ARTICLE

Environmental, Contextual and Existential Risk Governance

*Prof. Colin Coulson-Thomas

Board members have collective responsibility for ensuring that effective and regularly reviewed responsibilities, capabilities and actions are in place for identifying, assessing, addressing and mitigating risks to a company's assets, activities, operations and relationships, its people and the achievement of corporate purpose, vision, values, goals, objectives and priorities. A succession of events and developments in recent years has caused more directors to question the adequacy of assumptions, policies and practices in these areas. Involvement in them is increasingly everyone's responsibility and board members should encourage people to be alert and vigilant and to speak up when they have concerns.

Some risks result from a board's own decisions, deficiencies in the implementation of its direction and policies, or failures of corporate systems and controls. Others may be a consequence of the business a company is in, or the nature of its operations. They may feature in risk registers. In some cases, enough might be known to take out insurance and/or put arrangements in place to address them. These may be less able to deal with unexpected and exogenous developments over which a board may have little control. A single company's response may also have limited impact upon their root causes. Risk reviews may need to be accompanied by steps to increase resilience or ability to cope with challenges.

Risk governance, like corporate strategy, often begins with a review of what is happening in the business, economic, environmental, market, political, social and technological context within which a company is operating; how external

> Boards should reflect on their own ability to assess and understand the implications of potentially high-impact risks, how they might better prepare for them and whether new sources of independent, objective and informed advice are required.

trends and developments are likely to impact upon a company's activities, operations and stakeholders; and what could and should be done in response, either to address challenges or capitalise upon opportunities. The latter could include helping stakeholders and others to handle them. An understanding of opportunities and possibilities associated with risks, and the impacts of a longer-term trend such as global warming, might enable a board and management team to imagine and scope a new purpose and role based upon a company's position, capabilities and connections.

Contemporary Contextual Risks

Each year the World Economic Forum (WEF) commissions a wide ranging and international assessment of contextual risks which are ranked in terms of their severity or likely impact over both a two-year period and a ten-year period. The 'cost of living' crisis which tops the two-year severity of likely impact ranking does not feature on the ten-year list, which is dominated by environmental risks, the top three of which are failure to mitigate climate change, failure of climate change adaptation and natural disasters and extreme weather events. They are joined in the top five by biodiversity loss and eco-system collapse and large-scale involuntary migration that is associated with other leading risks These are all areas in which recent scientific evidence suggests much more needs to be done to avoid disaster.

The contextual risks identified by the WEF are inter-related and inter-dependent. Individually and collectively, they represent existential threats for which many directors and boards, the communities and societies in which they operate and the infrastructures on which they depend remain woefully unprepared. Certain risks such as environmental challenges, geo-economic confrontation, large scale involuntary migration, erosion of social cohesion and societal polarisation, and widespread cyber-crime and cyber insecurity are expected to persist over both two-year and ten-year periods. More boards may seek new members with expertise in these areas and/or those who can provide related advice and support. Will this be enough?

Too many contextual risks are topics for discussion when action plans are required. Boards should reflect on their own ability to assess and understand the implications of potentially high impact risks, how they might better prepare for them and whether new sources of independent, objective and informed advice are required. A review could include the composition of a board and whether additional and different skill sets around a board-room table might be needed in addition to external support and collective action. The latter could include collaborations with likeminded public and private organisations.

Root Causes of Existential Risks

Certain concerns of boards are shared by people and organisations across many communities and societies. They have common root causes and are the consequences of collective human activities, lifestyles and aspirations that lead to growth ambitions which scientific evidence suggests are not sustainable. Their consequences are compounded by global population growth, negative externalities and inadequate responses to climate change. Consumerism and corporate communications often appeal to human desires and greed. Weak and irresponsible leaders pander to unrealistic desires for ever more, rather than advocate transition to simpler, more sustainable and less environmentally damaging development paths.

What is sometimes portrayed as progress could alternatively be viewed as regression and a loss of ancient wisdom that allowed communities to live more in balance and harmony with the natural world. The promotion of digital technologies and connectivity has led to greater detachment from natural eco-systems and a shift of attention and time to virtual worlds. In many arenas, private and perceived self, vested and national interests appear to take priority over collective interests and the public good. Reinforced and encouraged by growth objectives and compensation arrangements, many value-creation processes are turning scarce natural capital that will be required by future generations into pollution and rubbish.

Enlightened leaders and more aware and responsible boards are identifying and addressing the negative externalities of corporate activities and operations. They recognise, rather than avoid or deny, realities and wider interests such as those of ecosystems, the excluded, the environment and future generations. Their priorities, investments and the innovations they champion are both responsible and risk led. They aim to bring people together and reconcile rather than balance contending interests by aligning aspirations around a shared goal of survival. If required, they change incentives, rewards and compensation arrangements to focus attention and effort on more sustainable and inclusive alternatives and opportunities to do things differently that often accompany adaptation and mitigation challenges.

Differing Relationships with Reality

Confronted with avoidance, denial, fake news, groupthink, hostility, spin and vested interests, some directors face an uphill battle to get colleagues to recognise realities and accept responsibility for negative consequences of corporate activities. In certain sectors, many corporate boards spent years and devoted significant resources to questioning, opposing and resisting suggestions that core corporate operations had

 © Institute of Directors, India I www.iodglobal.com

harmful end results. Conceding when scientific evidence of harm becomes overwhelming may be too late to avoid communities and societies having to bear the burden of delayed corrective action. Too often corporate reporting fails to fully identify, value and account for negative externalities. Boards may fear claims for compensation, loss and/or damages if they admit responsibility.

More widely, questions of trust arise. Leaders at all levels face challenges in getting people to focus on the realities of existential threats and related risks, such as what is happening to the environment, eco-systems, biodiversity, global temperatures and the climate and their likely future consequences. Fiction, fake news and propaganda present alternative realities. Some ESG initiatives are described as 'greenwashing' or 'PR'. Images are modified or 'improved'. 'Safe spaces', filters and other interfaces and screens 'protect' those thought to be vulnerable from harsh realities. Many people seek solace, refuge, entertainment or escape into virtual environments or alternative worlds such as the Metaverse. Holograms and augmented versions of reality can be free of blemishes and unpleasant features.

As well as changing the relationships many people have with the natural world or representations of it, significant investments in the creation of alternative and sanitised realities, and the development, production, distribution and sales of devices that allow access to them and activities within them, also have environmental and social consequences. They can increase the severity of impact of certain risks. Consequences include increased need for energy and greater use of natural capital. Minerals are needed for new devices before they can be recycled from those at the end of their useful lives and further sources of supply can come on stream. Opening new mines can require long lead times. Social consequences, such as more use of social media and mobile devices add to energy and mineral demand.

Implications for Risk Management and Governance

The changing risk environment, growing severity of certain risk impacts and the increasing urgency of adaptation, mitigation and other individual, organisational and collective responses has implications for risk management, managers and governance. A shift of focus is required from individual and organisational risk to environmental and shared risk and from individual entities to value chains, networks of relationships and public-private and other collaborations and partnerships. This may require reduced preoccupation with virtual worlds and reconnecting with nature and natural eco-systems and their challenges in the 'real world'. A pause, reflection and a review of priorities may be necessary to ensure a sustainable future.

Given the existential threats they face, the sustainability of corporate operations, human activities, communities and societies cannot be assumed. Some boards may need to put more emphasis upon longer-term and higher impact risks, risk-led innovation, identifying and addressing points of weakness and vulnerability, collective responses and inter-relationships and inter-dependences between risks. Responsibilities and resources may need to be allocated to joining up, alignment and coordination and the initiation and support of transitions and transformation journeys. In fluid and evolving situations and contexts more informal liaison and collaboration between formal board and committee meetings may also be required.

Risk managers and other central units represent a cost. They should be encouraged to think about their contribution to achieving the purpose, goals and objectives of a company and the value they add. Contribution could include protecting and enhancing value, relationships, reputation and trust, and the perception of a company as a prepared, responsible and resilient business and collaborative partner. Those responsible for areas of special vulnerability could be asked to present their risks to the board. Compared with head office prepared and sanitised summary slides, being able to engage with and question those closer to the front line can give directors more of a feel for the nature of risks and what might be done about them.

Understanding Climate Related Risks

Climate change is a societal and governance risk as well as an environmental one and of growing concern to ESG investors and various other people and organisations. For many investors reputational, ethical and legal concerns may take priority over financial risks. The latter could include stranded assets that may need to be written down and disposed of. This is likely to significantly affect the prospects of businesses concerned with fossil fuels. For some companies, opportunities to help others to cope with climate change and related mitigation and adaptation activities could represent significant future revenue streams.

Communications concerning risks should highlight their consequences in terms that are relevant for engaging and eliciting action from those who can prepare for them and mitigate or otherwise respond to the threats they pose and/or their impacts. There are also related physical, technological, transitional and other risks and various possibilities to take account off. Risks to infrastructure and the built environment could be considerable, especially in areas liable to flooding and coastal inundation as a result of rising sea levels. Over time, insurance and reinsurance may no longer be available in a growing number of locations. Tightening legislation and regulations may also increase legal and regulatory risks.

Overall, climate risk is not easy to price or hedge as there are so many different facets to consider. Boards should take steps to limit exposure to climate related risks. These could include reducing carbon footprints, possible stranded assets and certain programmes. Selected divestments and collective action across supply and value chains may be required. Investors should periodically review the weighting of their portfolios. This could involve engagement with companies to assess their risk related intentions and assessing emerging opportunities.

Board Involvement with Risk

Contextual risks such as climate risks are increasingly crystalising as crises and referred to as crises or emergencies. When events with damaging consequences occur, it is often found by later investigators that people within the areas concerned knew of risks being run before they materialised or 'blew up'. Whistle-blowing arrangements should allow for the reporting of sensitive and other risks that people may be reluctant to raise with local and/or line management, or within a particular unit or group. Risks also need to be owned by people in business units and other groups. They cannot just be left to risk managers to address.

On occasion, past crises have had more traumatic impacts than might have been the case had risks initially reported not been watered down by layers of management, and not rung alarm bells when finally presented to boards. It can be helpful to hear from those directly responsible and affected how they view a risk and what help and support they feel would be helpful. Directors should ensure concerns reach them and are not 'edited out'. They need to know if there are issues that keep people awake at night. Boards should consider the portability as well as the resilience of corporate activities, operations and capabilities during transition journeys, or in the event of a requirement for re-location.

Potential and possibilities for reinvention, redesign and corporate role and contribution in different situations and contexts could be explored. While there is an opportunity to do so, contingency arrangements and early-stage preparations could be put in place. Boards may also need to take a view on what, where and how to disclose their own positions and plans in relation to climate risks. Some may find themselves facing multiple pressures for greater disclosure and tougher legal, regulatory and reporting frameworks with greater penalties for non-observance. The introduction of new and varying measures in different jurisdictions may increase policy, legal and regulatory risks and associated operating costs, particularly for international companies. Calls for harmonisation and standards may increase.

Risk Governance Arrangements

While standard models and pre-existing frameworks may help to set agendas in terms of what might need to be covered, risk governance arrangements should be organisation, situation and context specific. They should reflect a company's purpose, strategic direction and goals, capabilities, obligations and relationships, and the challenges and opportunities confronting it. Existing arrangements may give insufficient attention to emerging and slow-burn or longer-term risks that were not uppermost in people's minds when they were put in place. Such risks could be considered in more detail during particular meetings in a cycle, and/or during ad-hoc meetings to which additional and relevant people could also be invited.

Many companies bring risk and audit together under a single board committee and the programmes and priorities of both internal and external audit should be risk-led. Care needs to be taken to ensure that proper attention is devoted to non-financial risks, arrangements and controls, particularly at certain times of the year in the audit cycle. In a sector such as financial services in which risk and return are related, credit and market risks and economic factors such as inflation can influence interest rates. A dedicated risk committee might be desirable and in some jurisdictions it could be a regulatory and licence requirement.

Identified and prioritised risks can also inform board and executive talent and skill, and capability and relationship development programmes and strategies. They may also influence corporate purpose, priorities and strategies. Changing risk assessments may also influence judgements on the continuing desirability and cost-effectiveness of certain courses of action and particular decisions and their justification. Rather than just plough ahead, or periodically review after a standard interval, a watch should be kept of areas where a tipping or decision point might be reached, beyond which changing direction could become problematic and crawl-out costs prohibitive.

Board-Led Transitions

Some boards may be tempted to seek short-term competitive advantage by delaying moves to net zero and mitigation, adaptation and resilience initiatives. At some point however, they may face the challenge of catch-up expenditures at a time when other companies are able to exploit emerging arenas of opportunity while they struggle with divestments and the disposal of stranded assets, reputational damage and problems recruiting talent. Boards that advocate more responsible, healthier, less stressful and more fulfilling lifestyles, and initiate transition and transformation journeys to more sustainable operations, communities and societies that

© Institute of Directors, India I **www.iodglobal.com**

live in harmony with the natural world may unlock related opportunities and attract talent.

Investors that shun particular companies or dispose of their shares can lose the opportunity to influence their boards and be a force for beneficial change. They may need to take a longer-term view of prospects. These and criteria such as momentum or potential may be difficult to judge when there is uncertainty as to how companies might perform during transition and/or transformation journeys to net zero and/or sustainable operation. Collaboration and collective responses may allow early movers to shape purpose, aims and priorities. Imaginative boards seize opportunities rather than avoid risks. The 2023 World Conference on Environment Management and Climate Change will examine challenges and explore related possibilities. ■

*__Prof. Colin Coulson-Thomas__ *holds a portfolio of leadership roles and is IOD India's Director-General, UK and Europe. He has advised directors and boards in over 40 countries.*

Institute of Directors, India

BRINGING A SILENT REVOLUTION THROUGH **BOARDROOM**

Membership

Training

Masterclass for Directors
leading to **'Certified Corporate Director'**

Golden Peacock Awards

Organization for Non-Executive Independent Directors

Conferences

Board Research & Advisory

MSME Division

Publications

S H A R E • L E A R N • N E T W O R K

www.iodglobal.com

INSTITUTE OF DIRECTORS
M-56 A, Greater Kailash, Part - II (Market), New Delhi - 110048, India
Board Nos.: +91- 11- 41636294, 41636717, 41008704
Fax: +91- 11- 41008705 • Email: info@iodglobal.com

follow us on

@iodglobal