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ERM, SRM, GRC: Is the Alphabet Soup of Risk Really just Risk Management?

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April 4, 2014**

- **ERM vs. SRM vs. GRC**
- **Evolution of risk management**
- **SRM vs. ERM: Is there a difference?**
- **Practices vs. best practices: who says?**
- **Emerging Risks: a board priority**
- **Risk and performance: the ultimate purpose of risk management**
- **Future state: ready or not, it's coming**

What IS ERM?

- “(An integrated set of)...robust risk-management processes that are carried across the entire enterprise and that form a basis for informing and directing the firm’s fundamental decision making.” – **Standard & Poors**
- “...a process, effected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”
– **COSO ERM**

- Recognizes that individual risks across the organization are interrelated and can create a combined exposure that differs from the sum of the individual risks;
- Provides a structured process for the management of all risks, whether those risks are primarily quantitative or qualitative in nature;
- Views the effective management of risk as a competitive advantage; and
- Seeks to embed risk management as a component in all critical decisions throughout the organization.

RISK MGMT - SIMPLY STATED

Risk Management:

- is a discipline that establishes and governs an orchestrating framework for the management of risk, enterprise-wide
- purpose is to help company's deliver consistent company performance
- improves decision-making by supplying current and relevant risk information and analysis
- is effected by the Board, carried-out by Management and applied to planning, budgeting, business performance review and decision-making

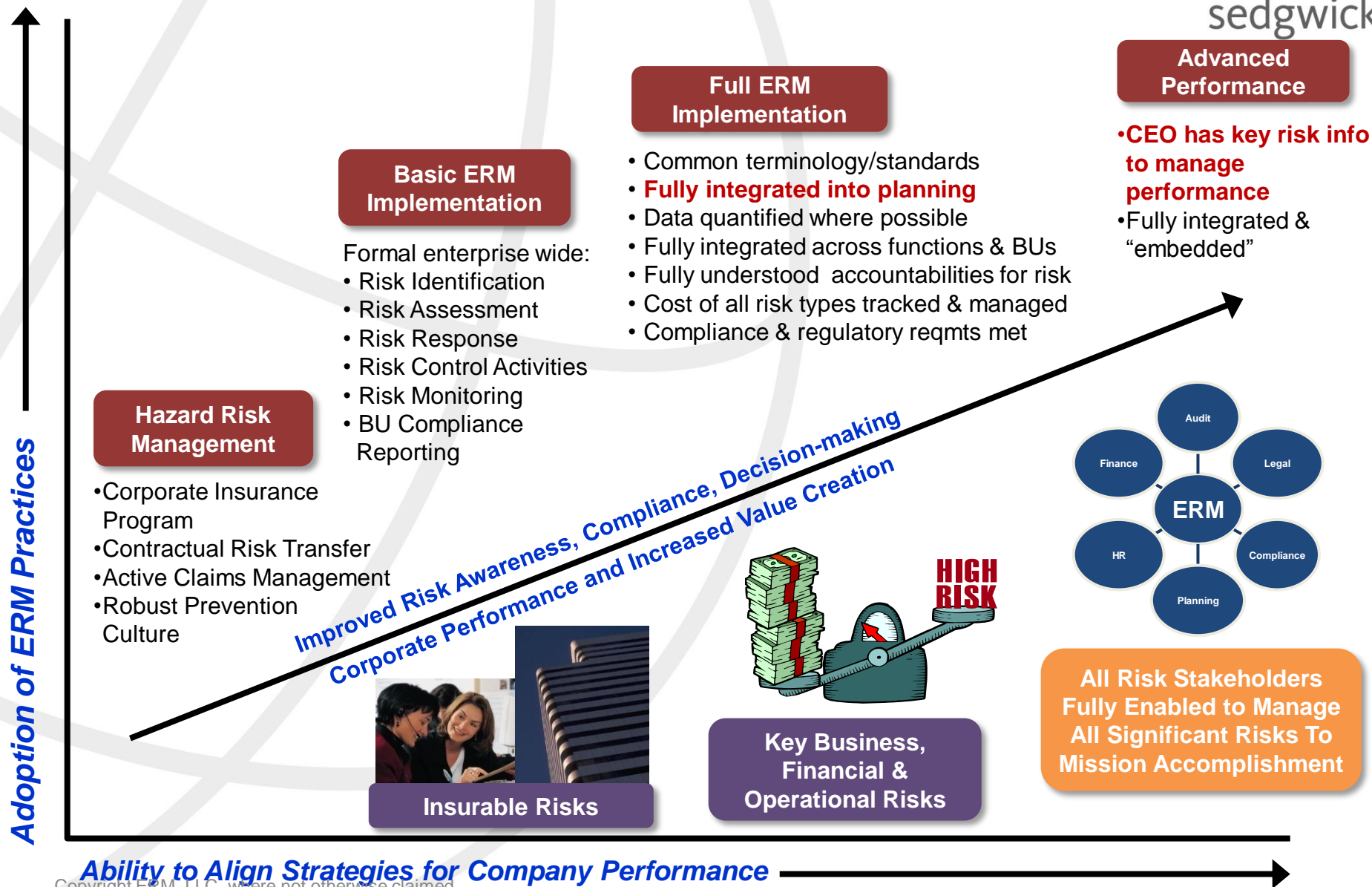
Source: Risk Management Society, Inc. (RIMS)

The Consistency of Standards Facilitates Successful Deployment



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Risk Management Capability Evolution



Why aren't ERM Programs More Successful?



- Most ERM Programs are built with a “Governance” or “Compliance” focus
- Measures are rarely quantitative
- Don’t play a material role in performance management, planning, budgeting or strategy
- Limited in scope and focus
- Not a “day-to-day” part of decision making
- Difficult to translate value proposition

Why Did “ERM” Fail During the Financial Crisis? Or did it?

- Misguided focus on risk processes vs.. agility
- Large amounts of info; no evaluation of risk interconnectedness
- A “check the box” risk management mentality
- Over reliance on statistical models
- Cultures of risk acceptance w/o regard to risk appetite, tolerance or capacity
- Compensation structures that rewarded excessive risk-taking
- Inadequate risk governance/oversight structures

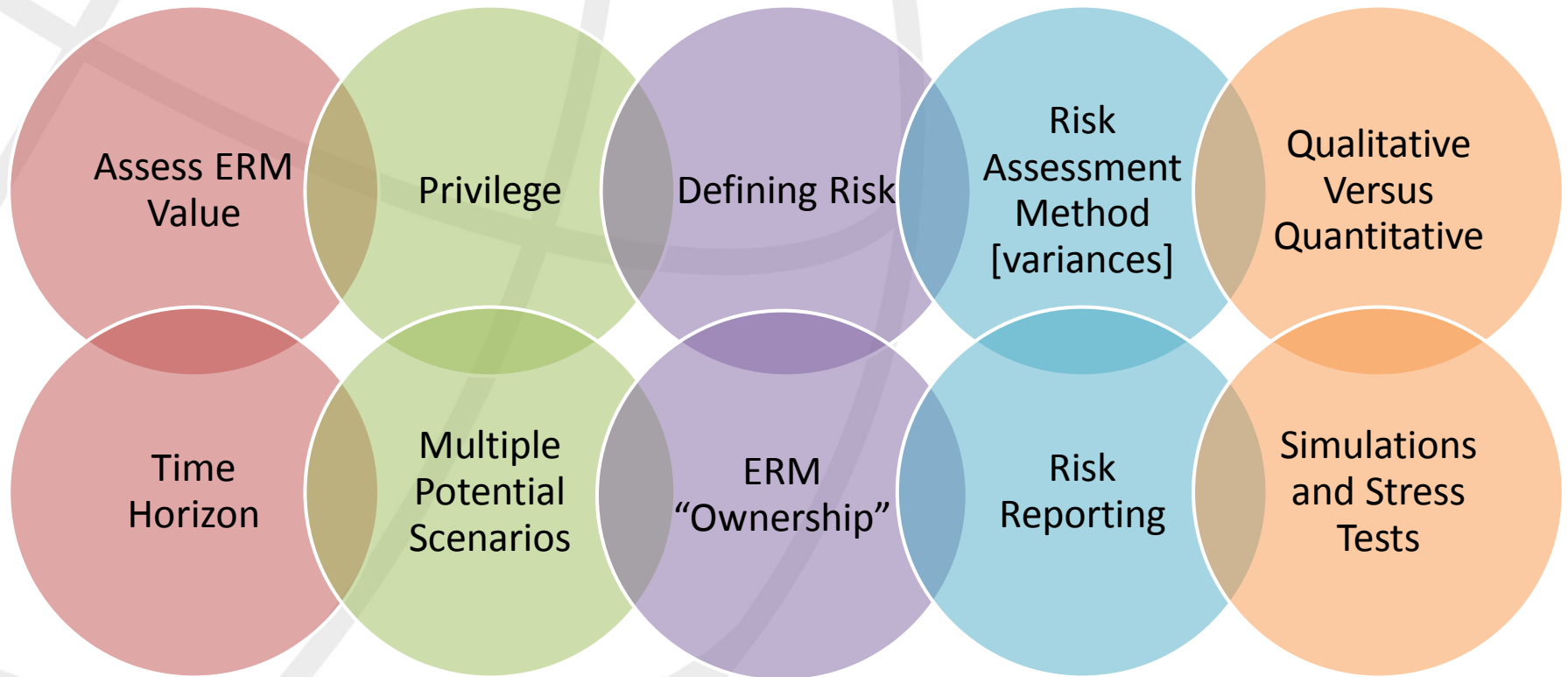
Financial Crisis Inquiry Conclusions



Final Report of the Nat'l Commission on the Causes of the Financial and Economic Crisis in the US:

- Financial Crisis was Avoidable
- Dramatic failures of corporate governance and risk management was a key cause
- Rating Agencies relied inappropriately on risk models & “were essential cogs in wheel of financial destruction”
- Risk management too often became risk justification
- Excessively risky investments and a lack of transparency were key
- Government ill prepared for crisis and inconsistent response exacerbated the crisis
- There was a systemic breakdown in accountability and ethics

Common ERM Obstacles



Source: *Risk Management*, March 2010 issue.
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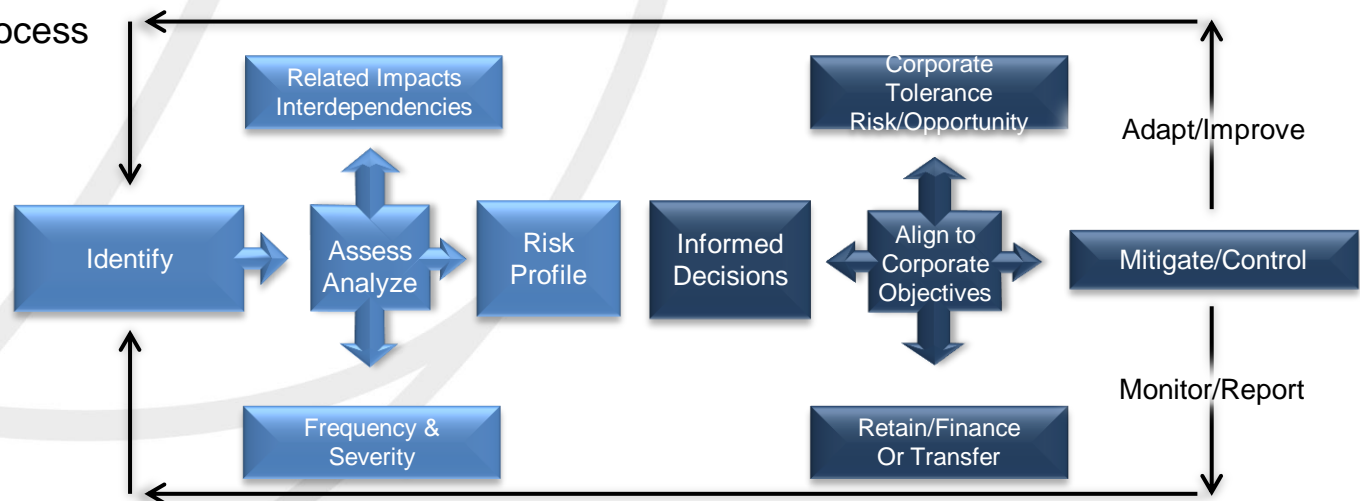
Where does Strategic Risk Management (SRM) fit in?

What is Strategic Risk Management?

➤ **Strategic Risk Management** (“SRM”) is a business discipline that drives deliberation and action regarding uncertainties and untapped opportunities that affect an organization’s strategy and strategy execution.

➤ **Guiding Principles of SRM:**

- Primary component of an organization’s ERM process
- Ultimate goal is protecting and enhancing shareholder value
- Effected by boards of directors, executive management and others
- A strategic approach to risk and managing uncertainty is necessary to achieve company objectives
- Continuous process



Do Some Risks Matter More than Others?

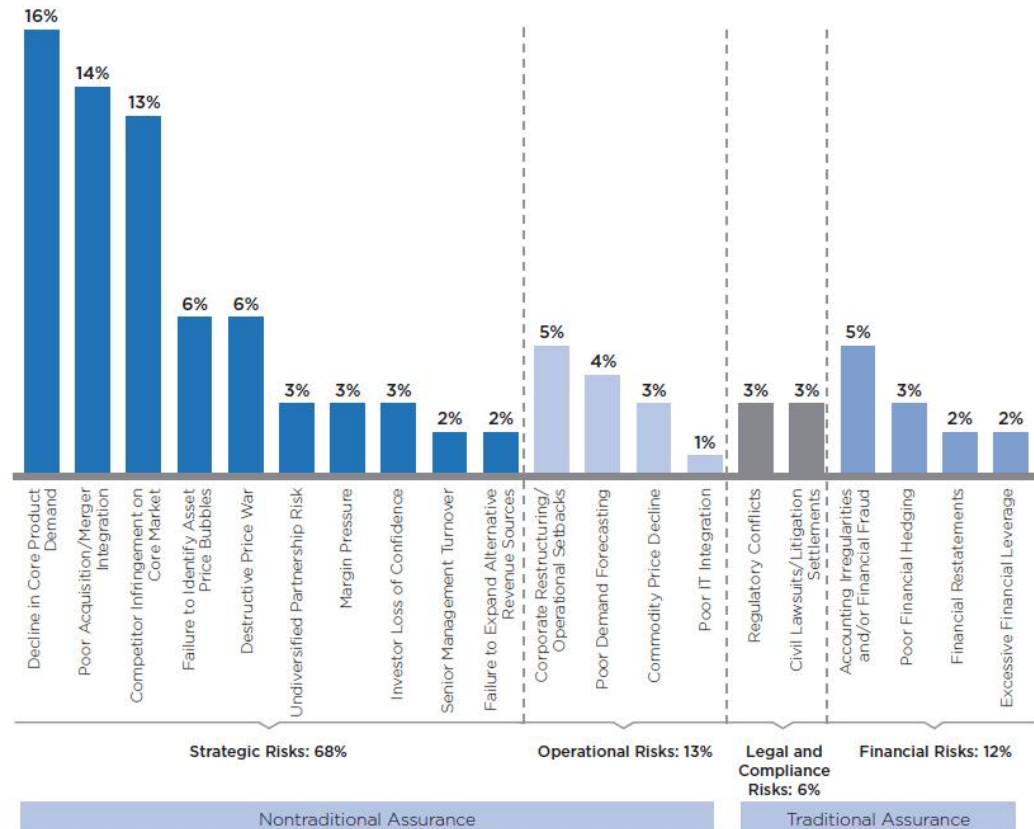
Strategic Risk Impacts

Strategic risks continue to have greater negative impact on stock price than more easily auditable risk areas.

- This analysis looks at root causes underlying market capitalization declines of 50% or more in a single year.
- Percentages refer to frequency of occurrence of each factor in the sample population.

ROOT CAUSES OF DECLINE

Market Capitalization Decline Drivers
Top 20% of Fortune 1,000 (1998-2009)



From the AUDIT DIRECTOR ROUNDTABLE*
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Why Should You Care?

- **Strategy** is a complete plan of action for whatever situations might arise in achieving an organization's goals within the established time. An organization's strategic plans will determine the actions the organization will take at any stage of the planning period as circumstances change.
- **Strategic risks** are those internal or external uncertainties, *whether event or trend driven*, which impact an organization's strategies and/or the implementation of its strategies.

The nexus between strategic risks and corporate success is all about if and how they're managed

Linking Strategy to Risk Management

ERM Process

- viewing risk as exploitable for gain and leveraging opportunities
- scenario building based on identified emerging risks
- Viewing risks as a portfolio

Strategic Planning Process

- assessing how risks can affect strategic goals and objectives
- Using scenarios to communicate about and understand goal achievement

Best Practice: Integrating Risk & Strategic Decision Making

- Develop ERM goals aligned to business goals
- Establish the internal and external contexts
- Analyze, evaluate and prioritize most significant risks to both short term and long term performance
 - Risk assessment
- Treat critical risks, considering priority
 - Risk treatment
- Monitor critical risks
 - Measure risk outcomes/impact on objectives
 - Monitor and review
 - Adjust and realign risk and business plans

Components of Risk-Strategy Alignment



**Emerging Risks: “Tell me
what I don’t know”**

“There are ***known knowns***. These are things that we know that we know. There are ***known unknowns***. That is to say, there are ***things we know we don’t know***, but there are also ***unknown unknowns***. These are ***things we know we don’t know***.”

- Donald Rumsfeld, Sec of Defense (2002)

WHILE THE RISKS LESS UNDERSTOOD ARE DIFFICULT TO ADDRESS,
THEY ARE OFTEN SO SUBSTANTIAL IN IMPACT, THEY CAN’T BE IGNORED

What is an Emerging Risk? “ask any two....”

- Those issues that have not manifested themselves sufficiently to be managed using the tools commonly applied to more developed exposures. They are “those risks an organization has not yet recognized or those which are known to exist, but are not well understood RIMS’ “Emerging Risks and ERM”
- A condition, situation or trend that could significantly impact the Company’s financial strength, competitive position or reputation within the next 5 years. Emerging risks involve a high degree of uncertainty. It is unclear where an emerging risk will land on the loss curve. - anonymous actuary

- **Lloyds:** An issue that is perceived to be potentially significant but which may not be fully understood or allowed for in insurance terms and conditions, pricing, reserving or capital setting.
- **PWC:** Those large scale events or circumstances beyond one's direct capacity to control, that impact in ways difficult to imagine today.
- **S&P:** Risks that do not currently exist.

What about **black swans**?

Value Preservation to Value Creation



The discipline of risk management has evolved from strictly a **value preservation-based** focus to a balanced focus between protecting assets and creating or enhancing value.

Risk Management

Model Risk

- Target Models (3B); Lifetime Value Models
- Churn Models; Discount Engine Models
- Upsell Models; Sales Territory Models

Entrepreneurial Risk

- \$100M Revenue Over Past 5 Years
- EGTRRA Restatement
- PBS, HRO, 401(k) Service Fees

Regulatory Compliance Risk

- Public Relations & Marketing Initiatives
- Industry Coalitions
- Client/CPA Webinars

Credit Risk

- EDI Program
- RCX Stale Date Fees
- Taxpay Premium Processing Fee

Operating Risk

- Federal Deposit Frequency Program
- Client Penalty Abatement Service
- IRS/Paychex Partnerships

Future/White Space

A flexible and dynamic risk management discipline is uniquely positioned **to quickly adapt to change and identify opportunistic risk** to create new streams of revenue and increase value

A VIEW INTO EMERGING RISKS IS CRITICAL TO A COMPLETE VIEW OF RISK

Best practices for Emerging Risks:

- Uncover the unknown or poorly understood threats to businesses
- Bringing resources to bear to address the risks efficiently
- Building resiliency and sustainability
- Include ERs as opportunities that lend themselves to exploitation
- Leveraging emerging risk processes for competitive advantage

Best Practice Sources for Uncovering Emerging Risks



- Industry events
- Competitor experiences
- Surveys/Questionnaires
- Financial Statements
- Flowcharts
- Personal Inspection
- New and Unexpected Events
- Expert Opinion Methods
- Environmental Scanning
- Scenario Analysis
- Trend Analysis

Best Practices: Emerging Risk (ER) Assessment

- Conduct regular emerging risk reviews
- Integrate or align ER reviews with the planning process(es)
- Drive agreement on key assumptions and test them with rigor
- Challenge conventional thought processes and the status quo
- Apply the right methods to better understand and predict ERs
- Balance an internal vs. external environmental view
- Manage ERs within the risk appetite and tolerances of your firm

Adapted from RIMS' Emerging Risks and ERM Report (2012)

Emerging Risk Process Summary

Identify Emerging Risk Relative to Goals & Objectives



Assess Risk Interconnectedness & Determine Appropriate Responses



Monitor and Report Leveraging KRIs tied to KPIs

ERM Strategy is Incomplete without Emerging Risk Process

**What is the next level for
progressive risk mgmt?**

PRM?

Risk Managers as “Strategic Advisors”

- Identifies key risk metrics and/or indicators to assist the responsible board committee and senior management in fulfilling their risk management responsibilities
- Provides risk leadership support to executive management, business units, resources units and lines of business in their respective risk management efforts
- Collaborates with legal, compliance, internal audit, corporate security, information security, controller, traditional risk management and other key risk stakeholders on risk identification, assessment and controls implementation
- In cooperation with other risk management functional areas, makes risk an explicit factor in selecting controls to be tested
- Reports to management and the board

Key Performance & Risk Indicators

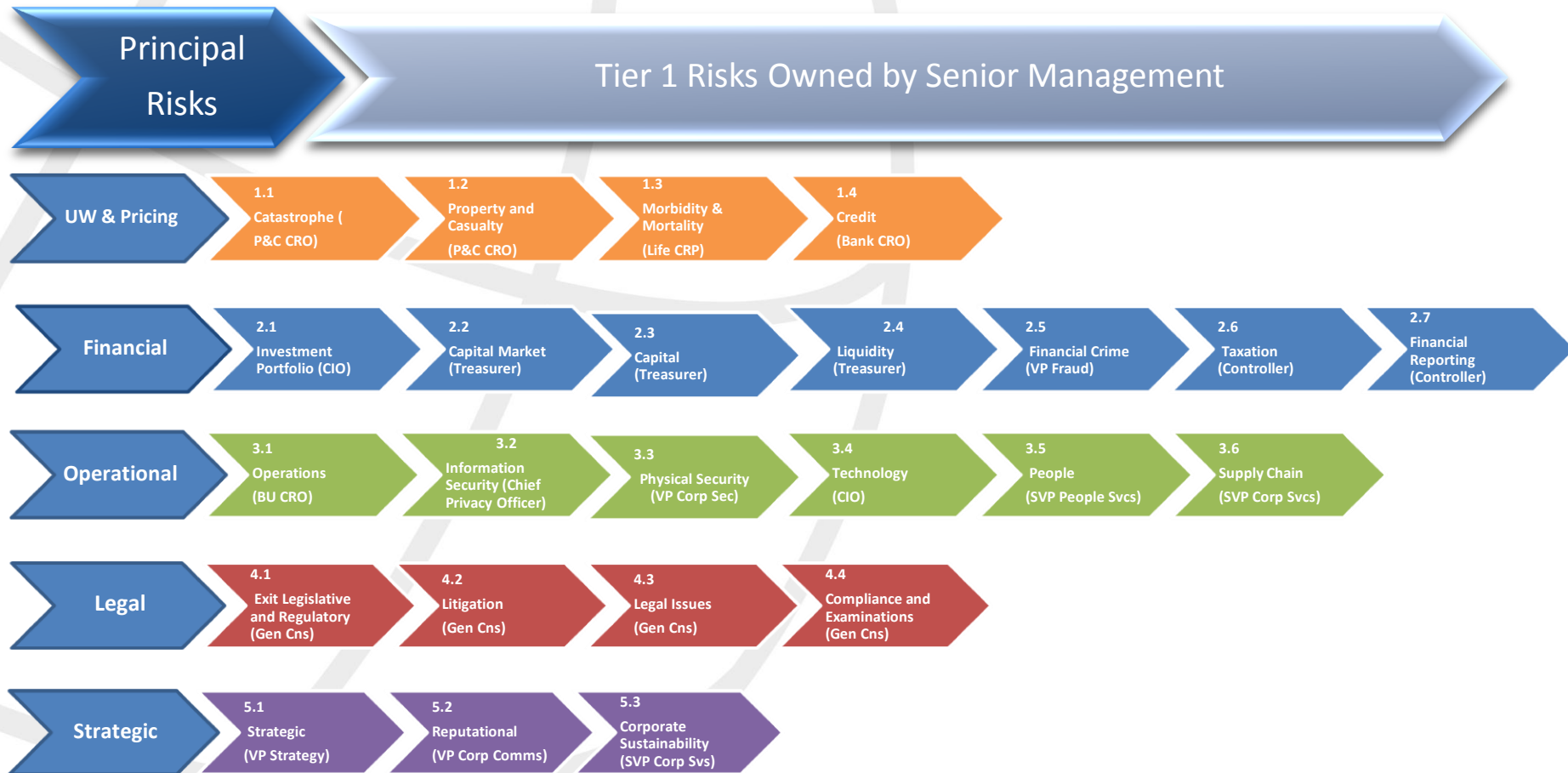
- Key performance indicators (KPIs) are the financial & nonfinancial metrics identified that reflect current & future performance
- Key Risk Indicators (KRIs) are those metrics which reveal the impact of risks on performance, both positively and negatively

Examples of Measures Used for Corporates

KPIs	KRIs
Earnings Per Share	Frequency of loss by risk type
Customer Satisfaction	Severity of loss by risk type
Net Income	Aggregate measures of loss
Cash Flow	Sales gain via leveraged opportunity
Operating Income	Market share gain through risk taken in new ad campaign
Employee Satisfaction	

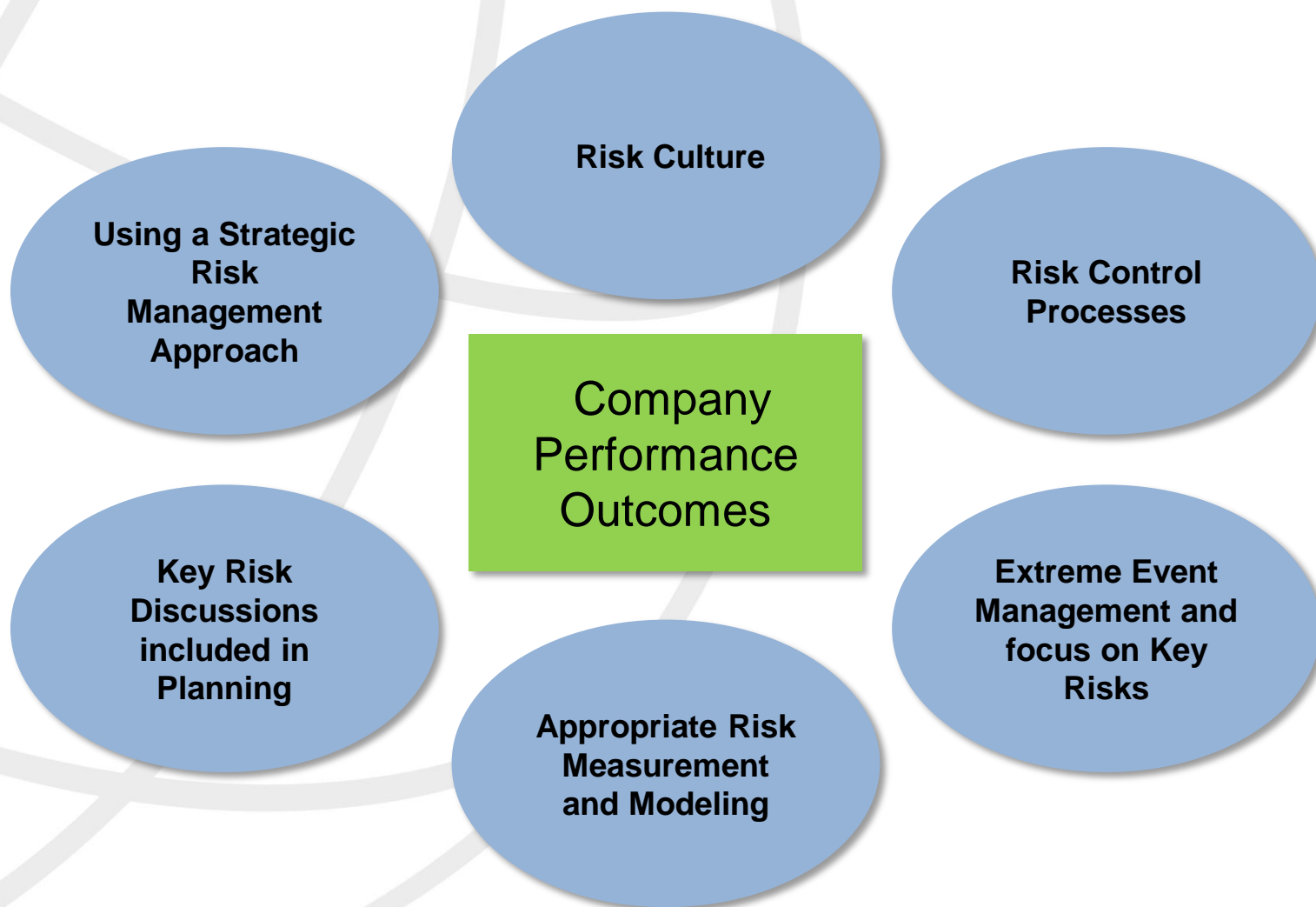
Two Level Risk Portfolio View

Driven by Management Accountability for Risk

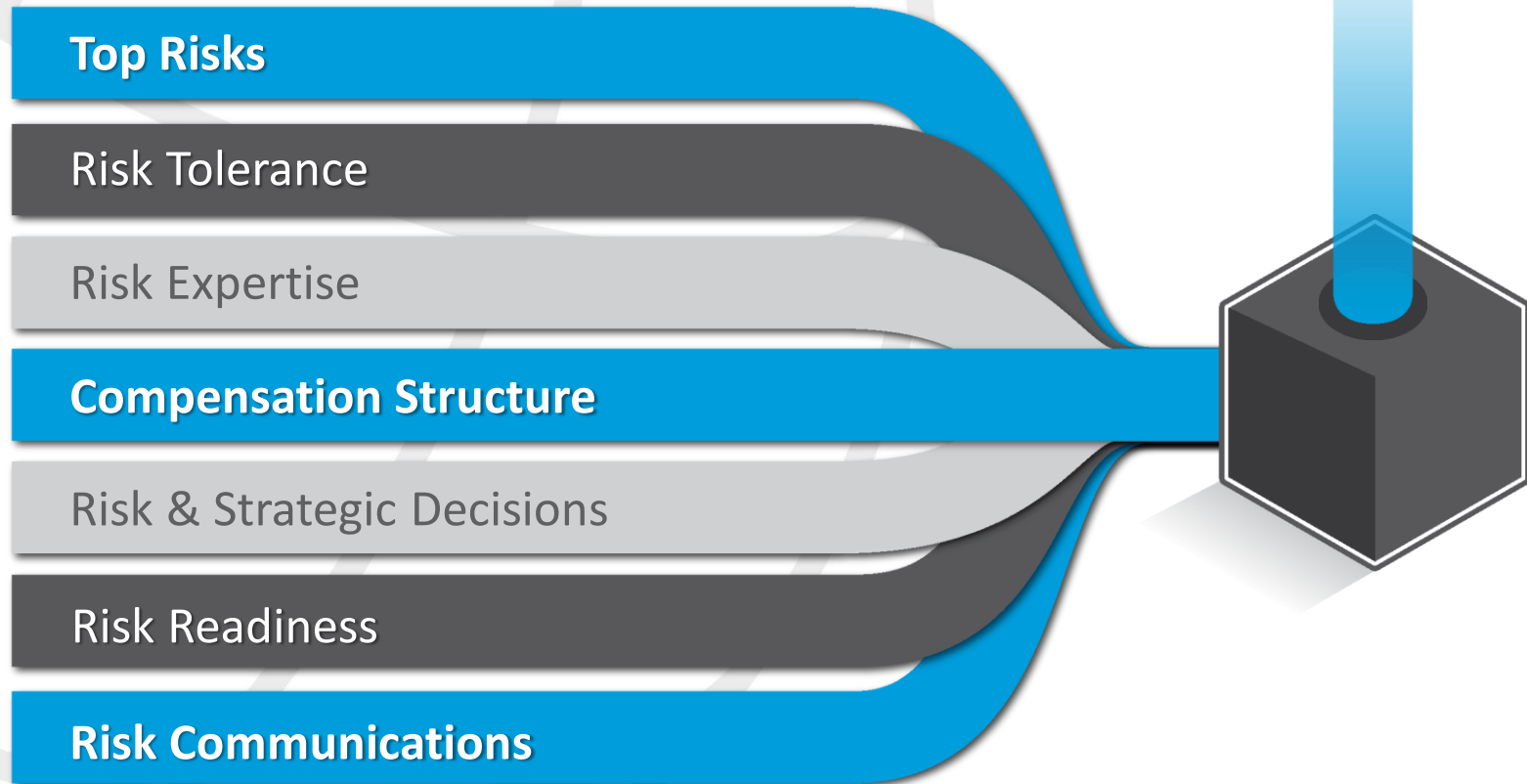


Consistent Risk Typing Enables Decentralized Risk Ownership

Risk-Performance Related Components



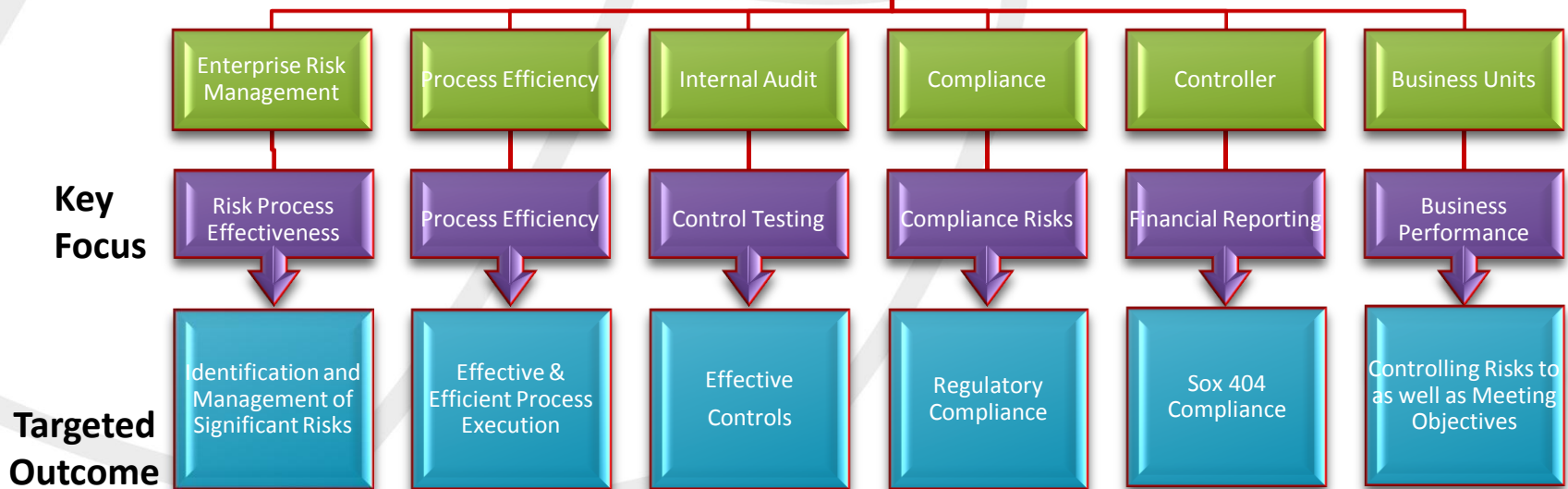
What's Important to Rating Agencies Now?



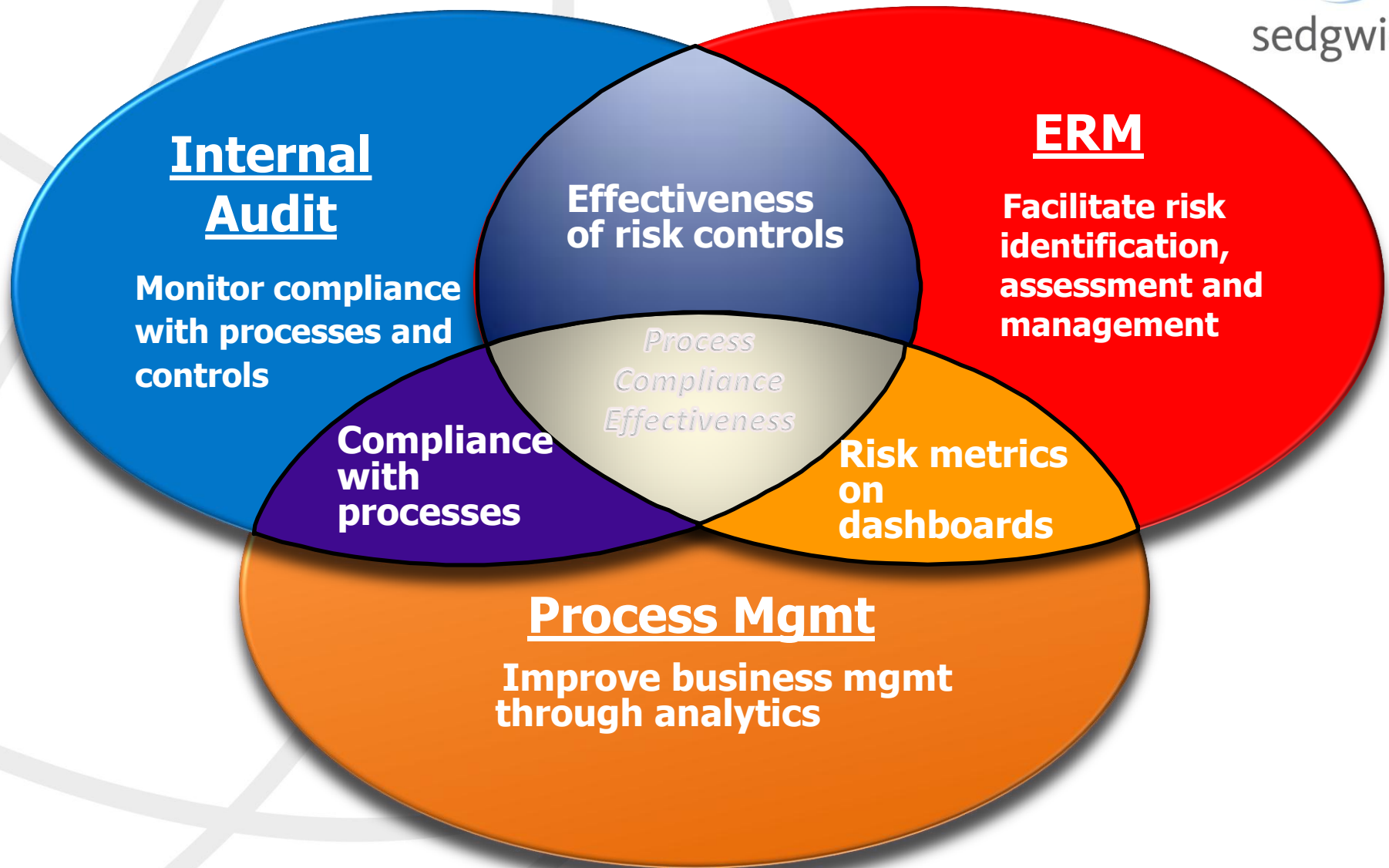
Risk Management Stakeholders

Enterprise Risk Management Process

Unified
Strategy



Functional & Stakeholder Alignment



Audit and Process Efficiency Functions are Important Risk Stakeholders

Risk Mgmt Goal Evolution

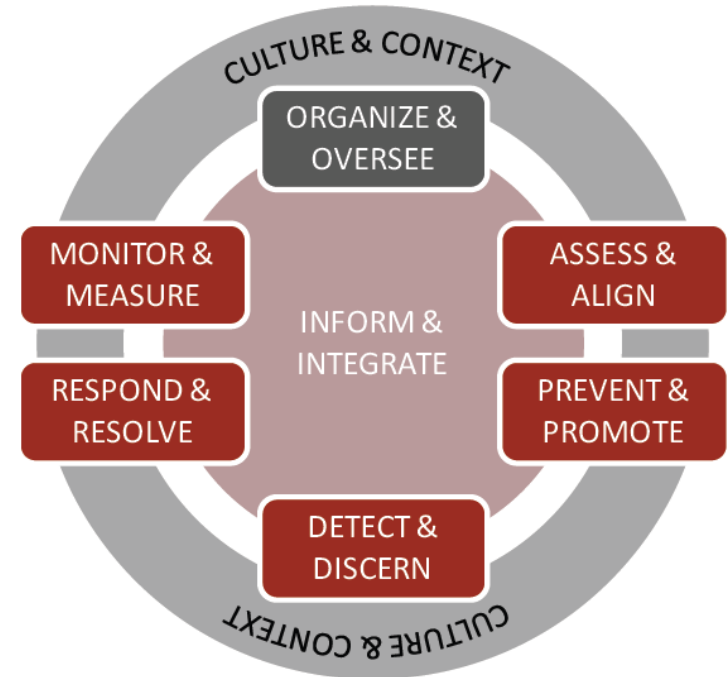
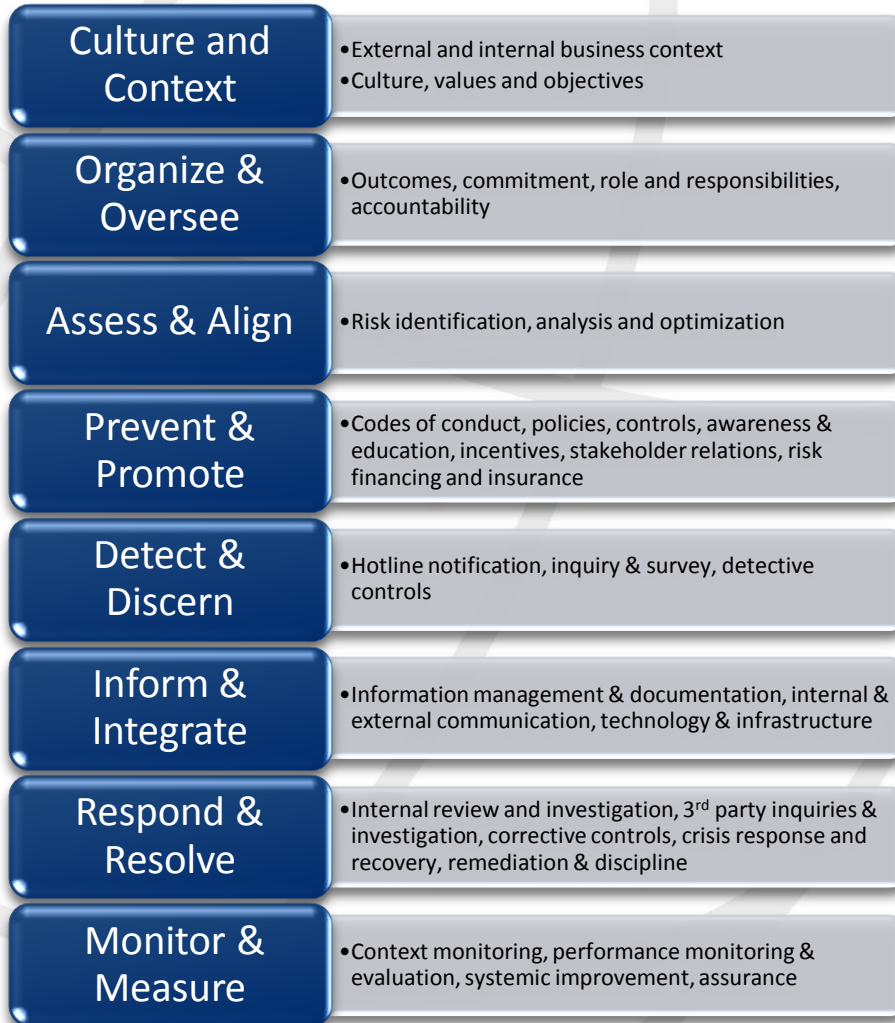


- Traditional Risk Management has four primary focal points:
 - **Stability**
Maintaining the firm's other goals – such as growth, earnings, dividends, or yield.
 - **Cost of Risk**
Manage the internal and external costs to acceptable levels.
 - **Community Responsibility**
Meet social, environmental, and ethical responsibilities (compliance).
 - **Manage Insurable Threats**
Understand the firm's insurable risks. Make better decisions.
- ERM adds a two more goals:
 - **Address all risks regardless of insurability**
 - **Create value by *connecting risk outputs to the planning and decision making processes***

Do We Need A Global Risk Standard?

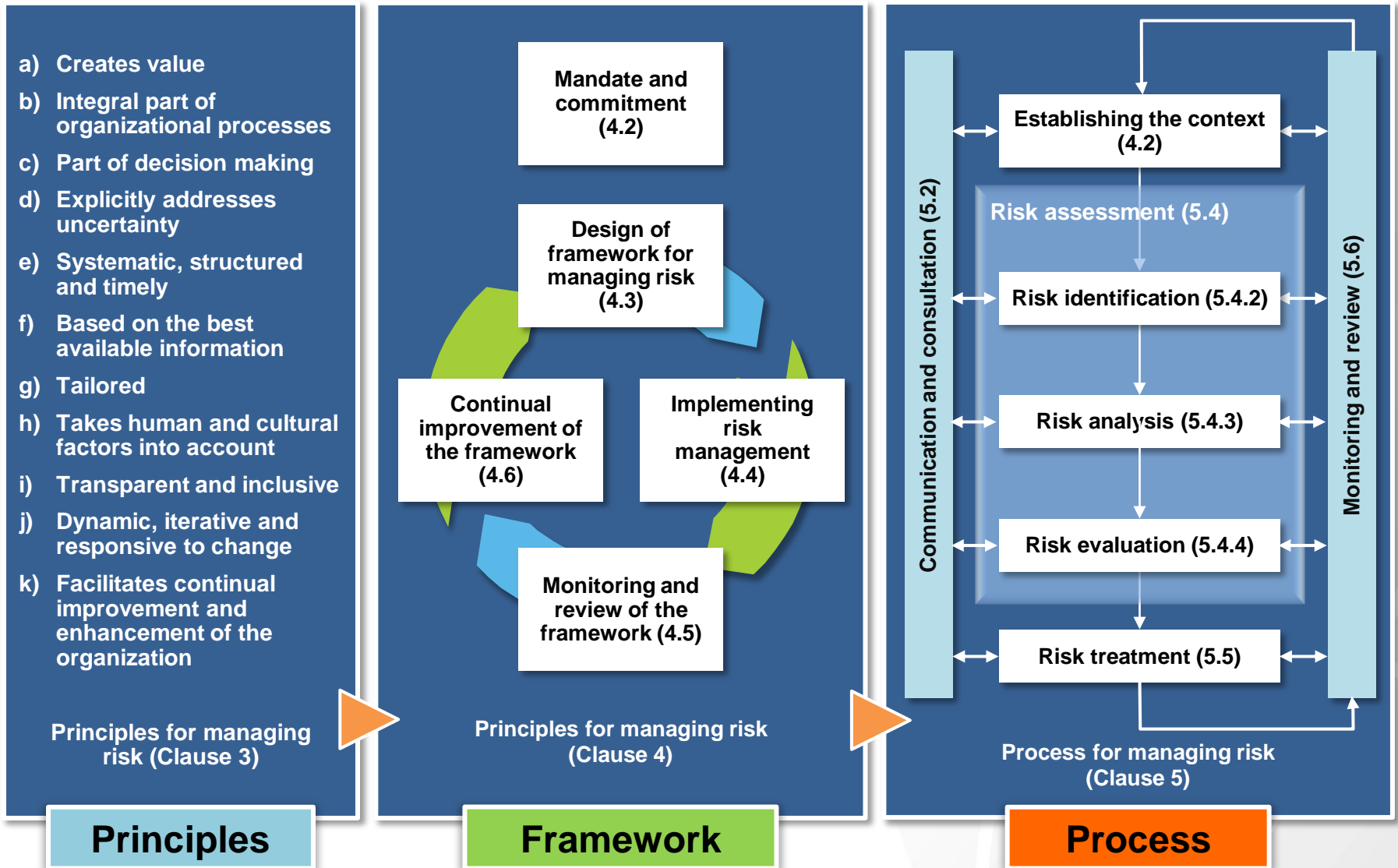
- Multinational companies operating in many countries around the globe
- A need to set priorities and address risks based on global importance
- Need a “common look and feel”
- Need to demonstrate that effective and reliable methods have been used.
- Many existing sub-standards are “down in the weeds” and unsuited to broad application

OCEG GRC Capability Model™ Components



Source: Open Compliance and Ethics Group, www.oceg.org.
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ISO 31000 – Risk Management



Considerations for More Effective Risk Mgmt



- **Board Level Interest.**

What “material” risks does the board need to know/manage?

- **Broadened Risk Management Teams.**

How to involve stakeholders in a coordinated effort?

Which stakeholders do you want to involve?

- **Clear, Understandable Risk Management Process.**

How to get board members, managers, and employees to understand the process?

How to get board members, managers, and employees involved?

- **Broad Focus.**

How to integrate RM into all key business processes, including all planning, operating, and financing activities?

RIMS Risk Maturity Model

Adopt ERM Approach

Denotes the degree of executive support for an ERM-based approach within the corporate culture. Activities cut across all processes, functions, business lines, roles and geographies.



ERM Process Management

Degree that a repeatable and scalable risk management process is integrated into business and resource/support units, using a sequential series of steps that support uncertainty reduction and promote opportunity exploitation.



Risk Appetite Management

Degree of accountability for (1) defining acceptable boundaries 2) calculating and articulating risk tolerance 3) developing a risk portfolio 4) considering scenarios, and 5) attacking gaps between perceived and actual risks.



Root Cause Discipline

Degree of discipline applied to measuring root cause by: 1) determining sources 2) understanding impacts 3) identifying trends, and 4) measuring effectiveness of controls .

RIMS Risk Maturity Model

Uncovering Risks

Degree of quality and coverage (penetration) throughout the organization for uncovering uncertainties related to organizational goals achievement.



Performance Management

Degree to which organizations are able to execute on vision and strategy in tandem with risk management activities.



Business Resiliency and Sustainability

Extent to which an organization integrates business resiliency and sustainability aspects for its operational planning into its ERM process.

Key Challenges for the Future State

Risk challenges are increasingly priorities for execs and boards, including:

- Understanding what risks are most threatening to mission accomplishment
- Connecting actionable risk information to goals & strategy
- Managing critical risk interdependencies
- Getting ahead of emerging risks
- Controlling risks brought to the firm by third parties
- Fostering a strong ethics and risk culture
- Addressing low-frequency, high-impact risks proactively
- Providing timely information on key risks not effectively mitigated

ADDRESSING THESE CHALLENGES WILL DRIVE THE FUTURE OF RISK MANAGEMENT

Components of Best-in-Class Risk Management



Including these key elements in your Risk Management Strategy will support Best in Class results

Key Take-a-ways

- What we call it shouldn't matter – it's the results we achieve
- The breadth and depth of what form of risk mgmt we pursue should mainly be a function of what your company needs
- Using a specific standard or framework can help but is not required
- Before investing in quantitative measurement tools and techniques, assess the need and appetite for sophistication
- ERMIS platforms can also be useful but are not required
- Let the business own the risk – you own the process
- Don't be afraid of the unknowns – invest in some form of emerging risk process
- Recognize that tying risk to corporate performance will get you the furthest, personally and professionally
- Understand that even in the best of circumstances, engaging and leveraging stakeholders is still most like herding cats
- Finally, be careful what you aspire to; more CROs have been displaced in the last 5 years than all prior years combined

References for Deeper Study

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- 5) Excellence in Risk Management 10 Report: Delivering Strategic Value Through Risk Management, RIMS/Marsh
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Christopher E. Mandel is the SVP for Strategic Solutions at Sedgwick, Inc. He is engaged in helping Sedgwick chart its future through the long term planning for products, services and strategic solutions for this claims and productivity management firm. He is also co-founder and EVP, Professional Services for rPM3 Solutions, LLC as well as founder and president of Excellence in Risk Management, LLC. both independent consulting firms specializing in governance, risk and compliance, with a special emphasis on enterprise risk management. rPM3 Solutions holds a patent for a unique risk measurement process known as ARQ™. Prior to electing early retirement and for ten years from 2001-2010, Mr. Mandel was head of enterprise risk management for USAA Group, a \$165 billion diversified financial services organization. At USAA, he designed, developed and led the enterprise-wide risk management and corporate insurance centers of excellence. He also served as President and Vice Chairman, Enterprise Indemnity CIC, Inc., an Arizona based alternative risk financing facility.

Mr. Mandel has more than 25 years of experience in risk management and insurance in large, global corporates. He has pioneered the development of cross-enterprise risk management capabilities resulting in S&P rating USAA as "excellent and a leader in ERM" from 2006 through 2010. In 2007, Treasury and Risk Magazine bestowed the Alexander Hamilton Award for "Excellence in ERM" on USAA. Mr. Mandel has been a long term senior leader in the Risk and Insurance Management Society including being elected President and Chief Risk Officer and was named Risk Manager of the Year in 2004.

Mr. Mandel's deep, wide and diverse experience in all facets of risk management and insurance allows him to offer those interested in managing risk with excellence to engage him to provide everything from a comprehensive strategy and complete ERM framework to targeted guidance, tools, techniques and/or training. Mr. Mandel's innovative approach to making risk a key strategically placed and results oriented function results from solidly connecting risk management outputs to a company's key performance metrics and ultimately, mission accomplishment.

Mr. Mandel received his B.S. in Business Management from Virginia Polytechnic Institute and State University and an MBA in finance from George Mason University. He holds the CCSA, CPCU, ARM and AIC designations and is a frequent industry speaker, teacher and writer. He writes the "Risk Innovation" column for Risk and Insurance magazine and in 2008 was elected a member of Risk Who's Who (RWW). He also wrote the Ask a Risk Manager column for Business Insurance from 1996 through 2008.

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This presentation will discuss where risk management has been, where it is today and where it's going with an focus on some key best practices and future trends that will affect every risk manager's job and future success. This session will also touch on the importance of having an effective emerging risk process and of informing management and governance in a timely manner with just the right, actionable information on which key decisions can be made to improve the change of achieving both short and long term objectives.

ERM, SRM, GRC: Is the Alphabet Soup of Risk Just Risk Management? Driving business performance by more effective risk management.

The risk management discipline is full of buzzwords which often only serve to confuse stakeholders. Is SRM just another such buzzword or a possible attempt to rebrand the discipline to jumpstart previously failed attempts to drive rigor and purpose into the risk process? This session will discuss risk management from a best practice standpoint and visit where it's been and where it's going with an eye towards its ultimate value to organizations that understand the nexus between risk performance. It will cover where risk management has been, where it is today and where it's going with an focus on some key best practices and future trends that will affect every risk manager's job and future success. Topics covered will include:

- Strategic Risk Management: buzzword or new paradigm?
- Evolution of risk management
- SRM vs.. ERM: Is there a difference?
- Practices vs.. best practices: who says?
- Emerging Risks: a board priority
- Risk and performance: the ultimate purpose of risk management
- Future state: ready or not, it's coming

Learning Objectives:

- Understand the evolution of risk management from hazard only to an all risk focus
- Learn the difference between downside and up side risk and how to modify your strategy to include both
- Understand the importance of having an emerging risk process
- Learn where the risk discipline is headed and how to leverage the future for your career path and your company