



James E. Blair, President

July 2010

Dear Colleague;

World business and government leaders are beginning to turn their eyes toward the long misunderstood and under-utilized Risk Management function! Historically leaders have understated the value of prevention-based and anticipatory management practice that takes on risk in order to succeed, while balancing the risks with preparation for the plans that fail. Pressure is building to change the perception that Risk Management is *bureaucratic and compliance based*.

Virtually every business periodical and news paper today mentions risk management. The stakeholders are reading about risks, risk taking, management and system failures, and best practice solutions. Leaders are beginning to realize the imperative of effective risk management. I have prepared the attached paper that captures the drivers of this sea-change and highlights a proven focus for success – Cash Flow!

Please take time to read this concise and informative paper. It highlights the internal and external drivers of change and provides a roadmap for transforming your company's approach to the integrated management of enterprise-wide risk.

I look forward to your thoughts and questions.

Sincerely yours,

Attachment



Eyes are Beginning to Focus on Risk Management

July 2010

World business and government leaders are beginning to turn their eyes toward the long misunderstood and under-utilized Risk Management function! Historically leaders have understated the value of prevention-based and anticipatory management practice that takes on risk in order to succeed, while balancing the risks with preparation for the plans that fail. Leaders are beginning to realize the imperative of effective risk management. This paper captures the drivers of this sea-change and highlights a proven focus for success – Cash Flow!

Virtually every business periodical and news paper today mentions risk management. The stakeholders are beginning to read about risks, risk taking, management and system failures, and best practice solutions. Leading the charge are the insurance and financial industries. All insurers now employ a Chief Risk Officer (CRO) designated to oversee the financial risks the companies must take. The primary focus is the financial risks associated with effectively managing premium dollars, collateral, lending and rigorous claims management. The CRO position is slowly being embraced by the banking and financial services sectors. Risk management, however, continues to be perceived as *bureaucratic and compliance based*.

Regulators are also part of the sea-change with new initiatives, including:

1. Federal Regulators have deployed new rules (SEC Rule 33-9089, 2/28/2010 and Federal Reserve Board final guidance, 6/21/2010) requiring financial institutions, public companies and government contractors to formally report how compensation practices align with effective risk taking.
2. Homeland Security, FEMA and local Safety and Security organizations have and continue to apply risk prevention and preparedness processes, technology and procedures to minimize risks to the public and infrastructure.
3. The British Petroleum Deep Water Horizon catastrophe is expected to generate new regulations that will impact world energy production for decades.
4. New ISO Standard 31000 outlines 11 worthy elements of an effective risk management program.
5. Credit rating agencies are developing techniques that attempt to assess a company's risk management practices and culture.
6. The US Inspectors General investigate world-wide fraud that continues to account for 6-8% of Gross Domestic Product. This risk is \$900 billion annually for the US alone.
7. Dodd-Frank Wall Street Reform and Consumer Protection Act (expected to be signed by President Obama in early July 2010) directs regulators to provide guidelines to financial institutions that prohibit incentive compensation that encourages inappropriate risk taking.



Corporate Boards of Directors are considering how to embrace and formalize the responsibility of enterprise-wide risk management. In addition to historic governance of strategic risks, market conditions, financial accountability, ethics and business standards, Boards are starting to turn their eyes toward operational risks, including employment, training, operations assessments, cyber risks, information management, revenue assurance, privacy, internationalism, emerging regulations and compliance. Unfortunately, risk management does not currently have prominence at the Board table, or in the C-Suite. Only 55% of Boards report improvements in risk management governance*. Risk management retains the aura of a *bureaucratic sand pit*.

Leaders generally don't respond well when being "pushed" into new paradigm thinking. We naturally strain when change is required by regulators. Leaders are slow to embrace risk management as much more than the insurance and claims function. Estimates are that only 7% of C-Suites have embraced enterprise risk management functionality and governance*. The following Myths of C-Suite thinking impede progress.

1. We're insured (covered) for that – for all we spend on insurance we are surely protected.
2. We hire really smart people and hold them accountable for managing the risks.
3. We don't need more bureaucracy – the risk folks just slow things down.
4. We'll take the risk and work through it – let's get on with the approvals, put the people in place and then worry about the risks.
5. We'll operate as if bad things won't happen on our watch.
6. The CEO is the Chief Risk Officer.

Recent history confirms that the myths drive inadequate attention to risks at all levels of an enterprise.

Leaders do respond well when change promises positive results. Improved operations, operational resilience and cash flow are the positive reasons to embrace the practice of risk management. Implemented properly, risk management becomes a cash flow producer for an enterprise.

All this sounds too good to be true! So, why isn't management climbing all over this best practice? Change of embedded habits is slow and leaders are often cautious when embracing uncertainty. The insurance industry has provided valuable risk transfer services for centuries. Accounting and auditing practices provide valuable compliance and reporting services. But, businesses are basically left alone to develop operational, prevention-centric and strategic risk management processes. The time for change is now.



It starts with the appointment of the C-Suite to the new Risk Management Executive Council (RMEC). Upon notification by the CEO, the top leaders are charged with determining the “material” risks to the business and then assessing the programs in place to mitigate the risks. This team begins to understand the total annual costs of all risk programs, which are typically 7-10% of revenue (\$7-10MM for a \$100MM company). The number is surprising and well hidden since it is not a budget line item. The RMEC aligns the cross-departmental risk functions, establishes priorities and measures performance. Every risk function is expected to produce a Return-On-Investment.

With this solution, the Board is not required to force risk management thinking into the business. The business leaders share the newly minted risk management process with the Board and provide quarterly progress reports. The total cost of risk (7-10% of revenue) is managed and prioritized. Costs drop and new risk based revenues emerge from:

- Assessing the operational performance of revenue and expense functions which leads to cash flow impact reengineering.
- Assessing fraudulent and under-performing third party supply/service chain functions that produce new cash flow.
- Scenario planning for business functions in order to become more sustainable when bad things happen.
- Customer recognition that the enterprise is more reliable and secure. Business thrives!

With expectations of improved cash flow, deployment of enterprise-wide and integrated risk management is an imperative. The benefits are measurable and immediate. The C-Suite sets a new “tone-from-the-top” that trumpets the commitment to corporate risk management, cross-departmental alignment, managing costs, preparing for crises and responding to issues and challenges. Clients quickly see a more dependable and resilient company.

The RMEC agenda is different from the regular operations and strategic discussions (staff meetings). The agenda deals exclusively with risks, mitigation strategies, cross-departmental synergy, preparedness and response. The RMEC invests a few hours each quarter, assessing progress and providing direction to the risk experts and resources across the business. The cash flow impact from reduced costs and new “found” revenue is extraordinary.

With growing public, regulatory and market pressure for operating excellence, it is time for management to embrace value of a “well risk managed” business. Leaders will learn to confront emerging risks such as those of the past 18 months where the magnitude of the financial melt-down exceeded our experience along with the speed with which it emerged.



“Change” is the 21st Century risk. The risks of perpetual change accompanied by the elements speed and magnitude can only be mitigated by cohesive and holistic thinking at all levels. Emerging risks we don’t anticipate are managed through quick response and recovery techniques. Nimble and cohesive teams are the solution – the RMEC delivers the leadership for these situations.

Ministers at the March 2010 World Economic Forum held in Davos-Klosters, Switzerland began to socialize the concept of country level Chief Risk Officers. The point is simple – a holistic risk management governance structure is equipped to identify risks, align mitigation resources, measure results and capture opportunities for improved operations. A country risk management function will perpetually search for and respond to risks so that otherwise busy leaders can tend to the business of the day.

*Global Enterprise Risk Management Survey 2010 from Aon Corp.

Integrated Risk Management Solutions, LLC offers consulting and coaching services enabling the deployment of cash flow-centric risk management cultures and programs. The results include:

- Establishment of an executive governance structure,
- Determination of key earnings impacting corporate risks,
- Alignment of risk program priorities, and
- Performance based measurement of risk related initiatives and programs.

Manage Your Risks Well!



Enterprise-wide Risk Management Stimulates Success

Typical returns are 4:1 ROI and significant cash flow improvement

Risk is anything that impacts cash flow! Successful companies manage risk more effectively than competitors. By practicing a “risk awareness” culture that engages every level of the business in prevention-centric behavior, cash flow is improved.

Key Risk Management Facts:

- Companies spend between 7 - 10% of revenue on risk related costs, including:
 - Safety
 - Security
 - Information Security
 - Health & Wellness
 - Absence*
 - Theft
 - Fraud Prevention
 - Revenue Inefficiency
 - Audit
 - Compliance
 - Investigations
 - Settlements
 - Claims
 - Insurance
 - Crisis Management
 - Emergency Response
- * Incidental absence can increase the costs of employee health and wellness programs by 2X.
- Risk costs are incurred in multiple corporate silos hiding the “Total Cost of Risk”.
- In 2010, companies that manage risks effectively will receive the best insurance prices and maximize the option to self-insure.
- Private companies seem to have weathered the current economic storm because of personal wealth protection – risk tolerance is lower sustaining overall quality performance.
- Enterprise-wide Risk Management is a complete vision of company risk. A strong risk management culture helps a company respond well to unforeseeable events.
- Those companies that establish awareness among top management that their job is to take risks intelligently are faring much better.
- Uncertainty and financial pressure renews the need to manage risk. These pressures have always been present, but the magnitude is currently greater.
- 70% of company information systems risks come from employees and trusted vendors.
- Third party vendor transactions often result in 10% or greater errors and inaccurate billing.
- Sarbanes-Oxley tests transactional controls – operational controls are “the source” of risk.
- Competitive performance is improved through regular operational controls reviews, which can improve revenue efficiency by up to 20% of revenue.
- Documented and tested Business Interruption/Resiliency Plans sustain key operations during an emergency and improve Company survival by 70%.
- Synergy from a common focus on risk reduction, cost/revenue efficiency, operational reductions in losses, underperforming 3rd party vendors and fraud often produce one of the most impactful cash flow opportunities available.