Alexander Hamilton Awards Summit

Enterprise Risk Management

October 28, 2008

It has been a watershed year in ERM.

- Explicit adoption by Standard & Poor's of ERM as a component in rating all corporate securities — May 7, 2008
- Worst financial crisis since the Great Depression — September, 2008
- First academically rigorous large-sample study linking ERM implementation to genuine share value creation — publication December or January.

ERM implementation has traditionally been limited.

- Risk identification and mapping exercises
- Compliance procedures
- Business continuity planning

ERM means much more.

- Economic framework for evaluating and managing risks fairly and consistently across silos
- Policies, infrastructure and methodologies for managing big strategic risks and for doing so at a cross-silo level
- Better anticipation of and reaction to emerging risks
- Integration of ERM processes into strategic decision-making
- Corporate culture built around risk awareness and consistent risk management practices

Joint Towers Perrin – CFO Research survey

Scope

- 125 US financial executives
- Conducted in the immediate aftermath of the Lehman, AIG and Fannie Mae insolvencies and/or rescue

Findings

- 72% of respondents rated risk management practices at their own companies as one of their top three concerns as a consequence of the recent financial crisis, ahead of long-term debt financing (65%), short-term financing (61%), banking relationships (59%), pension plan funding (40%), and ability to issue new equity (40%).
- 55% said they anticipated that their companies would change risk management practices at their companies as a consequence of the current financial crisis, either from the board level down, or the employee-level up.
- When the sample was restricted to companies with revenues greater than $500 million, the percentage rose to 63%, or nearly two thirds.
- Risk management practices at banks were viewed by 66% of the CFOs of nonfinancial institutions as a main reason for the current financial mess, followed by financial market speculators (58%) and the increased complexity of financial instruments (53%).

Implication

- CFOs view risk management reform as a top agenda item in fiscal year 2009.

Joint Towers Perrin – Georgia State University research

Scope

- Towers Perrin conducts an extensive, biennial survey of risk management practices in the insurance industry (250 largest companies).
- Towers Perrin engaged GSU to:
  - Construct highly defensible measures of operating efficiency and share value creation
  - Regress the ERM survey results against these measures, looking for causal patterns and relationships.
- The analysis of 2006 and 2004 surveys is complete. The 2008 survey is being analyzed this week.
- Publication expected in December or January

Findings

- Existence of an ERM system conferred $16 million in annual efficiency gains on the average insurer.
- Linking management incentives to risk management practices conferred $26 million in annual efficiency gains.
- Appointment of a chief risk officer conferred $50-60 million in annual gain.

Implication

- ERM is all about better navigation.

What do we expect in 2009?

- Accelerated trend toward assessing and managing risks on a company-wide integrated basis
  - Emphasis on identifying circumstances when multiple perils can coincide
  - More chief risk officers
    - — Broad responsibilities
    - — Direct board reporting
    - — Active oversight of strategic decision-making
- Boards will demand better metrics and information about risk management performance.
  - Premium on verifiable evidence of employee involvement
- Compensation programs in many organizations will undergo a transformation as companies attempt to rid themselves of inducements to exceed stated risk tolerances.