West Audit Committee Network - South Chapter

June 2019

WACN South

SUMMARY of THEMES

Privacy, risk, and transactions

Members of the South Chapter of the West Audit Committee Network (WACN) met in Santa Monica on May 23, 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 Phil Nemmers joined members to discuss the privacy landscape:

- **Evolving legal requirements provide a floor for privacy practices.** Mr. Nemmers updated members on privacy-related legal requirements, focusing on the EU's General Data Protection Regulation, California's Consumer Privacy Act, and pending state and federal legislation. He said, *"There are at least 30 states where privacy is being debated at some level. One area to watch is whether federal legislation will include national preemption. There is some desire by California representatives not to have the law here preempted, but there are benefits to having a single set of rules."*

- **Reputational risk is a key consideration.** Members and guests agreed that 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."* Members discussed the challenge of determining—in the face of rapidly changing expectations—whether a use is *"creepy or cool."* One said, *"Companies can choose to exploit consumer data because it helps drive the business model, but at some point consumers could decide they don't want to be the product anymore."* Mr. Nemmers said that obtaining true consent helps minimize risk: *"The goal is a consent policy that is crisp and easy to understand, without being too long."*

- **Privacy is related to, but distinct from, data security.** While privacy is often linked to data security and cybersecurity, it covers a broader range of issues. Mr. Jang said, *"Security is the foundation for privacy—you can't have privacy without security. But privacy is more subjective. Security focuses on preventing unauthorized access, while privacy looks at abuse of data by those authorized to have it."* One implication of broader attention to these issues is that privacy is now being considered earlier in the product or service development process. Mr. Jang discussed the concept of privacy by design: *"When a new* *product is in the development stage, it's important to consider the impact and risk to privacy and ensure the product has the features and functionality to honor an individual's rights. Each company needs to make a judgement call on exactly how much to invest and how to design these features, but the key is to consider privacy early in the process."*

- **Considerations for board oversight.** Members discussed how privacy oversight is organized at their companies; in most cases it is an issue for the audit committee or full board. One said, *"We house privacy at the full board because we think it can be a competitive advantage if handled correctly. It's a strategy issue for us."* Mr. Nemmers urged members to go deeper on privacy: *"The board should understand the ethics of how the company is using data. If the company had to defend its practices publicly, how comfortable would you be? Don't be caught blindsided. Ask 'why?' all the time."*

Board oversight of risk

While Enterprise Risk Management (ERM) 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: *"The audit committee tends to do more deep dives on some of the emerging risk areas to understand the details and nuances of certain risks when time is not available for the full board."* Members seek to avoid gaps or overlaps in coverage. One said, *"We go through the list of risks, delegate them, and allocate specific time in future meetings to discuss each one. We find this mapping system to be helpful."* Another discussed the importance of ongoing communication: *"We have four standing committees and we have a practice of meeting as chairs ahead of each board meeting to share updates on anything pertinent related to risk—that's how we handle overlapping responsibilities."*

- **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. A member said, *"There is no real magic to who runs the risk process. In one company, our ERM approach is strategic and the process boils down to four or five key risks with key owners and dashboards. It is run by the treasurer. It seems an unlikely choice but it works well for that company."* The cadence of board-level ERM reviews varies by company. Some members review it every meeting, while others review it annually. One member noted the importance of assigning an individual business owner for each risk and hearing from the owners directly: *"When we felt certain risks weren't getting proper attention, we brought in the risk owner from the business and it was so effective for putting a different lens on the conversation that we are now calendaring all of them."*

- **Assessing risk identification and mitigation processes.** Members described robust processes to identify top threats to their businesses. One said, *"Our company conducts interviews with top management and the board to identify a top 10 list. Some items are more operational, some are further out, black-swan-type risks. So we get together and have a dialogue about it, which is helpful in getting to a better list."* Members favored including a wide range of perspectives in the process. One said, *"If we see discrepancies between management's top 10 list and the board's, we have internal audit walk us through the risk identification process and explain which risks were ranked by which department."* Another member added, *"We bring in a third-party to do a review of our top risks. It provides the benefit of fresh eyes and industry experience and brings up many considerations for management."* Members raised the challenge of risk quantification, with one saying, *"You can spend lots of time working on quantifying risks and still miss big things. It's a good idea in fields where risks can be quantified, but it's not value-added work in every industry."* Low-probability, high-impact risks are especially difficult to identify and quantify. One member had a suggestion: *"Talking about how to handle those risks and putting playbooks together helps prepare the team for the unexpected."*

Board involvement in major transactions

Boards spend significant time and resources exploring corporate transactions. Simon Furie, managing director at Lazard, joined members to discuss the current deal environment and oversight of major transactions. They covered several topics:

- **The environment for M&A is cooling.** Mr. Furie attributed a recent slowdown in mergers and acquisitions to factors including modest economic growth in the US, stagnant growth in Europe, uncertainty about Brexit, declining CEO and consumer confidence, and trade tensions. He added, *"Despite a number of high-profile deals recently, deals greater than $10 billion have actually declined. Global deal volume is down 16%, but in the US we are up 2% year-to-date through April."* Yet members noted that private equity investors and others are still actively looking to deploy a great deal of capital. Mr. Furie agreed: *"Interest rates are still historically cheap, which makes capital and leverage readily available."* Despite the recent uptick in IPOs, some members were concerned about companies remaining private for longer periods of time. One said, *"We have seen a massive reduction in the number of listed companies because of the private equity money available. Investment opportunities for Main Street are becoming less available."*

- **Boards are doing more to vet potential acquisitions.** Members said that management teams are presenting potential acquisitions to their boards earlier in the process. One said, *"Management has become more inclusive of the board in sharing what deals are out there so that when they want to act, the board is already aware and supportive."* Though transaction oversight tends to be an issue for the full board, one member discussed a response to industry disruption: *"We created a separate strategic review committee where* *we review all M&A opportunities presented by management, among other things."* Members acknowledged that the price for many deals appears high. While it is important to maintain discipline, one member said, *"I find the board has to coach management to be less strict on pricing. An extra dollar per share is really okay if it is important to the strategy."*

- **Successful integration remains a major challenge.** *"The majority of deals that fall apart do so in the integration phase due to poor execution and a lack of synergies. It's important to drill down on these issues up front,"* said Mr. Furie. Members offered suggestions for integration oversight. One said, *"It's important to have integration strategy discussion up front. In some cases, you want to shed the old brand and name immediately, but in others it may make sense to hold things separately for a while. It is a place where the board can offer guidance."* Another added, *"I recommend looking back 12 and 24 months post-transaction and having management discuss what they thought would happen versus what actually happened. It's an illuminating process and it drives accountability."*

Meeting participants

- Kimberly Alexy, FireEye
- Judy Bruner, Seagate Technology and Varian Medical Systems *(WACN North member)*
- Vanessa Chang, Transocean
- Traci Dolan, Steel Dynamics
- Burl East, Comunidad Realty Partners
- David Engelman, Private Bancorp of America
- Matt Fust, Ultragenyx Pharmaceutical *(WACN North member)*
- Richard Goodman, Adient and Western Union
- Leslie Heisz, Edwards Lifesciences
- Diana Laing, Macerich
- Sara Lewis, Sun Life Financial and Weyerhaeuser
- Dick Poladian, Occidental Petroleum and Public Storage
- Stephanie Streeter, Kohl's
- Joe Tesoriero, Smart & Final Stores

EY was represented by:

- Todd Moody, West Region Markets and Accounts 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.