Directors’ Duty of Care in the 21st Century
Charles Sullivan, Member, Bond, Schoeneck & King

Aligning Risk Management Strategies:
A Director and Manager Point of View
Leon Berthiaume, Chief Executive Officer,
St. Albans Cooperative Creamery

Building a process for
Risk Assessment and Control
Jay McWatters, Partner, Dopkins & Company
Directors’ Duty of Care in the 21st Century

Charles Sullivan, Member, Bond, Schoeneck & King
Introduction/Overview

Director’s Fiduciary Duties

- **Primary duties:**
  - Duty of care
  - Duty of loyalty

- **Other duties:**
  - Duty of obedience
  - Duty of confidentiality
  - Duty of disclosure
Introduction/Overview

Role of the Board of Directors

- Oversight of Operation through Direction of CEO and Senior Staff
- Strategic Guidance, not Micromanagement
- Policy Setting
A. Director’s Fiduciary Duties
Duties of a Director

- A Director has legally enforceable duties to the owners (members) of the Cooperative.

- The members and the Cooperative may sue the Director **personally** for failures by the Director to properly discharge his or her duties.
Duties of a Director

• Each Director works for the benefit of the Cooperative and **all** of its **members**.

• A Director does **not** represent any subset of the membership.

• Generally, a Director owes two legal duties, a duty of **care** and a duty of **loyalty**.
Duty Of Care

I. Duty of Care

- A Director must perform his or her responsibilities with the degree of care that an ordinarily prudent person in a like position would use under similar circumstances.
Duty Of Care

Need to be Informed and Prepared

• Management should provide Directors sufficient information to enable Directors to make informed decisions.

• Directors should not be reluctant to request additional information in order to be fully informed.

• Directors should review all information and participate in an informed manner.
Duty Of Care

Right to Rely on Others

- A Director is entitled to rely (absent knowledge that would make the reliance unwarranted) on management performing their delegated responsibilities.
Duty Of Care

Reliance (Cont’d)

- Also, a Director is entitled to rely on information presented by the officers or employees whom the Director reasonably believes to be reliable and competent; legal counsel, public accountants and other professionals; and, board committees on which the Director does not serve.
Duty Of Care

Inquiry

- During Board meetings, a Director should inquire into potential problems or issues when alerted by circumstances or events which indicate that Board attention is appropriate.
Duty Of Care

Candor Among Directors

• Each Director must inform the other Directors and management about information material to Cooperative decisions of which the Director is aware.
Duty Of Care

Recap

- Need to be informed and prepared
- Right to rely on others
- Inquiry
- Candor among Directors
Duty Of Loyalty

II. Duty of Loyalty

• A Director must act in good faith in the best interests of the Cooperative and not in the Director's own interests or in the interest of another person or an organization with which the Director is associated.
Duty Of Loyalty

- A Director may be in breach of the duty of loyalty if he/she has a conflict of interest.
Duty Of Loyalty

Conflicts of Interest

- Each Director should be alert and sensitive to any interest the Director may have which might be considered to conflict with the best interests of the Cooperative.

- A transaction in which any Director has such an interest should be approved by the disinterested Directors.
Duty Of Loyalty

When a Director:

- has a financial, personal or business interest in a contract or transaction to which the Cooperative is to be a party; or
- is contemplating entering into a transaction that involves use of the Cooperative’s assets or competition against the Cooperative

the Director is considered to be “interested.”
Duty Of Loyalty

Independent Advice

- Independent advice, which may be confirmed by oral or written opinions, appraisals or evaluations from advisors, is often helpful when a transaction is significant and conflicts are involved.
Other Duties Of Directors

- Duty of Obedience
- Duty of Confidentiality
- Duty of Disclosure
Duty of Obedience

A Director should ensure that the Cooperative complies with applicable laws and regulations and its charter and bylaws.
Outside the Board Room

- Directors only act as a body – the Board of Directors. An individual Director has no independent legal authority.

- A Director should support the decisions of the Board.
Duty Of Confidentiality

A Director must keep confidential all information involving the Cooperative that has not been disclosed to the general membership or the general public.
Duty Of Confidentiality

A Director should avoid responding to inquiries from members and others for nonpublic information regarding the Cooperative.
Duty Of Confidentiality

A Director may disclose information to members and others which has been publicly disclosed by the Cooperative or which the Cooperative has authorized the Director to disclose.
Duty Of Confidentiality

- Unauthorized disclosure of nonpublic information may expose the Cooperative (and the Board) to claims by members harmed by the disclosure.

- Unauthorized disclosure of nonpublic information may trigger federal and/or state reporting requirements.
B. Role of the Board of Directors
Management of the Cooperative

The Board of Directors provides the general direction and oversight of the Cooperative and is responsible for providing effective and efficient management of the Cooperative.
Strategic Plan

To carry out its responsibilities, the Board should develop a strategic plan.
Strategic Plan, continued

1. Policies and Procedures

As part of its strategic plan, the Board of Directors should develop policies and procedures. These policies and procedures should be designed to support the Cooperative in best serving the interests and needs of its membership.

Comprehensive policies and procedures provide direction and instruction for officers, employees, and committees.
Strategic Plan, continued

Policies and procedures should be reviewed at least annually, and any policy changes should be reflected in the Board minutes. The Board should maintain a policy record book that contains a copy of each policy and the date of adoption or amendment.
Written policies and procedures should conform to the following guidelines:

a. Purpose should be clear and firm.

b. Consistent with the goals and objectives of the Cooperative.

c. Be in compliance with the applicable law.

d. Based on prudent and sound business practices.
Strategic Plan, continued

2. **Program Management**

   After establishing the policies and procedures, the Board is responsible for implementing them. To provide appropriate implementation, the Board should confirm (in its oversight role) the following:

   a. The staff members who are responsible for carrying out the policies and procedures are made aware of the intent and expected results.
b. Each policy statement contains a periodic reporting system to permit the Board to evaluate the effectiveness of the policy and amend the policy, as needed.

c. The efforts of the staff members responsible for implementing the policies and procedures are coordinated.
d. Unauthorized actions that can impede the financial growth and operations of the Cooperative are prevented.

e. Members are informed of the Cooperative’s progress.
The Role of the Board in Managing Risk

The Board’s Strategic Plan should address the elements of Managing Risk.
The Role of the Board in Managing Risk

- The Board should oversee the risk management policies and procedures that are developed and implemented by management.
- The Board should not be involved in daily risk management.
The Role of the Board in Managing Risk

• Risk management policies should be consistent with the Cooperative’s overall strategic plan and tolerance for risk.

• The Board should be satisfied that the risk management policies and procedures are functioning as expected and followed by management and staff.
The Role of the Board in Managing Risk

• Many organizations rely on the audit committee of the Board for general oversight of risk

• The Board should consider establishing one or more committees to oversee the various risks of the Cooperative.

• For example, the Board may establish
  • an information technology committee to oversee risks associated with cybersecurity
  • a food safety committee to oversee risks associated with food production
The Role of the Board in Managing Risk

• The Board’s oversight of risk management should be coordinated and promote a culture of risk awareness and appropriate actions by management and staff.

• A lack of comprehensive oversight in managing risk may subject Board members to a claim for breach of a fiduciary duty.
Aligning Risk Management Strategies: A Director and Manager Point of View

Leon Berthiaume, Chief Executive Officer, St. Albans Cooperative Creamery
The Underlying Concept Behind Risk Management

What do we intend to accomplish?

Events that threaten the attainment of those objectives

Not all risks are alike

- Avoid
- Reduce
- Share
- Accept

Are the responses working?
Why Have Risk Management Approaches Become More Prevalent?

- Customer requirements
- Investors want more information
- Regulatory and legal requirements
- Supply chain interruptions
- Cyber crime
- Catastrophic weather events
- Product recalls
CEO and Board Member Roles

- Understand the responsibilities of each
- Learn the Industry, the Environment, Regulatory Climate
- Access Industry Tools, Webinars, Reading Materials
- Alignment of the Board and CEO
- Question and Develop in your Roles
- Identify Tools, Measurements
- Trust and Transparency
Board Member and CEO Role

- **Board**: Long Term Perspective
- **CEO**: Focus on Day to Day
- **Board**: Informed/Information comes from CEO
- **CEO**: Continuous Attention
- **Board**: Develop Shared Vision, Strategies, Risk Appetite
- **CEO**: Short term time Frame Decisions
- **Board**: Evaluation
CEO Perspective on Risk Management

- Supports understanding of the risks across the Organization
- Prioritization of risks
- Basis for Recommendations to the board
- Connects the Board to Business Environment
- Prioritization of resources with the Board
- Keeps risks in the forefront of decisions
- Allows for measurement and progress
- Supports strategic planning
Board Member Perspective on Risk Management

- Focus on Strategy rather than tactics
- Allows for Board Orientation
- Identifies Areas of Focus and Emphasis
- Periodic Updates on the Status of Risks
- Evaluation of the Mitigation Strategies
- Redirection of the Strategic Plan
Cooperative Overview

**Business Factors/Operational**
- Employee Base - Succession Planning
- Legislative - Local/State/National

**Operational**
- Sourcing
- Logistics

**Legal**
- Regulatory

**Marketing**
- Competition

**Customer**
- Customers
- Product and Services

**Brand Protection**
- Social Media - Brand Protection

**Corporate Structure**
- Team
- Members
- Board
- CEO
Cooperative Organization

- Board
- Customer Concentration
- Supplier Concentration
- Insurance Coverage
- Business Risk Management Strategies
- Regulatory
- Preparation for Unplanned Disruption
Community Hospital

Board Oversight

• Accreditations (Highly reliable organization)
• Financial compliance/ Reimbursement
• Dashboard/ Quality Metrics
• Credentialing Process
• Changes in Health Care
• SurgicCenters/ Urgent Care
Community Bank

Board Oversight
- CAMELS Rating
- Risk Ratings- Low/ Medium/High
- Impact of interest rates- shock the rates
- Technology/Security
- Risk Appetite
  - Quality of investments- strategy
  - Loan Portfolio- concentrates
Board and CEO

Challenges

- Ensuring sufficient resources
- Agreeing to Risk Profile
- Measuring Risk
- Using risk management strategies
- Board Member Experiences and Knowledge
Risk Management

- Critical to Success of an Organization
- Essential in our Roles – CEO and Board Member
- Engagement of the Team
- A Defined Process and System
Building a process for Risk Assessment and Control

Jay McWatters, Partner, Dopkins & Company
Value of Implementing Formalized Risk Management Processes

- Establishes the language of risk throughout the organization
  - Begins to build a risk-management culture
- Pivot point between strategy and tactics
- Allows managers across the organization to understand risks and how they are prioritized
- Increases visibility on risk mitigation strategies and activities
- Establishes a baseline from which future progress can be monitored
- Allows for better continuity
The Practice of Managing Risk

- The history of risk management traces back to the beginnings of business
  - Formalized in late 1950’s
  - Enterprise Risk Management (ERM) as a holistic approach entered the scene in the 1970’s
- Full fledged ERM has since evolved into a “lifestyle”
- Since 2002, corporate risk assessments have formed the foundation of the universally used COSO internal control framework
The Practice of Managing Risk

- COSO has now developed a full-fledged ERM framework in addition to its internal control frameworks
  - In short, formalized risk assessments are a key component of all COSO frameworks
- Bottom line - understanding and documenting risk is becoming a much more prevalent focus in business today
## Risk Maturity Model

### Example maturity model for risk management

<table>
<thead>
<tr>
<th>Governance and Culture</th>
<th>Risk Identification</th>
<th>Risk Assessment</th>
<th>Response/Control</th>
<th>Monitoring and Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ad Hoc</td>
<td>Basic</td>
<td>Managed</td>
<td>Optimized</td>
<td></td>
</tr>
<tr>
<td>Informal or inconsistent</td>
<td>Meets basic stakeholder needs</td>
<td>Integrated into business operations</td>
<td>Supports the delivery of strategic objectives</td>
<td></td>
</tr>
</tbody>
</table>

**Governance and Culture**
- RM considered at certain levels of the business
- Adhoc risk identification
- General sense of most critical risks
- Loose association of business activities & risks
- Informal communication of risk

**Risk Identification**
- Risk committees with basic mandates and periodic interaction
- Infrequent risk identification performed by limited departments/functions
- Basic definitions for impact and likelihood
- Responses are delineated between existing controls and recommended actions
- High-level RM reporting (e.g. risk dashboard)

**Risk Assessment**
- "Three lines of defense" of RM operating
- Ongoing risk identification through formalized approaches
- Consistently applied criteria assessing risk both inherently and residually
- Response/control has accountability, specificity, and can be measured
- RM ‘check and challenge’ at all levels of the business

**Response/Control**
- RM directly informs business planning and supports decision-making
- Risk identification embedded across operations and activities
- Evaluation of risk appetite for each risk type
- Response/control is integrated into budgeting and other decision-making
- RM outputs used to optimize planning and decision-making

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Reflections on the Risk Maturity Model

- Ad Hoc does not mean that risks are not being managed
- One size does not fit all – need to consider what will work best for your business and culture
- Best to begin the journey somewhere and find the right fit for your organization – institute a risk management process

Must first understand the concept of the “Cascading of Risks”
Cascading of Risks – Staying Strategic

Objectives

- Strategic
- Operational
- Transactional

Entity
Division
Department
Process
Why Focus on Strategic Risks?

Strategic Risk Assessment

- Facilitated input from Board and multi-functional management

- Strategic objectives
  - Inventory of strategic risks
  - Ranked by importance
  - Recognized risk ownership
  - Mitigation strategies
  - Means to monitor and follow-up
Risk Assessment Process

1. Identify Strategic Objectives
2. Identify the risks which threaten them
3. Define Entity’s Risk Appetite
4. Assess and Prioritize
5. Respond and Monitor
Risk Assessment Framework

- A means to assess and prioritize risks
- Dual scale rating
- There is no one-size fits all – needs to be responsive to the organization
- Formalizes the entity’s level of risk tolerance
Typical Risk Responses

- Avoid
- Transfer or Share
- Mitigate
- Accept

We need to remember that risks are not always adverse
Building a Risk Management Process- Healthy Reminders

- There is more than one way forward – what fits with the culture?
- Tone at the Top – chance for failure increases exponentially without it
- Keep the assessment fresh and relevant
- Set up the right structure
- There will be dialogue and disagreement

Failure to work from the strategy level on down has been cited as a fatal flaw in many attempts to implement an assessment process
Benefits of Strategic Level Risk Assessment

- Better connects management and the board without turning agency’s culture on its head
- Less costly than an ERM
- Down payment on building a more risk-mature environment
- Eliminates silos
- Serves as a baseline for future concept development
- Begins to build a risk management culture
Thank You