OVERVIEW OF ENTERPRISE RISK MANAGEMENT

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HOW ERM DIFFERS FROM TRADITIONAL RISK MANAGEMENT

• ERM encompasses both hazard risk and business risk, traditional risk management focuses on hazard risks.

• ERM seeks to enable an organization to fulfill its greatest productive potential; traditional risk management seeks to restore an organization to its former pre-loss condition.

• ERM focuses on the value of the organization; traditional risk management focuses on the value of the accidental loss.

• ERM focuses on an organization as a whole; traditional risk management focuses on specific loss exposures.
THERE ARE FOUR AREAS IN WHICH TRADITIONAL RISK MANAGEMENT DIFFERS FROM ERM

- **Risk categories** - Not just operational and hazard risks, but also strategic, financial, legal, human capital, environmental, reputation....etc (Example Dallas For Worth International Airport)

- **Strategic integration** - Linking risk to the entire enterprise and seeing how risk exposures can adversely affect its long-term financial outlook

- **Performance metrics** - Use of key performance indicators measures success of achieving strategic goals and key risk indicators measures potential losses

- **Organizational structure** - Empowering all managers to consider risk optimization and the cost of risk
BENEFITS OF ERM INCLUDE:

- Enhanced decision making - An ERM approach allows an organization to systematically explore new opportunities for economic efficiencies while managing threats that stem from internal and external context (Example is University of California and their ERMIS).

- Improved risk communication - ERM also encourages an organization to widely communicate its risk management approach across all of its layers. This include making all manager aware of the need to identify obstacles that could interfere with the achievement of the organization's strategic goals (Example Constellation Energy and their risk communication process).
ERM IMPROVES

• **Profitability**—Early detection of emerging risks and proper risk mitigation techniques curbs the potential for losses making the organization more profitable

• **Reduces earning volatility**—Proper assessment of capital needs to meet risk challenges ultimately results in stable earnings

• **Ability to meet strategic goals**—Provides organization-wide involvement in the identification and assessment of all risks, thus improving organization's ability to meet strategic goals
ERM IMPROVES

• **Increase management accountability** - Those closet to a particular risk are in the best position to evaluate and manage it

• **Management consensus** - Creating a corporate culture that embraces risk as an additional component of each decision

• **Acceptance by internal and external stakeholders** - Creates a spirit of cooperation among management
RISK OPTIMIZATION

- Is all risk bad? Upside of risk (opportunities) and downside of risk (threats)

- **Risk optimization** is the balance between assuming too much risk and too little risk by engaging in risks that are consistent with its culture and its stated goals while simultaneously practicing fiscal responsibility.

- Basis of decision making is based on the organization's beliefs, values and behaviors.
INNOVATION'S INFLUENCERS

- **Internal influences**

  1) **Resource allocation**- distribution of available resources
  2) **Risk attitude**- How you perceive, assess and treat risk
  3) **Risk appetite**- How you retain, treat, and monitor risk
  4) **Risk tolerance**- Residual risk an organization is willing to bear
  5) **Employee rewards**- How employee is rewarded for good decisions
INNOVATION'S INFLUENCERS

• **External influences**

1) **Political**- government regulations

2) **Social**- labor availability on both a skills and a knowledge basis

3) **Economic**- capital requirements and capital availability

4) **Technological**- development and rate of change
THREE LEVELS OF OBJECTIVES AND GOALS USED BY ORGANIZATIONS

• **Strategic goals** - established at the board and executive level; broad-based and conceptual; give the organization direction (Example WSDOT's Strategic Plan 2011-2017)

• **Operational objectives** - established at the staff management level; cut across all departments (Example WSDOT's Strategic Plan 2011-2017)

• **Tactical objectives** - established at the line management level; specific tasks; related to producing the organization's products and service (Example Longmont, Colorado creation of their emergency recovery plan)
SWOT ANALYSIS

• **Internal Context**
  
a) Strengths in the organization  
b) Weaknesses in the organization

• **External Context**
  
a) Opportunities to the organization  
b) Threats to the organization
DEVELOPMENT OF AN ORGANIZATION STRATEGIC PLAN

- **Suitability** - Can the strategic plan be accomplished?

- **Feasibility** - What will the strategy cost?

- **Acceptability** - Will the strategic plan meet expectation of shareholders?
THREE STAGES OF STRATEGIC MANAGEMENT PROCESS:

• **Strategy Formation**-creating the plan

• **Strategy Implementation**-putting the plan to work

• **Strategy Evaluation**-checking the results to determine whether the plan is working as envisioned
RISK CRITERIA

1) Its comfort level in accepting risk (appetite for risk)

2) The nature and types of consequences that can occur

3) Its definition of unacceptable risk

4) How "likelihood" will be defined and depicted
RISK CRITERIA

5) The immediacy of the risk and development of the consequences

6) Impact measured in financial or operational terms

7) Impact to its reputation and/or sustainability

8) How combinations of risk could affect it
ROOT CAUSE ANALYSIS

• Causes of Risk - physical, human and organizational

• Risk Event - economic, natural, industrial, and human

• Impact - primary and tertiary (British Columbia Preparing for the Vancouver Winter Olympics in 2010 article in Risk Management Magazine April 2011)
NINE STEP APPROACH TO ROOT CAUSE ANALYSIS - STATE OF WASHINGTON

1) Verify the incident and define the problem
2) Map a timeline of events
3) Identify critical events
4) Analyze the critical event's cause and impact
5) Identify root causes
6) Support each root cause with evidence
7) Identify and select the best solutions
8) Develop recommendations
9) Track implementations of solutions
RISK REGISTER- HOW TO TRACK RISK INFORMATION IN THE ORGANIZATION

1) Assign a risk owner
2) Potential risk event
3) Potential impact
4) Risk level- minimum, low, medium, high, and maximum
5) Risk treatment
6) Proposed Improvement action
7) Next review date
ERM'S ROLE IN GOVERNANCE

1) Drivers of governance reform-SOX, SEC 33-9089 about board level risk oversight responsibilities, and Dodd Frank Section 165 - formation of risk committees

2) Compare IIA audit committee charter with NACD's risk committee charter - Look at the difference between the Purpose and Duties and Responsibilities of Audit Committee and Risk Committee charters

3) General Motors' composition of their Finance and Risk Policy Committee
S & P QUESTIONS ABOUT ERM PROGRAMS

1) What are the organization’s top risks, how big are they, and how often are they likely to occur? How often is the list of top risks updated?

2) What is management doing about top risks?

3) What size quarterly operating or cash losses has management and the board agreed to tolerable?

4) Describe the staff responsible for risk management programs and their place in the organization chart. How do you measure the success of risk management activities?
5) How would a loss from a key risk affect incentive compensation of top management and planning/budgeting?

6) What discussions about risk management have taken place at the board level or among top management when strategies decisions were made in the past?

7) Give an example of how your company responded to a recent "surprise" in your industry. How did the surprise end up affecting your company differently than others.
• **Risk Identification**- the process of taking inventory of all risks in the organization and tying them to the organization's strategic plan

• **Risk Assessment**- the process where we determine the cause, risk event, impact, and velocity of all risk exposures

• **Risk Analysis**- examines the interrelationship of risk both within and outside the organization (also known as integrated risks)
CASE STUDY- MORETON COMPANY

- **Implementation** - includes the structure, practices and ERM strategies used (COSO II or ISO 31000)

- **Monitoring** - tracking risk information from the ERM program (use Excel spreadsheets or ERMIS)

- **Evaluation** - ascertaining the strengths and weaknesses of the ERM program with regards to the organization's strategic goals