

Enterprise Risk Management: *A Rating Agency View*

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Why are we Interested in ERM?

- **More Prospective Ratings**
- **Facilitate “What If” Scenarios**
- **Better Differentiation in Rating Categories**



Where ERM is Applied in Ratings

Financial Institutions

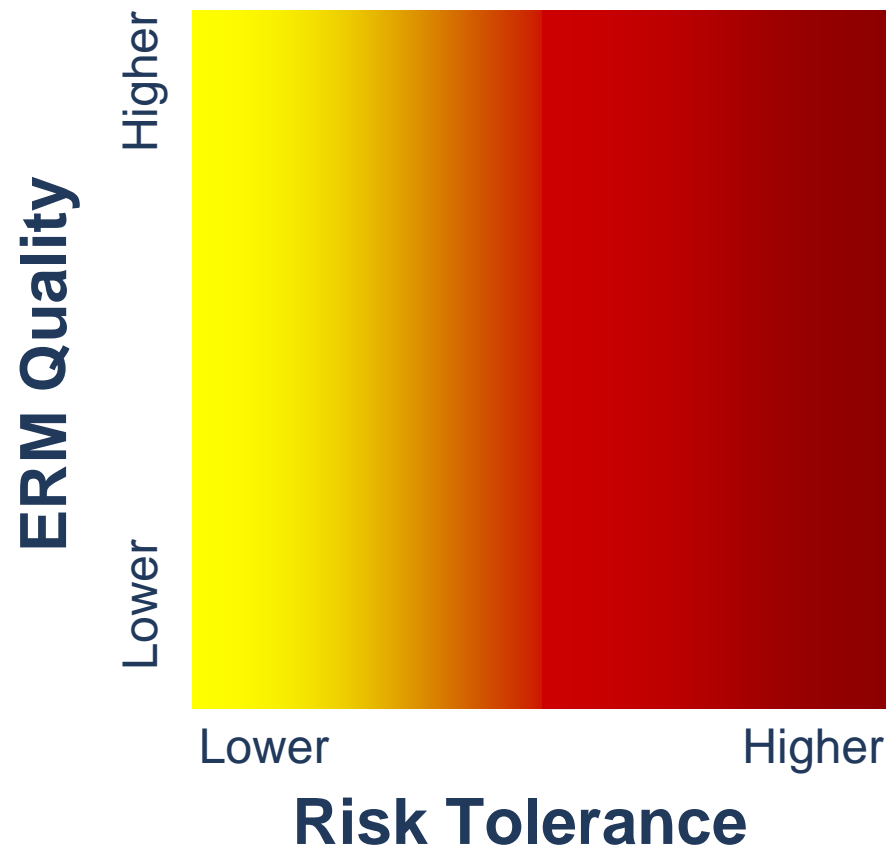
Insurance

Traders (Power, Agriculture, Commodities)

Other Sectors



Before Formal ERM Evaluation

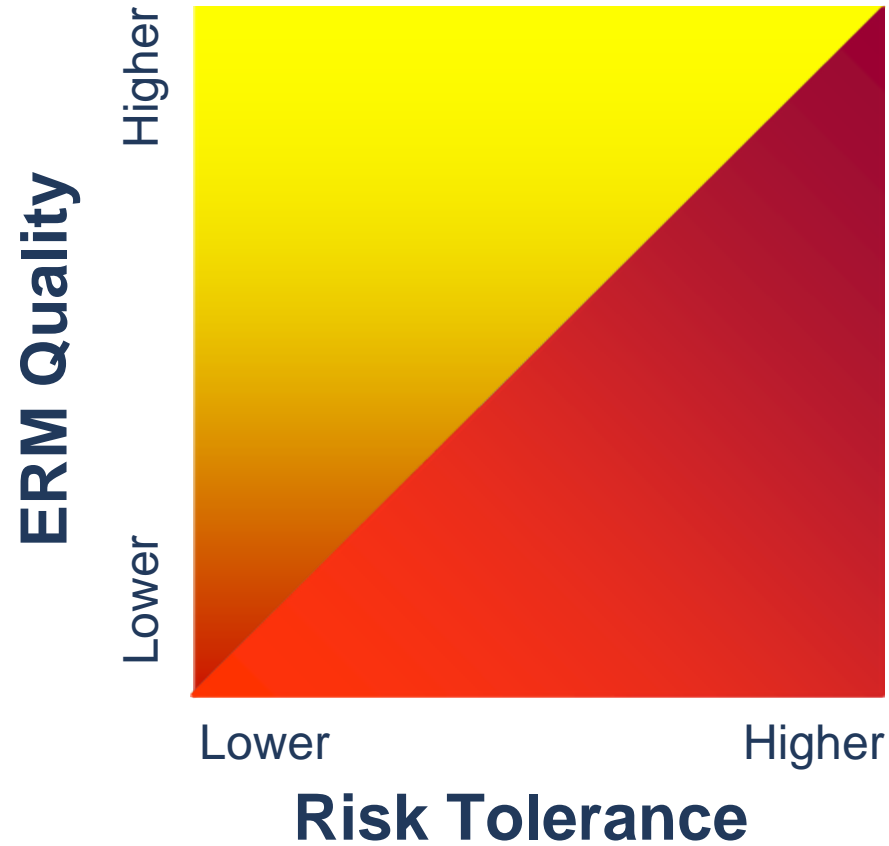


Credit Rating:

High

Low

With Formal ERM Evaluation

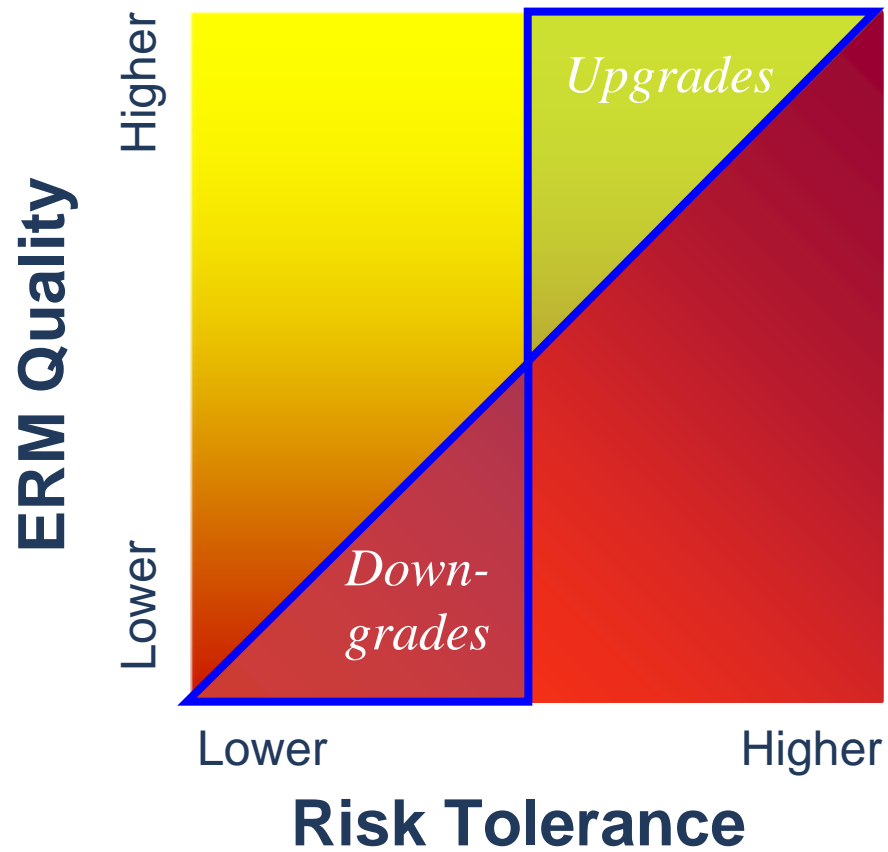


Credit Rating:

High

Low

With Formal ERM Evaluation



Credit Rating:

High

Low

General Framework



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Proposed ERM Framework – Corporate Ratings



Proposed ERM Framework – Corporate Ratings

Sample Questions:

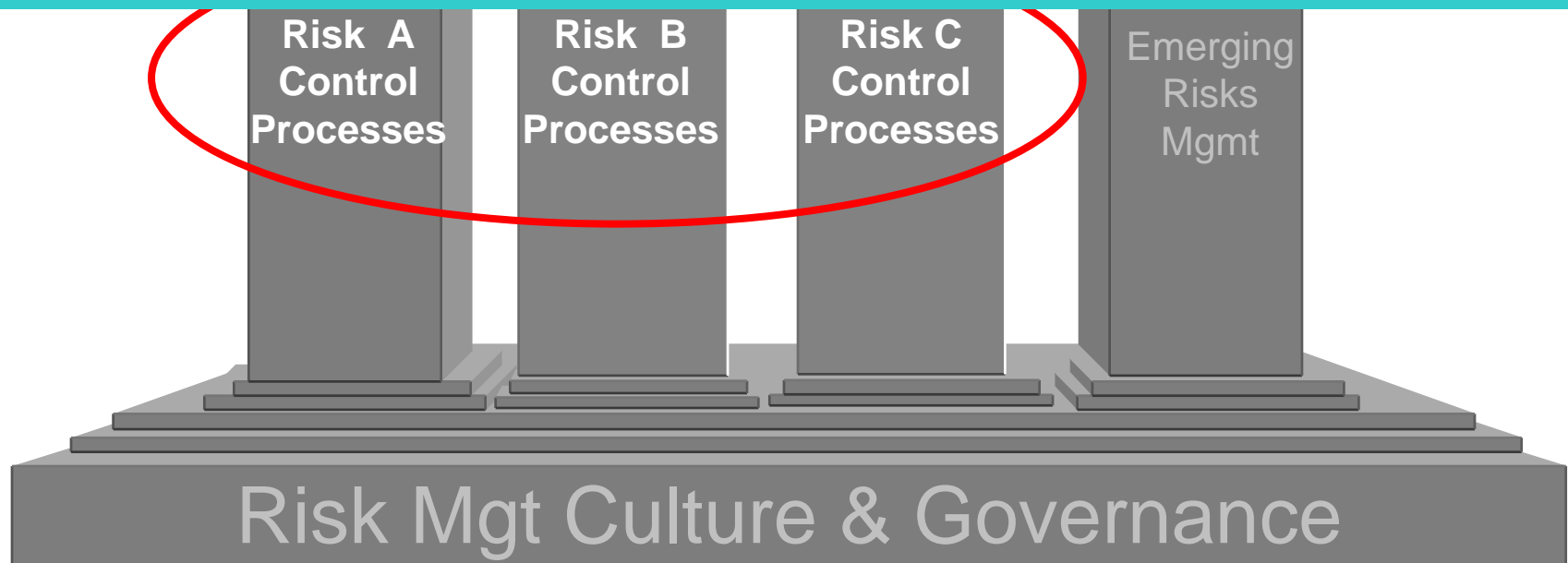
- Is there a statement of risk appetite/tolerance?
- What staff are responsible for risk management?
- What are reporting relationships?
- What reports do the CEO/Audit Committee/Board see?
- How do you measure success of the RM program?
- How is RM integrated into performance/budgeting process?
- How do RM metrics impact compensation for managers?

Risk Mgt Culture & Governance

Proposed ERM Framework – Corporate Ratings

Sample Questions:

- How do you identify and control major risks?
- What are your risk limits for these major risks? How are they enforced?
- How did you manage losses in the most recent loss event?
- What changes were made to RM procedures as a result of the experience?
- What information about each risk is shared w/senior management/board?



Proposed ERM Framework – Corporate Ratings

Sample Questions:

- What do you do to prepare for extreme disaster situations?
- What types of extreme disasters are of active concern?
- What are your stress testing practices?
- What are your liquidity risk management practices?
- What contingency plans have you developed?
- What environmental scanning techniques do you use to anticipate emergence of extreme disasters?

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Emerging
Risks
Mgmt

Risk Mgt Culture & Governance



Strategic Risk Management

Sample Questions:

- What are the top risks of the firm, and in what order of importance?
- How has management assessed likelihood & impact of each?
- How often are major risks reviewed to reassess importance?
- How has risk view impacted liability management and financing?
- What strategic decisions have been impacted by risk management?

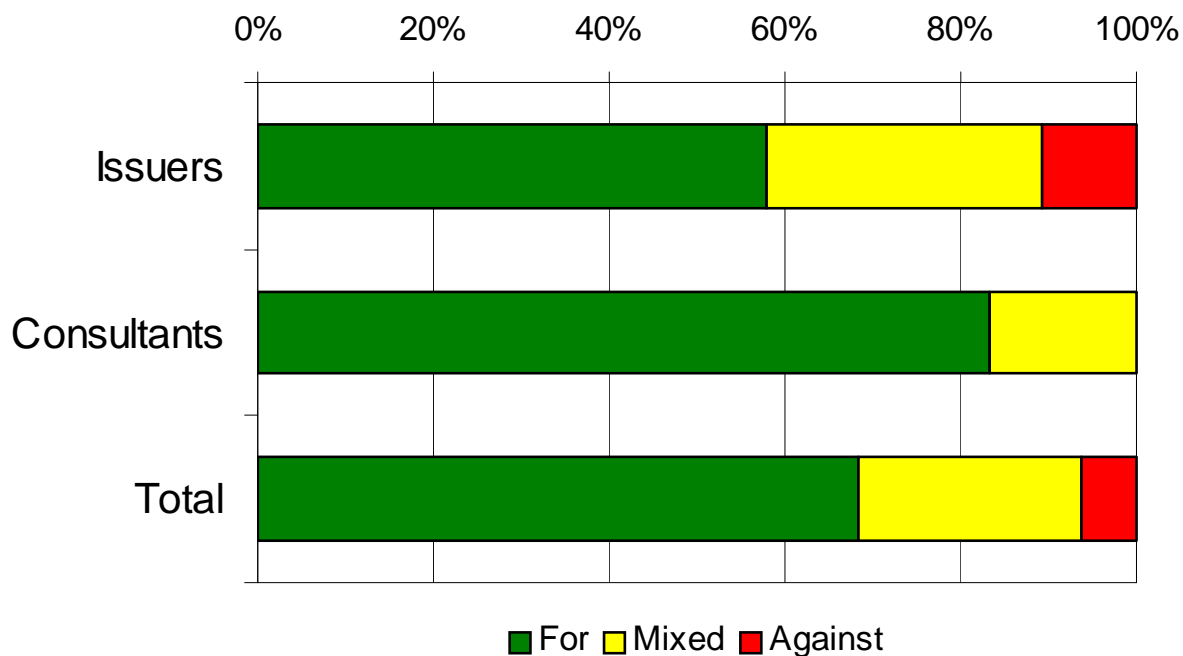
Risk Mgt Culture & Governance

Request for Comment – ERM for Corporate Ratings

- Is it Worth the Considerable Effort?
- Does the Proposed Framework Adequately Capture Companies' Risks and Capabilities to Manage Them?
- Are the Proposed Sector-Specific Risks the Right Ones?
 - Does the Proposed Scoring System (Excellent/Strong/Adequate/Weak) Work for Non-Financial Companies?
 - Are Non-Financial Firms 'Ready' for this Discussion?
 - Suggestions for the Process



Comments Generally Supportive...



- “... it would be best for the assessment to be conducted by a consistent independent party such as a rating agency” (*financial exchange*)
- “... [ERM] discussions ... would be important for assessing credit.” (*rating advisor*)
- “... risk evaluation is and should be part of the rating analysis.” (*manufacturer*)
- “We ... welcome the opportunity to benchmark our ERM capabilities” (*oil company*)

... But Most Expressed at Least Some Concerns

Consistent application

“... risk management is an important exercise for a corporation, but we don't see a constructive and equitable method to incorporate it into a ratings system across diverse industries.” *(manufacturer)*

Recent events in F.I. cast doubts

“... events exposed some of the failings of current ERM frameworks amongst financial institutions and their regulators and rating agencies.” *(association of Treasurers)*

Resources Questioned

“... could significantly absorb the analysts' time....” *(rating advisor)*

Suggestions

“ Drop the attempt altogether, fold it into the already broad discussion with management... , or collaborate with peers, the SEC and other regulators.” *(association of Treasurers)*

Common Themes, Paraphrased

“Don’t make this a box-checking exercise; stress culture and execution, not quantitative metrics.”

“Be consistent but reflect differences by industry.”

“Ensure it is meaningful, i.e., it should impact ratings.”

“Look at the upside as well as the downside.”

“Use existing disclosures and give credit to existing frameworks.”

Next Steps in ERM Analysis for S&P



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