Exclusive Interview

"Business processes for enterprise risk management deployed within Pakistani enterprises are mostly in the developing phase and have not reached advanced levels of maturity, barring some exceptions"

Mian Imtiazuddin
Chairman, Enterprise Risk Committee Pakistan Petroleum Limited (PPL)

ICMA: What are the specific roles of the (Board) Enterprise Risk Committee in any organization?

Imtiazuddin: Risk management is no longer considered simply a business and operational responsibility of management; it has become a governance issue that is squarely within the oversight responsibility of the board. The Board of Directors, through their risk oversight role, not only design risk policies but also ensure that the policies and procedures implemented by the company's senior management and enterprise risk manager are consistent with the corporate strategy, the risk appetite, and that necessary steps are taken to foster an enterprise-wide culture that supports appropriate risk awareness, behaviors and judgments about risks.

In compliance with statutory requirements, such as Public Sector Rules 2013, the Board is required to set up a Board Enterprise Risk Committee to support it in reviewing and overseeing the risk function. This Committee oversees the identification and monitoring of the principal risks and opportunities faced by the organization and ensures that appropriate controls are in place to mitigate these risks, including safeguarding the company's interests against operational, strategic, financial, commercial, reporting, compliance, and reputational risks. The Board and the Committee should regularly review the company's risk management system with management.

The board should not be involved in actual day-to-day risk management; this is delegated to the management team, which ensures that the first two lines of defense, management controls, and risk control & compliance oversight functions, including a dedicated ERM department, should be in place. It is the responsibility of the ERM department to ensure that well-defined and consistent risk management processes, tools, and techniques are applied across the entire organization.

ICMA: What types of operational, financial, and strategic risks are generally faced by Pakistani enterprises?

Imtiazuddin: Pakistan is currently experiencing a very challenging and unstable business environment. The unpredictable political climate and impending economic crisis have created many uncertainties within the business community. All this is further aggravated by the disastrous floods that have destroyed infrastructure, dwellings, food stocks, and standing crops.

On the financial front, the country remains on monitoring lists by global financial agencies (such as FATF's grey list), a dampening effect on borrowing, making it a difficult choice globally for doing business. The global economic downturn led primarily by the war in Ukraine has caused prices of key commodities to rise sharply and brought about a shortage of Oil, Gas, and Grain. Its immediate aftermath is reduced foreign investments and negatively impacts export-oriented companies.

A high risk of a possible national default against outstanding public debt payments can inflict severe economic costs to society, which is already reeling from the pain of inflation, driven by low exports, low employment, and a depressed manufacturing sector. A currency that is getting weaker day by day and consequent high inflation levels have made supply and equipment procurement expensive. In addition, the low purchasing power of a majority of the population has taken a multiplier hit, brought about by recent climatic disasters that have generally lowered demand.

> "Crisis management and business continuity planning took center stage as the pandemic broke out and this scenario led to bridging some of the separations between the two processes viz. ERM and BCM"

Strategically, government policies lack consistency and clear direction and generally are not devised with long-term benefits and overall stability in sight. In general, policies are not business-friendly; a recent example is the imposition of a super-tax. High level policy flaws, inconsistencies and weaknesses have given rise to unique issues, such as a whopping generation of circular debt within the energy sector, which is only experiencing growth.

Operational risks are burdened by poor infrastructure, which adds to the cost of doing business. Weaknesses in our legal system are not attractive for foreign investments and the security situation makes the country a high-risk working environment. This, among other reasons, has led to the exit of most of the big players from the energy sector. It certainly dampens the willingness of foreign partners to work in such an environment. It prevents business operations in some parts of the country since there is restricted freedom of movement due to the risks resulting from a weak law and order situation. Our bureaucratic processes, lack of stable power supply, and increasing electricity costs are unfriendly environment for a thriving business sector.

Mr. Ather Saleem, Vice President & Chairman, R&P Committee and Mian Imtiazuddin, Chairman, Enterprise Risk Committee, Pakistan Petroleum Limited (PPL) during meeting for his interview

ICMA: What are the key elements of an effective risk management strategy in the petroleum industry?

Imtiazuddin: There are three main segments in our industry which are:

1) **Upstream** - comprising exploration & production (E&P) companies
2) **Midstream** - comprising pipeline and road transportation companies, and lastly,
3) **Downstream** - comprises oil refineries, petrochemical plants, petroleum products distributors, and natural gas distribution companies.

The nature of risks faced by each segment varies due to differences in the nature of their operations. PPL being a hydrocarbon exploration and production company is part of the Oil & Gas upstream sector, and here, I will mention some of the major risks involved and our corresponding risk management strategies.

Risk management in petroleum exploration must keep in view the high-risk nature of petroleum exploration, of which a major element is the geological risk. Globally, the success ratio for exploration wells is less than 30% (in most cases 1 in 10).

Geological uncertainty must be reduced by the acquisition and thorough evaluation of Geological & Geophysical (G&G) data using the best available technology. Sharing the risk with joint venture partners is at times necessary for small-sized companies to mitigate exploration risks. In addition, the value of discovery is influenced by the following factors:

a) Size of discovery
b) Quality of oil or gas discovered, and
c) Proximity to infrastructure (markets)

Any exploration failures, no doubt contribute to failure in replenishing reserves. Reserves are used in share valuation by the stock market.

Other key risks faced by E&P companies are discovery monetization risks due to commercialization challenges. A majority of such risk is driven by the slow pace of regulatory approvals, allocations, and pricing. Market risks include volatility of global crude oil prices. Operational risks are impacted by the environment, occupational health & safety standards, process safety, well safety including blowouts, physical security, IT & OT cybersecurity, and legal & regulatory compliance.

Selection of appropriate risk management strategy depends on a range of factors, including risk nature, mitigation options available, risk manageability, etc. An Oil Company may decide to either mitigate, transfer, avoid or accept the risk exposure subject to the Company's risk appetite, strategic objectives, and constraints.

ICMA: What are the emerging ERM best practices that Pakistani enterprises need to adopt for sustainability?

Imtiazuddin: Before we speak of sustainable practices' adoption in the ERM domain, I would like to define sustainability risk as an uncertain social or environmental event or condition that can cause a significant negative impact on the company's bottom line or reputation. Alternately, it can be referred to as humanity meeting its current needs without overburdening the natural environment or future generations as defined by the Global Association of Risk Professionals, USA.

Sustainability in itself is a broad category; ranking firms on environmental, social, and governance (ESG) performance lies within the ambit of sustainability, and therefore, through increased focus on ESG-related risks ERM frameworks contribute to establishing sustainable practices. Well-known and established ERM frameworks, such as COSO (Committee of the Sponsoring Organizations of the Treadway Commission) ERM frameworks, have issued guidance regarding their application to ESG risks. Such ERM practices include identifying sustainability-related risks based on key ESG issues. Particular actions are outlined throughout the guidance to help an entity in identifying and managing the ESG-related risks of today while maintaining the capability of adapting and responding to the megatrends of tomorrow. These actions pertain to governance and culture, strategy and objective setting, performance, review, and reporting against ESG risks.

There is a realization that since ESG-related risks are managed and disclosed by a team of sustainability specialists and viewed as separate or less significant than conventional strategic, operational, or financial risks, leads to a range of biases against ESG-related risks. To address such biases, Pakistani enterprises need to manage enterprise risks while adopting guidelines as described in such established frameworks.

> “Scenario planning and foresight management are indeed an essential part of effective enterprise risk management”

Sustainability also pertains to the business environment, pricing, supply & demand, and of course the efficiency of the company. All such elements must be regularly reviewed in a holistic framework and the business model fine-tuned accordingly.

ICMA: As the Chairman of the Board Enterprise Risk Committee, how were you involved in pre-COVID-19 crisis management and business continuity planning? Did this change during the pandemic?

Imtiazuddin: Business continuity planning (BCP) and crisis management are natural components of ERM since all the resources and plans that make up a business continuity plan are developed to address business interruption risk in an organization and should be part of a comprehensive mitigation plan for all the enterprise risks.

Before the pandemic, the Board Enterprise Risk Committee would review business continuity planning to address process gaps, thereby enabling PPL to continue critical operations. In order that incidents causing business interruption and risks arising out of such incidents to be minimized to an acceptable level.

Crisis management and business continuity planning took center stage as the pandemic broke out and this scenario led to bridging some of the separations between the two processes viz. ERM and BCM. Examples of such bridging periods included the second and third quarters of the calendar year 2020 when the scenario analyses for residual risk assessment were frequently analyzed by ERM whereas continuous incident monitoring and implementation of business continuity measures were done in parallel by BCP teams. This was overseen by the direction of the Board Enterprise Risk Committee.

During the pandemic, it became evident that certain scenarios were not covered in the existing approved business continuity plans, and had to be modified, such as the possibility of full-scale working from home.

ICMA: How has the COVID-19 pandemic changed the ERM approach to identifying and managing risks?

Imtiazuddin: COVID-19 pandemic has been referred to at times, as a "Black Swan" event that has an unexpectedly huge impact and is unpredictable. The pandemic and the following events, including the global lockdown of unprecedented scale and oil price collapse, highlighted certain gaps or areas of improvement in many of the corporate ERM frameworks and practices in the country and outside.

The "Outbreak" has shown the clear business benefits of managing risk from an enterprise-wide perspective. It red-flagged the impact of a pandemic that was underestimated and unprecedented in both magnitude and dimension. One key realization was that the pandemic imposed threats to any entity's overall strategic objectives and emphasized that risk management approaches in many organizations needed a substantial redefinition. Unprecedented events lead to a total revision of underlying risk management plans.

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The first new gap was the lack of Biosecurity risk area in the Risk Appetite Frameworks. Statements defining risk appetite breach limits in this area were included in the frameworks on the lines of "occurrence of biosecurity incidents, such as the spread of infectious diseases, resulting in a fatality, restricted work conditions or unavailability of a certain portion of the Company's staff strength."

Secondly, the importance of certain risk assessment techniques, particularly scenario analysis, gained focus, as their use enabled the impact assessment of these new risk events on a Company's operations and business strategies. Extreme impacts on the Company's operations were observed during that period, such as drastic demand reduction, forced production curtailments due to lockdown, etc. This mandated conducting stress testing on the Company's integrated models for such scenarios to establish the worst outcomes possible and devise mitigation plans accordingly.

Thirdly, the pandemic emphasized establishing strong links between independent business processes of Enterprise Risk Management (ERM) and Business Continuity Planning (BCP). To combat the spread of the disease, appropriate SOPs were enforced within all the organizations throughout the period to ensure social distancing at company premises, along with work-from-home directives and mandatory vaccination for all staff and their immediate family members.

Lastly, the pandemic was exactly the type of fast-emerging risk with uncertain consequences that are often ignored until it becomes too late for traditional escalation procedures to be effective. When reports of lockdown came from China, most organizations in other parts of the world had weeks to act on this information but chose to wait and see. For such events, the threshold for escalation in traditional ERM systems was too high because it relied on a trigger where operations have already been badly affected. Only better-prepared companies responded to news of minimal spread and rapidly drafted contingencies before the situation deteriorated further and went out of control. Redefining ERM processes to early identification of fast-developing risks was a major takeaway for risk managers and senior executives.

I am pleased to mention that PPL proactively implemented a successful work-from-home program with the use of technology; work-from-home was started on 19 March 2020.

ICMA: How can scenario planning and foresight management supplement enterprise risk management?

Imtiazuddin: Scenario planning and foresight management are indeed an essential part of effective enterprise risk management. Given that the contemporary world is an ever-changing mix of political, social, economic, and climatic changes, advanced attention to scenario planning is essential to ensure preparedness and resilience for a range of situations in case they occur. All this feeds into a successful sustainability model.

Scenario planning has, in more recent decades, been applied to a wide variety of challenges at global and corporate levels to capture uncertainty limits and assess risk levels. A notable example at the global level is that of Climate Change, for which scenario analyses are performed using computer simulations known as the Global Climate Model (GCM). Many of the best risk assessment methods rely quite heavily on scenario analysis. Modeling and analyzing risk through the use of scenarios help companies and institutions to prepare for various possible risk outcomes. In often cases, reference scenarios get established and are commonly used across industries. Financial firms use scenario analysis for portfolio risk management and stress testing as well as pre-emptively in portfolio selection. Corporations conduct scenario analysis for mitigation of operational risk and resiliency planning.

When we consider the recent global and regional events, such as the increasing volatility the global economy is currently facing due to climatic disasters, pandemics, political and military conflicts causing supply disruptions, and high inflation levels, we could clearly see the necessity for conducting scenario analysis periodically at least for the key parameters that could potentially impact the corporation's bottom line significantly, such as oil price, foreign exchange currency rates, etc.

Modeling the financial and other impacts of adverse movements of such key parameters can allow a company to better plan mitigation strategies.

ICMA: Are Pakistani enterprises investing in risk management technology and data analytics? Do you think adopting technology can help improve risk assessment, especially in the petroleum sector?

Imtiazuddin: Enterprise Risk Management is still a relatively new concept in Pakistan but one that is quickly gaining traction as a necessity for sustainable business operations. Business processes for enterprise risk management deployed within Pakistani enterprises are mostly in the developing phase and have not reached advanced levels of maturity, barring some exceptions. The extensive value that comprehensive risk management systems could add to the business started getting recognized particularly during the second half of the 2010 decade, and emphasis was initially more on the operational side.

With the passing of time, risk management has started making inroads into the strategic side as well and this is where the role of data analytics and other advanced technological tools has become particularly very useful and important.

As the field is in the growth phase, the current deployment of technological solutions for risk management is not optimum in Pakistan except for instance in the banking sector. However, it is expected that more and more organizations in Pakistan will invest in advanced tools as traditional methods of risk management are not efficient. Given the risky nature of the petroleum business, it is imperative to exploit the power of data analytics and other scientific & engineering tools at each step of the risk management process which can detect lurking and trending risks and can promote real-time risk reporting to optimize management decisions.

Such toolsets, entailing financial, economic, and technical models among other features, can not only support enterprises in reaching better, risk-aware decisions but can also be crucial at the governmental level, if appropriately utilized, for devising effective public policies that are able to mitigate certain critical risks at the macro-level. Data analytics, when carried out using integrated enterprise data platforms, can present a panoramic view of the internal and external technical and business environments. Such a holistic picture can significantly improve the quality of the risk assessments and monitoring of risk movements over time and under different situations & scenarios.

Such tools and technologies, however, will also require organizations to go the extra mile and make extra efforts for acquiring and maintaining reliable data related to possible risk scenarios. At the end of the day, "if tools are not used properly, they do not add any value."

I have the pleasure to add that PPL has started utilizing technological solutions for enterprise risk management and is considering switching to advanced tools to improve the effectiveness and capability of the ERM process.

ICMA: How the recent devastating floods in Pakistan would pose threats to the productivity and supply chain of the Pakistani enterprises? Do you have a risk management plan to deal with this issue?

Imtiazuddin: The recent flooding in Pakistan due to torrential rains in association with higher than normal glacier melt has compounded the existing economic and public health crisis in the country. While the major brunt of the crisis is, unfortunately, being borne by the poor and vulnerable groups of the country, the destruction of crops, homes, infrastructure (roads, bridges, etc.), and livestock will have a huge spillover effect on the rest of the economy. The textile sector is particularly dented by these events and is expected to suffer due to its reliance on the mostly destroyed cotton crop.

These disastrous and cataclysmic flash floods are expected to have lingering impacts. They may lead to indirect damage of greater proportions to society and companies, even outside the flooded area. The impact of floods on at-risk businesses and their supply chains will vary widely, depending on how alert, prepared, and responsive to supply chain risk an individual company was. This will also depend on investments done earlier for making their supply chains resilient. Another factor will be the presence of manufacturing or shipping companies in the flood-affected areas leading to disruptions in their respective product supply chains.

Pakistan is one of the world's most vulnerable countries to climate change, according to a number of studies including the Global Climate Risk Index (CRI) 2021 by the nonprofit organization, German Watch. Authorities in Pakistan have traditionally focused more on flood management and less on disaster risk reduction, largely due to a lack of resources for taking necessary adaptive measures and an inability to anticipate the sudden onset and intensity of floods. However, considering the scale, scope, and intensity of climate-induced disasters, systemic responses to the climate risks must be worked upon for achieving the maximum disaster risk reduction possible.

Fortunately, the current floods did not cause any disruption in PPL's operations at any location, barring a few instances where site access routes became temporarily unusable due to flooding. For enterprise risk management against any future climate-induced natural disaster event, scenarios will be sketched out where the crucial operational or supply chain assets get affected by climate risk-related shocks (e.g., extreme weather events, etc.) so that potential material effects on the business if any, can be identified and assessed.

I think the greatest contributions to the depressed economic climate are the war in Ukraine and the disastrous flooding in Pakistan. Unfortunately, that translates into less business, less attention to Pakistan's woes, and less funds available to assist.

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