

OECD Principles of Corporate Governance

4th January 2015

Dear members of the Corporate Governance Committee,

I am in full agreement that now is an appropriate time to revise the OECD Principles of Corporate Governance and I welcome this initiative to help address this challenge.

During the ten years since the publication of the OECD Principles of Corporate Governance the concept of governance and the importance of its role has evolved in line with constantly mutating corporate circumstances. Analysis of the global financial crisis and subsequent corporate scandals has served to highlight the requirement to improve existing governance and oversight. It has also highlighted that this requirement particularly applies at the strategic level of the board and executive management.

Please find attached my comments in relation to required amendments to the OECD Principles of Corporate Governance which are in the form of two appendices.

Appendix I: Specific Observations and Recommendations

Appendix II: An example of a Board Oversight framework

I would like to thank the OECD for providing this opportunity to comment on the consultation draft. Should you require any additional information or wish to discuss any of the issues raised in more detail please do not hesitate to contact me.

Yours sincerely

Sean Lyons

Email: sean.lyons@riscinternational.ie

Selected Corporate Defence Publications: <http://ssrn.com/author=904765>

SPECIFIC OBSERVATIONS

A. Delivering Long Term Sustainable Stakeholder Value¹

In the minds of many stakeholders an organisation has a corporate responsibility to defend their stakeholder interests. This responsibility includes safeguarding, protecting, and valuing the interests of all of its stakeholders, with a view to ensuring the long term sustainability of stakeholder value. This responsibility begins with the board.

The financial crisis of 2008 and the subsequent economic recession highlighted serious weaknesses in corporate business models and exposed a mindset of excessive risk taking in search of short-term rewards at the expense of achieving longer-term sustainability. Such recklessness has severely tarnished the reputation of the corporate world in the eyes of many of its stakeholders. Consequently there has been increased stakeholder focus on, and scrutiny of, boardroom affairs, with many stakeholders now demanding higher standards of board oversight in order to provide them with better protection and greater assurance going forward.

An old sporting aphorism states that “offence wins games, defence wins championships”. In business the ability to deliver sustainable value to stakeholders requires a subtle blending of both value creation (offence) and value preservation (defence) efforts. This requires an understanding of these two antagonistic yet complimentary principles, which are inherently intertwined and mutually interdependent within a dynamic environment. It requires an appreciation that these two principles represent two sides of the same coin, and therefore cannot and should not be addressed in isolation of one another. Now more than ever, 21st century business requires a balanced integration of both value creation and value preservation at all levels of the business.

Recommendation: Board Governance should include ensuring the existence of a healthy corporate strategy which reflects a balanced focus on both value creation and value preservation. Unfortunately the financial crisis clearly highlighted the existence of an unhealthy imbalance in this regard. It is now apparent that in the build up to the financial crisis too many boards were preoccupied with focusing on short term value creation at the expense of long term value preservation.

¹ This submission is primarily based on my article entitled “Striking a Balance: Offence v Defence” which was recently published in The Ethical Boardroom Magazine, Winter Edition, 2014 (also available online at their website: <http://ethicalboardroom.com/risk/striking-balance-offence-v-defence/>)

B. Boardroom Focus on the Value Preservation Imperative²

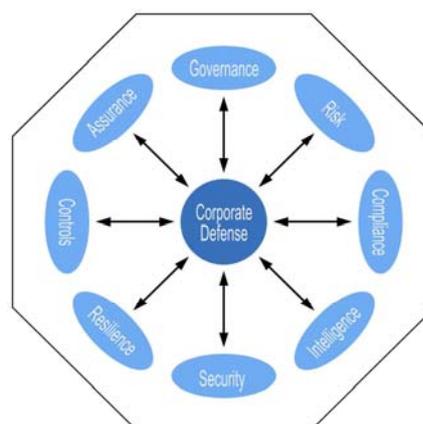
Value preservation is widely associated with the notions of guardianship and protection. In its broadest sense it encompasses an organisation's collective efforts at self-defence. The concept of the value preservation imperative refers to the necessity to defend the organisation itself and the interests of its stakeholders. This requires safeguarding against a multitude of potential hazards (risks, threats, and vulnerabilities), the occurrence of which could be detrimental to the achievement of the organisation's objectives, and consequently to its long term sustainability. This includes the board being able to successfully demonstrate that it has taken all reasonable steps to ensure that there is a robust corporate defence programme in place to help achieve its stakeholder obligations.

Everyday in the media we see scandals whereby organisations have found themselves in difficulties all of their own making. These are often as a result of events and/or series of events which in retrospect the organisation could have and should have better anticipated, prevented, detected or reacted to. Typically these scandals have exposed deficiencies and weaknesses in their corporate defence programmes which have led to unnecessary large scale losses, significant reputation damage, and negatively impacted on stakeholder value. Clearly from a stakeholder perspective corporate defence represents a very important challenge which needs to be adequately addressed by the board. In fact some stakeholders would argue that the board's true valuation of their stakeholders is most clearly reflected in the organisation's corporate defence efforts.

The board in particular needs to be aware of, understand, and appreciate each of the critical components of a corporate defence programme (Figure 1) and the purposes they serve.

- **Governance:** How the organisation is directed and managed, all the way from the boardroom to the shop floor.
- **Risk:** How the organisation identifies, measures, and manages the risks it is exposed to.
- **Compliance:** How the organisation ensures that its activities are in conformance with all relevant mandatory and voluntary requirements.
- **Intelligence:** How the organisation ensures that it gets the right information, in the right format, to the right person, in the right place, at the right time.

Figure 1: Critical Components



² Please also see my 2012 submission to the HBR/McKinsey M-Prize for Management Innovation: Long-Term Capitalism Challenge, entitled "Achieving a Healthy Balance Between Offense and Defense in 21st Century Capitalism". <http://www.managementexchange.com/hack/achieving-healthy-balance-between-offense-and-defense-21st-century-capitalism>

Response to OECD Consultation - November 2014

- **Security:** How the organisation ensures that it protects its critical assets from threats and danger, its people, information, technology and facilities.
- **Resilience:** How the organisation ensures that it has the capacity to withstand, rebound or recover from the direct and indirect consequences of a shock, disturbance or disruption.
- **Controls:** How the organisation ensures that it has taken appropriate actions in order to address risk and to help ensure that the organisation's objectives will be achieved.
- **Assurance:** The system in place to provide a degree of confidence or level of comfort to the stakeholders that everything is operating in a satisfactory manner.

A corporate defence programme involves the collective management of all these components in order to help maximise their potential added value. Their collective management is required as recent developments in each of these disciplines has meant that the boundaries between these activities have become somewhat blurred, and therefore it is now increasingly difficult to determine where one component ends and another begins, as each includes elements of the others.

Recommendation: Board Governance should involve ensuring that the organisation can demonstrate that it has a robust corporate defence programme in place. Effective corporate defence requires an appreciation by the Board of the continuous interaction, interconnections, and critical interdependencies which exist between these disciplines and the potential cascade of consequences which can result. It requires an understanding that the management of these complimentary components continuously impact on one another in this increasingly complex corporate ecosystem. In fact the symbiotic nature of their relationships means that each contributes to, and receives from, each of the other disciplines.

C. [The Five Lines of Defense Approach to Board Oversight](#)³

Success in corporate defence requires vigilance and oversight in order to manage these multi-dimensional activities across the entire organisation, both vertically (top-down bottom-up) and horizontally (cross-functionally). A corporate oversight framework needs to provide a clear structure of accountability and a solid foundation from which to both safeguard stakeholder interests and optimise stakeholder value. In order to gain a measure of comfort that the critical components are being appropriately addressed within the organisation, stakeholders increasingly rely on various lines of defence (LOD) (see Figure 2) to be in place and to operate as effective oversight layers within the organisation. A LOD oversight approach is intended to operate on the principle of providing transparency in the assignment of oversight responsibilities, and in holding individuals (or groups) to account for these responsibilities. The logic of a LOD approach is that each LOD has “*skin in the game*” and has the capability to provide separate and additional levels of comfort which can be relied upon in the event that a subordinate LOD fails to operate effectively.

1. **Operational Line Management** has responsibility for overseeing the daily operations of staff, services, practices, mechanisms, processes, and systems.

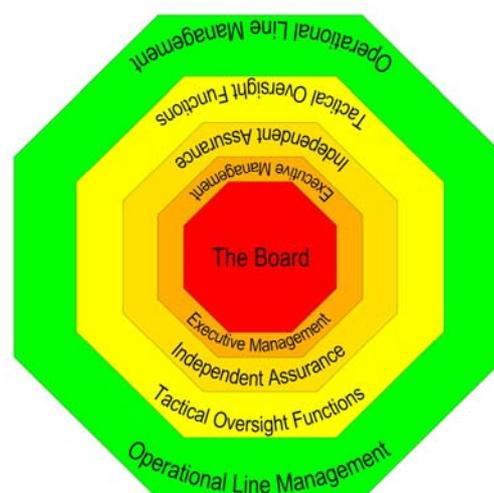
2. **Tactical Oversight Functions** monitor, facilitate, and coordinate the consistent, competent, adequate, and effective operation of defence activities established by operational line management. Examples include the compliance, risk management, and internal control functions.

3. **Independent Internal Assurance** provides the board with a level of independent assurance in relation to the effectiveness of the activities of the other lines of defence. Examples include the audit committee, risk committee and the internal audit function.

4. **Executive Management** provides assurance to the board that the objectives of the organisation are being achieved by providing adequate oversight of those they manage and by ensuring that the organisation’s activities are consistent with business strategy and policies approved by the board.

5. **The Board** is responsible for overseeing the activities of the organisation and is accountable to the shareholders for the organisation’s strategy and performance. This includes overseeing the activities of its standing committees and executive management.

Figure 2: Five Lines of Defence



³ Please also see “Corporate Oversight and Stakeholder Lines of Defense”, published in the Conference Board, Executive Action Report No. 365 : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1938360

Response to OECD Consultation - November 2014

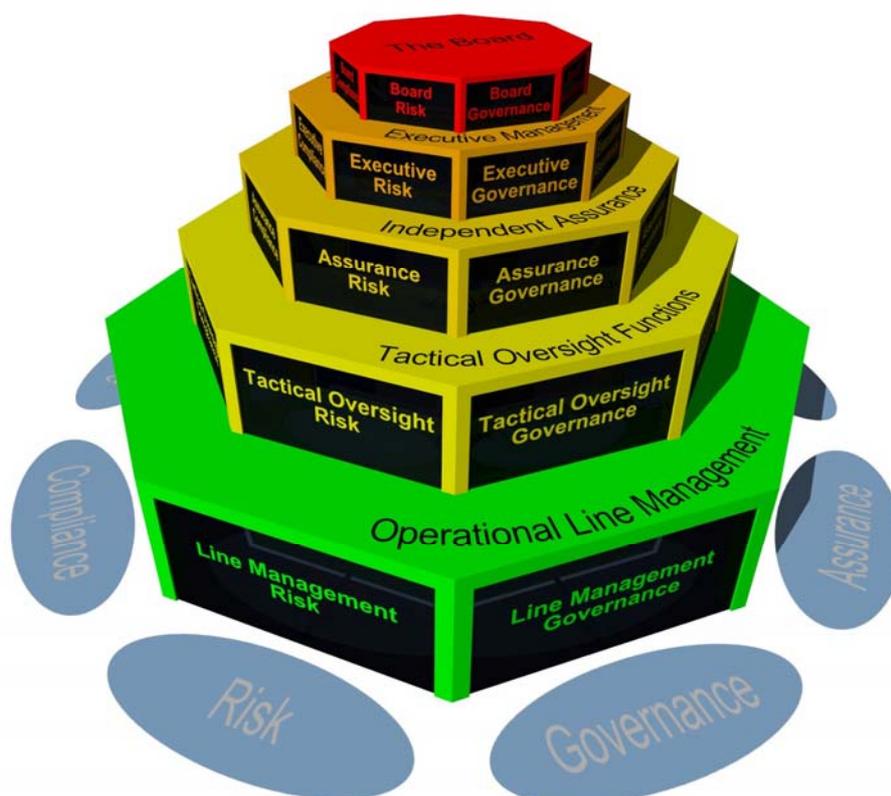
It is essential that each LOD recognises that it has specific responsibilities in relation to each of the critical corporate defence components. To operate effectively each LOD must play its part both individually and collectively (the chain is only as strong as its weakest link) thereby fulfilling their oversight duties within a holistic framework. Corporate defence is ultimately a team sport in which each LOD is accountable for helping to safeguard the diverse interests of the multiple stakeholders.

Recommendation: Board Oversight should involve ensuring that the five lines of defence oversight model is in place and operating in a satisfactory manner. The Board as the last line of defence must appreciate that these oversight responsibilities begin at the boardroom but run right through the organisation all the way to the front line, the 1st LOD.

Corporate Defence Management (CDM) Framework

A truly holistic perspective requires a conceptual understanding and practical appreciation of how to successfully integrate the critical defence components at each LOD. The CDM framework (see Figure 3) represents a multi-dimensional model which can help an organisation to visualise this integration while also helping to understand their continuous interactions, interconnections and critical interdependencies. The implementation of the CDM framework can help to better manage the critical defence components by unifying, aligning and integrating them at strategic, tactical and operational levels. Such a framework enables the board to provide appropriate oversight to address the organisational challenge of transparency over corporate defence responsibilities and accountabilities.

Figure 3: Multi-dimensional CDM Framework⁴



Copyright © 2014 Sean Lyons. All rights reserved.

⁴ Please refer to short video which provides a visual image and overview of the workings of this multi-dimensional framework: <http://www.youtube.com/watch?v=vLoA8U0GZHI>