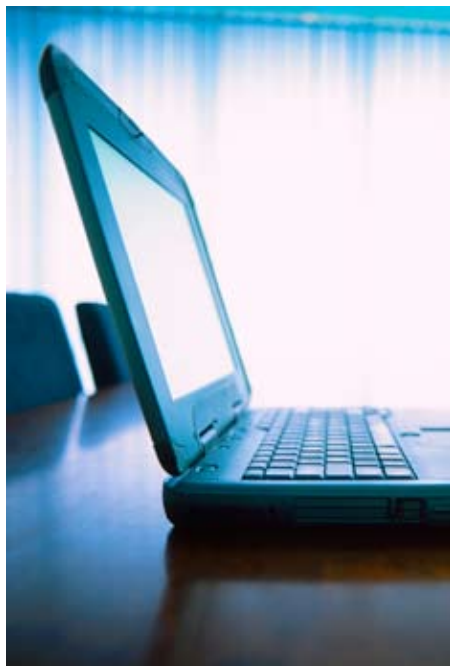


The Board's Role in Risk Oversight



The subprime lending turmoil and related events have led activist shareholders to question the risk monitoring activities of boards. Some investors are questioning the adequacy of risk disclosures, which the board is responsible for overseeing. They argue that certain boards failed to monitor management adequately as risks escalated, and they are pressuring companies to reveal more details of operational risk management so investors can better assess the potential for future crises.

The Laborers' International Union of North America, for example, has submitted shareholder proposals to five companies seeking more detailed disclosure of mortgage practices and risk, including exposure to subprime loans. CtW Investment Group, an organization of seven labor unions, has sent letters to directors at six large financial services companies asking for information about how they assess mortgage risks. If CtW is not satisfied with the answers, it has announced its intention to oust certain directors.

These developments pose several questions. What is the board's role with respect to risk oversight? Should the board's focus be on monitoring management's policies and procedures for risk management, or should directors become more actively involved in assessing risk themselves? Resources throughout the [Center for Corporate Governance](#) Web site help address these concerns.

The [NYSE corporate governance listing standards](#) require the audit committee to discuss policies and processes for risk assessment and risk management. Commentary in the standards clarifies that although it is the responsibility of senior management to assess and manage the actual risks, the audit committee should focus on areas of major financial risk exposure and discuss the guidelines and policies for addressing those areas.

Former SEC Chairman Harvey Pitt provides his perspective in a recent article, "[Learning the Lessons of the Sub-Prime Crisis](#)." Mr. Pitt says it is critical to have a separate board-level committee that examines risk, because audit committees are too busy to face this vital issue. Mr. Pitt further recommends that the board-level risk committee be charged with assessing and managing all risks the institution faces: financial, operational, and reputational.

In a position paper, Moody's Investors Service reports that, in most cases, the oversight of risk programs is undertaken by board committees. Effective committee-level risk oversight practices include having directors with a good understanding of risk management and having sufficient time to coordinate risk oversight. For more information, see "[Best Practices for a Board's Role in Risk Oversight](#)" by Moody's.

Standard & Poor's (S&P) has now taken steps to introduce [ERM analysis into its corporate credit ratings process globally for nonfinancial companies](#), explaining that its ERM analysis would serve as a "forward-looking, structured framework to evaluate management as a principal component in determining the overall business profile." S&P invited comments on its proposal and expects to decide whether to include ERM analysis in its ratings; at that time, it will provide a methodology and a timetable.

Executives are feeling the impact of heightened board interest. In a recent Deloitte Dbriefs webcast on "[The Board's Role in Risk Oversight](#)," Deloitte asked 1,700 financial executives whether their boards have requested a more systematic approach to understanding and managing risk. A dramatic 44 percent of executives replied in the affirmative; only 19 percent said that they have not received this direction. This webcast focused on risk intelligence as a means of managing risk in a systematic and disciplined way.

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