attempting to minimize events and/or underestimate impacts.
- Assigning blame; finger pointing.
- Declaring victory too soon.
- Delivering inconsistent and contradictory messages to various stakeholder groups.
- Neglecting to address "human" impacts.
- Refusing to engage with media; "No comment."

"In a crisis, don't hide behind anything or anybody. They're going to find you anyway."
-- Bear Bryant

Management has a duty to keep the board informed, and the board has a duty to stay informed, but – increasingly - boards of directors are serving as an important (active) tool and resource for management teams in crisis mitigation, particularly in events where the backgrounds of individual directors lend themselves to adding value. It is always important in a crisis situation for Boards to not become too operationally involved in the decision making process, but given today's more active-shareholder environment, and the fact that crises can lead to shareholder activism and major litigation, Boards are more involved than ever before in both crisis scenario planning and are sometimes an integral part of the crisis response.

Best Practice Notes for Crisis Communications

- **Take control of the story**. Companies must frame their stories before lawmakers, news media, analysts or other competing interests frame it for them. Populate the environment with information ahead of the curve, correct the record vigilantly, dispel misinformation, and engage stakeholders so they understand the company's position. The "art" is doing so in a way that is on the right "volume setting".
- **Understand key stakeholder sentiments and ensure a proportionate response.** Use qualitative and quantitative research to assess perceptions of key stakeholder groups to inform strategy and identify threats and opportunities. Are opinions moving? If so, are they moving positively or negatively? If opinions are moving, it is imperative to craft a response that is correctly calibrated to create the right framing of the issues. This also provides a basis of measurement to ensure consequent strategies are effective.
- **Work from the inside out.** When employees are not informed and engaged on the company's position and key messages or initiative, chances of success diminish greatly. Solid communications strategies start from the inside.
- **Communicate early and often.** Companies must have the capacity to provide information to key stakeholders promptly and consistently for the duration of the crisis.
- **Identify & activate supporters.** Educate and activate third party stakeholders, who can serve as credible surrogates for the company's messages.
- **Prepare for competitive opportunism.** Understand, anticipate, and mitigate tactics deployed by adversaries (regulators, activist shareholders, etc.) likely to leverage unfortunate events to reap competitive advantage.

Additional program resources on these topics can be found at:
https://texastricities.nacdonline.org/Resources/meeting.cfm