PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers Accountants N.V.
Thomas R. Malthusstraat 5
1066 JR Amsterdam
Postbus 90351
1006 BJ Amsterdam
Telephone (020) 568 66 66
Facsimile (020) 568 68 88
Direct phone (020) 568 42 47
www.pwc.com/nl

OECD
Steering Group on Corporate Governance
F.a.o. Lya Villasuso, OECD Corporate Affairs Division

Amsterdam, 16 April 2009

Reference: JdG/JvM/16042009v1

Subject: OECD consultation on Corporate Governance and the Financial Crisis

L.S.,

We thank the OECD for offering us the opportunity to participate in the consultation on Corporate Governance and the Financial Crisis. The OECD plays a vital role in establishing and improving corporate governance practices across the globe. We therefore expect the current OECD initiative on how better corporate governance and improved implementation of its corporate governance principles will successfully contribute to the G20 agenda of restoring global growth and achieving needed reforms in the world’s financial system.

Indeed, given the importance and influence of the OECD Code in the field of corporate governance, we would welcome an opportunity to contribute beyond this response to the consultation in terms of ideas and debate over a more extended timetable. Such a process would give OECD the means of encouraging further debate and winning even more widespread market acceptance for its ideas, without sacrificing to any unreasonable degree the urgency of responding to the financial crisis. We expect that market acceptance of new developments and the highest standards is especially important in the field of corporate governance where compliance is achieved through national codes which often operate through so called “soft law” or “comply or explain” regimes. Hence we would be pleased to participate in any such further reflections which OECD might consider appropriate about particular aspects of the matters which are the focus of the present consultation.

PricewaterhouseCoopers is de handelsnaam van onder meer de volgende vennootschappen: PricewaterhouseCoopers Accountants N.V. (KvK 34180285), PricewaterhouseCoopers Belastingadviseurs N.V. (KvK 34180284), PricewaterhouseCoopers Advisory N.V. (KvK 34180287) en PricewaterhouseCoopers B.V. (KvK 34180289). Op diensten verleend door deze vennootschappen zijn Algemene Voorwaarden van toepassing, waarin onder meer aansprakelijkheidsvoorwaarden zijn opgenomen. Deze Algemene Voorwaarden zijn gedeponeerd bij de Kamer van Koophandel te Amsterdam en ook in te zien op www.pwc.com/nl

In this spirit, the suggestions put forward in this letter are made as ideas and topics for further debate and reflection in the field of business risk disclosures and enhancement of the quality of risk management systems. We trust you will find them helpful.

The role of corporate governance in the current financial crisis can be looked upon from many different angles and perspectives. For example, this is illustrated in the OECD discussion paper 'Corporate Governance lessons from the financial crisis' and the key questions addressed in the OECD consultation document 'Public Online Consultation on Corporate Governance and the financial crisis'.

Notwithstanding the fact that all subjects in the consultation document are relevant and important, we focus in this comment letter on the area of risk management implementation, and especially on two specific subjects:

1. the opportunity to improve business risk disclosures in the annual and half-yearly reports by companies, which will stimulate both the quality of risk management within organisations and the right dialogue between stakeholders and directors on the business risks, the risk appetite of the company and the way the company responds to those risks; and

2. the opportunity to enhance the quality of risk management systems within organisations through adding independent assurance thereon to the board and potentially to external stakeholders.

Our contribution is on behalf of the PricewaterhouseCoopers (PwC) The Netherlands (Corporate Governance Unit) and therefore does not necessarily reflect the points of view of all PwC network firms. We hope our contribution will stimulate debate and help the OECD in drawing balanced conclusions and defining recommendations on how to improve corporate governance.

The need and opportunity for more transparent risk disclosures

Because of the current credit crunch and economic turmoil, shareholders and other stakeholders will increasingly challenge directors on their strategy, their risk appetite and the way they respond to the rapidly changing strategic, operational, financial and compliance risks facing the company. Everyone has become aware that business risks are not static: new business risks can emerge suddenly; the likelihood and/or the impact of risks may change dramatically at short notice; and risk responses can quickly become ineffective.

Shareholders and other stakeholders therefore seek clear and comprehensive risk profile disclosures – a description of the principal strategic, operational, financial, and compliance business risks the company faces. However, generally stated, the current risk disclosures in annual reports do not meet that demand and are therefore somewhat criticized in literature and research. In those research reports it is stated that the information value of those disclosures is frequently low as:

- too often, too long a list of risk factors are presented (e.g. prospectuses contain quite often over 15 pages of risk factors);
- too often, the true important principal strategic and operational risk factors are not clearly presented; and
- the risk disclosures are difficult to read and to understand for readers.

We also note that in most corporate governance codes around the globe, the focus has been on disclosures / descriptions about the risk management responsibilities and internal control systems. In some jurisdictions it is required to also include a statement on internal control effectiveness regarding internal controls over financial reporting (e.g. Sarbanes Oxley section 404 and Dutch Corporate Governance Code).
However, the requirement and guidance for risk profile disclosures appears to be given less attention. In many countries company law prescribes that companies should disclose their principal risks in their annual report, which principle is also included in the OECD corporate governance principles (principle A6, see below).

6. Foreseeable risk factors.
Users of financial information and market participants need information on reasonably foreseeable material risks that may include: risks that are specific to the industry or the geographical areas in which the company operates; dependence on commodities; financial market risks including interest rate or currency risk; risk related to derivatives and off-balance sheet transactions; and risks related to environmental liabilities.

The Principles do not envision the disclosure of information in greater detail than is necessary to fully inform investors of the material and foreseeable risks of the enterprise. Disclosure of risk is most effective when it is tailored to the particular industry in question. Disclosure about the system for monitoring and managing risk is increasingly regarded as good practice.

Source: OECD Corporate Governance principle A6

We therefore concur with the conclusion in the OECD discussion paper which states that: '*Company disclosures about foreseeable risk factors and about the systems in place for monitoring and managing risk have also left a lot to be desired even though this is a key element of the Principles.'*

After some comparison of the rules, regulations and guidance available across different countries, we conclude that there is consensus on the overriding generic principle regarding risk disclosures: principal risks should be disclosed, so as to help readers understand and evaluate the risks faced by the company, and its decisions regarding the management of those risks. However, if we go any more deeply into the matter, it is quite hard to achieve consensus on additional practical reporting principles and guidance on what (and what not) to do, and what disclosures on business risks should be included in the annual report.

The question on the table is how directors (executive as well as non-executive directors) can be assisted in such a way that they feel able to disclose the risks that really matter. If one asks the question in a board room, what the 5 – 15 principal risks of the company are, this question is normally answered immediately. But when it comes to disclosing the principal risks in a formal document such as the annual report, this is more difficult. Maybe this is due to the fact that, whether one likes it or not, financial reports are legal documents with consequent risk of liability for statements made. Risk-averse behaviour in the disclosure of risks may lead to disclosures that do not meet shareholder expectations. This is a worthwhile area for further debate and research.

We suggest the development of a set of generally accepted risk management reporting principles to enhance transparency and consistency in reporting on business risk in our global economy. Those principles should, on the one hand, establish the nature of directors' responsibilities and roles regarding risk disclosures, and on the other hand, contain additional guidance for disclosing the principal risk factors. As outlined in our article 'Business risk reporting' (De Groot & Van Manen in 'The Handbook of International Corporate Governance', published by the UK Institute of Directors, 2009, page 97-104) such principles could aim to address risk disclosures so as to:

- Present a balanced image. Cover the full spectrum of strategic, operational, compliance and financial risks, and provide a balanced insight into each risk category. Include both external and internal risks.
- Be specific instead of generic. Be company and industry specific, and take into account specific regulations that apply.

- Focus on the principal risks faced by the company instead of simply making a long list of all possible risks.
- Articulate the risk appetite of the company, as this sets the tone as regards risks taken and response(s) selected.
- Link the risks faced by the business to its strategic and operational objectives.
- Describe for each risk its potential impact.
- Quantify the impact of specific risks if such quantification is common practice in the industry.
- Articulate the risk response. Describe for each risk the response: how the risk is accepted, mitigated, transferred or managed.
- Present an up-to-date risk profile given the current rapid changes in social, economic and environmental conditions.
- Acknowledge that some things do go wrong, no matter how well designed an internal control system may be, breakdowns will occur.
- Use plain, crisp language that readers can easily understand.

To summarise, the development of additional risk disclosure principles in line with those presented above, could help directors in fulfilling their responsibilities in this area, and empower better, more transparent disclosures of foreseeable risk factors in the annual and half-yearly reports as included in OECD corporate governance principle A6.

Embedding risk management through independent assurance

Several recent studies state that risk management has not played its role in financial institutions as it was intended. For instance, the UK Turner report (2009 page 92) states: *'But improvements in the effectiveness of internal risk management and firm governance are also essential. While some of the problems could not be identified at firm specific level, and while some well run banks were affected by systemic developments over which they had no influence, there were also many cases where internal risk management was ineffective and where boards failed adequately to identify and constrain excessive risk taking.*'

Embedding risk management within the organisation is one of the key success factors for an effective risk management system. One element in improving the effectiveness of risk management systems appears to receive less attention in the current debate: the opportunity for independent assurance.

Assurance on (elements) of the design effectiveness and/or operating effectiveness of risk management systems, and/or on the reasonableness of the risk profile, supports directors

in their oversight role and supports embedding risk management in organisations. Such assurance can be provided either by external auditors or internal auditors, or possibly a combination of both. Non-executive directors in particular, could use such assurance reports in their oversight role, and in our opinion independent assurance has the potential to enhance the quality of risk reporting and risk management (as seen in the Sarbanes Oxley section 404 environments, as it has evolved).

A FEE survey a few years ago of European practices on control reporting showed that many forms of such reporting were mandated or proposed. Given developments since and experience of different forms of reporting, it could be valuable to survey practices again as a prelude to wider debate.

We hope the OECD will stimulate the debate about the need for, and the contribution of, the future role of independent assurance for enhancing the quality of risk management and risk reporting within organisations.

In case of questions and or remarks, we are more than happy to provide you with additional information and/or insights.

Kind regards,

Jaap van Manen
Jos de Groot

Corporate Governance Unit
PricewaterhouseCoopers Accountants N.V.
The Netherlands

Contact details:
Jos.de.Groot@nl.pwc.com T ++31 20 568 42 47
Jaap.van.Manen@nl.pwc.com T ++31 20 568 70 13