West Audit Committee Network - North Chapter

June 2019

SUMMARY of THEMES

Privacy, risk, and transactions

Members of the North Chapter of the West Audit Committee Network (WACN) met in Palo Alto, CA, on June 10, 2019, for discussions on data privacy, risk management, and major transactions. This *Summary of Themes* provides a brief overview of the meeting.[1] *For a full list of meeting participants, please see the list on page 5.*

The risks and opportunities of data privacy

Companies must balance opportunities to capitalize on access to vast quantities of data with the legal and reputational consequences of misusing that data. Cisco's Harvey Jang and EY's Angela Saverice-Rohan joined members to discuss the privacy landscape:

- **New legal requirements provide a floor for privacy practices.** Ms. Saverice-Rohan updated members on privacy-related legal requirements, focusing on the EU's General Data Protection Regulation (GDPR), the California Consumer Privacy Act (CCPA), and pending state and federal legislation. She said, *"GDPR is the most transformative privacy law we have ever seen, with 384 requirements for companies to operationalize."* While the GDPR itself focused on protecting EU citizens, many US-based companies have followed its principles when designing their privacy policies. State and federal legislators are considering additional privacy laws. Ms. Saverice-Rohan said, *"Privacy legislation is being debated in at least 30 states. The CCPA is effective in January 2020, with new protections. There is also the possibility of federal legislation. One area of contention is whether a new federal law would preempt state law—some California representatives argue that the CCPA's forthcoming protections should act as a floor."*

- **Reputational risk is a key consideration.** Privacy is about more than just compliance. Mr. Jang explained, *"Customers want companies to be transparent about what data they are handling and to be accountable for ensuring the right controls are in place to protect that data."* Ms. Saverice-Rohan added, *"The most important angle is customer perception. You may never get investigated or sued, but these issues are heavily framed by the media. Companies must manage for this."* Members discussed the challenge of determining—in the face of rapidly changing expectations—whether a practice is acceptable. One said, *"Generational views of privacy differ—kids post everything online. Companies need to use common sense. Consider, if it sees daylight, how would it make the company look?"* Mr. Jang said that obtaining true consent has nearly become impossible to achieve in the product arena: *"True, effective consent means fully informed, freely given, and revocable at any time without consequence."*

- **Privacy is a tool for differentiation.** One result of broader attention to privacy issues is that certain features are now being considered earlier in the product or service development process. Mr. Jang discussed the concept of privacy by design: *"It is thinking at inception about the data you are handling, the impact and risk to privacy, and injecting an appropriate level of protection, controls, and functionality that you think a customer might need to meet their requirements."* Ms. Saverice-Rohan added, *"Some companies see this as an opportunity. They view privacy as a consumer touchpoint and build privacy into their products as a method of differentiation."*
- **Considerations for board oversight.** Mr. Jang encouraged members to give privacy a closer look: *"The board should understand the company's data—what is being collected and processed and how data is being used—the board should decide - is that use appropriate and in line with the company's ethos and values? What does the company stand for?"* Ms. Saverice-Rohan said that while customers are important, directors should ensure that their companies protect all stakeholders: *"Many companies are prioritizing their customers, but in reality, employees will not like the narrative that you care more about consumers, so that needs to be managed."*

Board oversight of risk

While enterprise risk management is relatively mature in members' organizations, questions remain about how to enhance and improve board oversight of risk. Members explored different approaches:

- **Assigning board oversight.** The audit committee often owns the process for delegating risk oversight responsibilities. One member described a division in which the full board retains strategic risks while the audit committee handles operational ones: *"Oversight of risk is a full board responsibility, but the audit committee leads the rigorous process of mapping the risks. The risks assigned to the board are the flip side of strategy and the audit committee takes the risks that require us to dig deeper."* When risks are divided among the board and its committees, close communication can help to avoid gaps or overlaps in coverage. Members also considered the merits of having a board-level risk committee. One described the decision to create one: *"We found the agenda was getting packed at the audit committee and when we added cyber, it just became too much. The risk committee is able to have deeper conversations with the business units about specific items."*
- **Defining management ownership.** Some members' companies have a chief risk officer who provides centralized reports to the boards; in most cases, however, management-level ownership of risk is assigned to an executive with other responsibilities in the organization. Members noted that regardless of who presents the overall risk assessment, boards should also engage directly with the business-level owners of individual risks. The cadence of board-level risk reviews varies. Some members review it every meeting, while others review it annually.

- **Assessing risk identification practices.** Companies follow robust processes to identify their top threats. One member said, *"We survey both the board and management for their top 10 risks. When we see discrepancies, we like to use external data to validate the risks. We then have a discussion based on wholistic data to decide what the company should prioritize."* The process only works when the board gets the full picture, not a sugar-coated version. One said, *"Trust and transparency are driven from the top down. Prioritizing those traits is of the utmost importance."* Low-probability, high-impact risks are especially challenging to identify and quantify. Members suggested that even if you cannot predict the exact risk that will hit the company, it is critical to have a crisis management plan in place. One added, *"You need to run exercises. Some people have a crisis and forget there is a plan in place because they don't practice."*

Board involvement in major transactions

Boards spend significant time and resources exploring corporate transactions. Colin Stewart, managing director and vice chair at Morgan Stanley, joined members to discuss the current deal environment and oversight of major transactions. They covered several topics:

- **Ongoing US economic expansion.** Mr. Stewart told members, *"The US economy is closing in on 10 years in the current economic expansion, approaching the longest expansion in US history. While no one is predicting an imminent recession, factors including trade, tariffs, and interest rates are causing some angst about what is coming next."* He noted that sustained low interest rates might make it more difficult for policy makers to intervene should the economy turn. He also discussed the barriers to companies going public: *"People expected 2019 to be a banner year for IPOs, but despite many high-profile IPOs, the number of IPOs is actually down while the dollar amount is actually up. This is mostly due to stretched valuations, companies staying private longer, and a wave of consolidation. Investors who buy public companies are now involved in the private markets, so an IPO today isn't really an IPO. There isn't as much scarcity value, especially for the large companies who have been active in the private financing market."*

- **Opportunities and risks of major transactions.** Members discussed how transactions often fail to produce the intended results which presents challenges for companies and their boards. Mr. Stewart said that it can be difficult for a board to meet the market's high expectations for a transaction, given the unintended consequences. Mr. Stewart offered some guidance for members and opined that some transactions are more likely to achieve success than others: *"The most successful transactions come about when you take an amazing product or technology and combine it with an amazing sales force. That alone can pay for itself."* He also cautioned members to be wary of alliances: *"Partnerships can be difficult to manage because the parties do not always share the same goals. As the Chinese saying goes, 'shared pillow, different dreams.'"*

- **Board approaches to due diligence and integration efforts.** Members discussed various tactics to handle some common hurdles that arise during a major transaction. One stressed the importance of pre-deal thoroughness: *"On significant deals, the board is heavily involved in the due diligence process and closely scrutinizes the information presented."* Another added, *"For smaller transactions, it is helpful to have a subset of the group talk through the transaction. With bigger deals, you need full board involvement."* Members offered suggestions for integration oversight. One said, *"Boards don't always have the discipline to look at how the deal is lining up to expectations after it is completed. This leads to integration issues."* One member described an approach to combat these issues: *"We had a director who forced a highly disciplined process. The team knew they needed a good idea to present to the board because we would provide sign-off and then hold that person accountable for the results. That mentality forced self-policing and worked well."*

Meeting participants

- Raman Chitkara, Xilinx
- Henry DeNero, Western Digital
- Jeff Epstein, Twilio
- Earl Fry, Hawaiian Holdings
- Steve Gomo, Micron Technology
- Bala Iyer, Power Integrations and Skyworks Solutions
- Mercedes Johnson, Synopsys *(SWACN member)*
- Ed Lamb, Real Industry *(WACN South member)*
- Lou Lavigne, DocuSign and Zynga, Inc.
- Cathy Lego, Cypress Semiconductor
- Chuck Robel, GoDaddy and Model N
- Karen Rogge, KEMET
- Peter Taylor, Edison International *(WACN South member)*
- Hilliard Terry, Umpqua Bank
- Malia Wasson, Columbia Sportswear

EY was represented by the following:

- Lee Dutra, San Francisco Office Managing Partner and West Region Center for Board Matters Leader
- Frank Mahoney, Americas Vice Chair, Assurance Services and incoming West Region Managing Partner
- Kay Matthews, Vice Chair and West Region Managing Partner
- Mike Verbeck, West Region Assurance Managing Partner

Endnotes

[1] *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. Guests, however, have given permission for their remarks to be attributed. Comments by guests and network members are shown in italics.