VIRGINIA GALT

EXPLORING THE

UNKNOWN, UNTHINKABLE AND UNMEASURABLE

VOLATILE TIMES REQUIRE BOARDS TO CONSIDER POLITICAL EXPERTISE AND NEW RISK OVERSIGHT PROCESSES

For a time, after the 2008 financial crisis, the recruitment of directors with political expertise fell a little out of fashion. "What do they know about business?," the thinking went, as corporate boards placed a premium on people practised in navigating business adversity during the economic downturn.

Now, in the face of emerging geopolitical risks, some boards are asking: "Do we have someone who can make sense of the wild developments of 2016?"

With British citizens voting in a June referendum to pull out of the European Union, and United States president-elect Donald Trump pledging to rip up trade deals, boards want to understand what might actually happen, what the impact might be, and how they should position themselves to deal with growing protectionist sentiment and trade tensions. (Not to mention how their organization should respond if it becomes the target of one of Trump's critical Twitter attacks.)

While there are still many unknowns, boards with highly evolved risk-oversight processes are already well under way with their assessments of potential threats and opportunities.

It's not yet clear "what the exit from Brexit will look like" or how profoundly the Trump administration will change the business environment in the United States and around the world, said Bank of Montreal director Christine Edwards, who is a corporate partner in the Chicago office of Winston & Strawn LLP and chair of the law firm's bank regulatory practice.

"We don't know … what that [political] paradigm shift is going to look like, the positive changes, the negative changes," said Edwards, who also chairs BMO's governance committee.

"But we know a little more every day. … We can begin planning well, well in advance, and we can consider the range of possibilities," she said.

At the outset of her career, as a young lawyer, Edwards headed the government relations office in Washington, D.C., for her employer. Later, as corporate counsel for that same company, she retained responsibility for government relations at the local, state, federal and international levels.

"You never quite get that political perspective out of your system," she said in an interview. And directors who have those political instincts can bring an added perspective to board deliberations, she believes.

Indeed, when it comes to oversight of external risks beyond their control, all boards should reflect on whether they have enough "diversity of thinking" in their ranks to plan effectively in an increasingly complex and interconnected global environment, the Global Network of Director Institutes says in a soon-to-be released position paper entitled "Uncontrollable Risks: Principles for Board Action."

The identification of these risks requires not only innovations in the mapping of known risks, but also an exploration of "known unknowns," the "unthinkable," and the "unknowable," according to the global network, an organization that brings together member-based director associations from around the world with the aim of furthering good corporate governance.

In reflecting on these "unmeasurable but critical uncertainties … that are not included in the corporate risk statement," boards should also consider the best venue for the innovative thinking that's necessary for such discussions. Sometimes the conversation flows more freely in an informal setting, the paper suggests.

These are strategies that many well-governed corporate boards already employ.

For instance, while the pollsters and pundits got it wrong, predicting with certainty that Brexit was not going to happen, and that Hillary Clinton would win the U.S. election, many corporate boards had run their own scenarios to prepare for any eventuality, said global economist Dambisa Moyo, who serves as a director at Barrick Gold Corp., Seagate Technology PLC, Chevron Corp. and Barclays PLC.

"You say, 'Okay, what happens if Hillary Clinton wins, what happens if Donald Trump wins, what happens if Hillary Clinton wins the presidency but the Republicans control Congress?'

"So there's lots of scenario planning to try to understand what the environment might look like" and that can form the basis for action plans to address those various scenarios, she said.

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It's essential that boards draw on all the resources at their disposal to get as much visibility as possible on how external events are playing out, says Moyo, the author of *Winner Take All: China's Race for Resources and What it Means for the World.*

"We spend time with regulators, with politicians, with employees, with academics … to try to get a sense of their broader expectations around the future investment environment or the community environment in which the businesses operate," she said, adding that expectations around corporate and social responsibility have evolved "quite aggressively" in recent years.

"The best businesses focus heavily on making sure the information flow that actually ends up in the boardroom is accurate and as timely as possible," whether they are talking about the impact of interest rate increases and the

higher cost of borrowing, or the way the political winds are blowing.

"In terms of things like protectionism, there is a lot of data around this. The average trade negotiation takes seven years, so these things don't happen overnight; there's a little more of a slow burn. So very often you do have time to embed different scenarios and to engage with public policy makers and politicians to get more visibility on what is happening in the policy environment," Moyo said.

Well-governed boards have processes in place to deal in a balanced way with the unexpected, whether it's a natural disaster or an abrupt shift in public and political sentiment, "and are comfortable enough with their risk-assessment processes that they feel they can deal with the uncertainty," Edwards said.

"You analyze, you address what needs to be addressed, you put together an action plan and remain flexible enough that if there are other issues that need to be addressed, you can bring the team back together and create a correction to your action plan."

These are highly unusual times that call for more than good governance as usual, says Walid Hejazi, an associate professor of international business at the University of Toronto's Rotman School of Management and an instructor in the Institute of Corporate Directors' directors education program.

"I don't want to be an alarmist … but I believe that, with the rise of protectionist policies in the United States, the U.K. and several other countries … the geopolitical risks today are much greater than they were just five years ago," Hejazi said in an interview.

If Trump follows through with everything he has said he will do (including undoing the Obama administration's nuclear accord with Iran – potentially putting that country's US$16.6-billion order for planes from Boeing at risk – and imposing tariffs on imports from China and on goods from U.S. companies that move production offshore) there will be far-reaching implications, he said.

If Trump undermines the "One China" trade policy between Beijing and the United States, for instance, it could have a profound impact on Canadian ventures as well, said Hejazi, who is part of a Rotman team conducting a survey for the Canada-China Business Council on opportunities for enhanced trade and investment links.

"These are multifaceted and very, very complex geopolitical risks," said Hejazi, adding that a big part of a board's due diligence is knowing the right questions to ask. In this respect, he agrees with the Global Network of Director Institutes that board composition is critical.

"I believe on every single board there should be people who have finance, who have accounting, who have strategy, but also people who have geopolitical understandings of the major regions they are involved in. If they don't, they are exposing themselves to risk they may not understand, and this [issue] has become increasingly important."

In addition to looking to former politicians or corporate executives with extensive government relations experience, boards might consider recruiting former ambassadors who are familiar with the countries in which they do business, he suggested.

Drawing on lessons from the 2008 financial crisis, boards should also re-examine their risk-assessment models and expand their thinking about the realm of possibilities, Hejazi said.

"If you go back to the 2008 financial crisis, banks had these models as well. But the one thing we know in the aftermath of the 2008 crisis is that the stress-testing, the scenarios that the banks were testing themselves against, were not nearly as extreme as what actually happened. … They didn't realize that things could be so bad."

On the other hand, there are times when the worst-case scenario does not play out, said Edwards, whose first year working in Washington coincided with the first year of Ronald Reagan's presidency.

"People thought of him as a Hollywood movie star, and what did he know about running our country? There were concerns about what this would mean to all the advances people had worked for, things like equal employment opportunity and fair lending … but the truth of the matter was it wasn't all rolled back; it was part of the fabric of the way people operated and they didn't want to change back again," Edwards said.

"That's why I think in a very balanced way about these things. It's important to defend areas of progress [from being dismantled], but also to recognize there are some opportunities there, too."

As the Global Network of Director Institutes notes: "The ability of a company to successfully adapt its business and processes is the very essence of corporate resilience."

VIRGINIA GALT, a former business and education reporter for *The Globe and Mail*, covers legal, education and management issues for a number of publications.