

The Gold Standard for the Risk Committee

A Red Hot Issue

March 9, 2010

NACD New England - Breakfast Series



Panelists & Moderator

Panelists

- ◆ **Laurie Champion**, Aon Global Risk Consulting, Formerly Vice President Risk Management at Coca-Cola Enterprises and Global Director of Risk at Ford Motor Company; Member, RIMS: Risk and Insurance Management Society.
- ◆ **Shawn C D Johnson**, Senior Managing Director, State Street Global Advisors and SSgA Investment Committee Chairman.
- ◆ **James Lam**, Risk Management and Governance Professional. Formerly Chief Risk Officer, Fidelity Investments and GE Capital. Board Member, Covarity, Inc.

Moderator

- ◆ **Linda McGoldrick**, Current and Former Board Member: Rondol Technologies Ltd, Vocera Communications Ltd, GenomeQuest, Inc. Charles River Laboratories International, Inc, Axis-Shield Group plc.

STATE STREET GLOBAL ADVISORS.

National Association of Corporate Directors

March 9, 2010
Shawn C.D. Johnson



RISK – The US Government Perspective

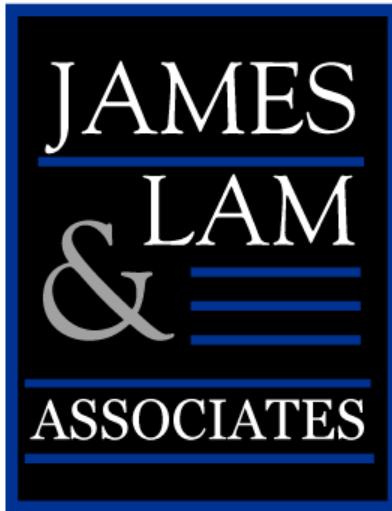
- Homeland Security Presidential Directive 7 – Critical Infrastructure Identification, Prioritization, and Protection
 - Critical sectors of the economy identified and assigned to a “Sector Specific Agency” (SSA)
 - Private sector counsels created to support each SSA in a confidential manner
- Financial Services Sector Coordinating Council (FSSCC)
 - Mission: To foster and facilitate coordination of financial services sector-wide voluntary activities and initiatives designed to improve Critical Infrastructure Protection and Homeland Security
- Functional Areas
 - Policy Development
 - Crisis Management
 - Intra-sector Operations
 - Cross-sector Participation
 - International Critical Infrastructure
- Objectives
 - Identify Threats and Promote Protection
 - Drive Preparedness
 - Collaborate with the US Federal Government
 - Coordinate Crisis Response

RISK – US Private Sector Perspective

- **Russell 1000 boards that have disclosed their adoption of a separate board committee or subcommittee specifically responsible for the oversight of risk management**
 - Only 48 companies on this list*
- What types of risk do most boards focus on?
- Are boards focused on financial reporting risk at the expense of business or reputational risk?
- How many boards have participated in a table top exercise for various disaster scenarios?

Country	Company Name	Ticker
USA	Allied World Assurance Company Holdings, Ltd	AWH
USA	American International Group, Inc.	AIG
USA	Aspen Insurance Holdings Ltd.	AHL
USA	Axis Capital Holdings Limited	AXS
USA	Bank of America Corporation	BAC
USA	Baxter International Inc.	BAX
USA	BB&T Corporation	BBT
USA	Bunge Ltd.	BG
USA	CA Inc.	CA
USA	CenturyTel Inc.	CTL
USA	Comerica Incorporated	CMA
USA	DeVry Inc.	DV
USA	Dominion Resources Inc.	D
USA	Duke Energy Corporation	DUK
USA	Eli Lilly and Company	LLY
USA	Endurance Specialty Holdings, Ltd.	ENH
USA	Exelon Corporation	EXC
USA	Fifth Third Bancorp	FITB
USA	First Niagara Financial Group Inc.	FNFG
USA	Flowserve Corporation	FLS
USA	HCC Insurance Holdings, Inc.	HCC
USA	HCP, Inc.	HCP
USA	Huntington Bancshares Inc.	HBAN
USA	JPMorgan Chase & Co.	JPM
USA	KeyCorp	KEY
USA	King Pharmaceuticals, Inc.	KG
USA	Kraft Foods Inc.	KFT
USA	Lennox International Inc.	LII
USA	MBIA Inc.	MBI
USA	MetLife, Inc.	MET
USA	Northern Trust Corporation	NTRS
USA	Owens-Illinois Inc.	OI
USA	PartnerRe Ltd.	PRE
USA	People's United Financial, Inc.	PBCT
USA	Popular, Inc.	BPOP
USA	Progress Energy, Inc.	PGN
USA	Regions Financial Corporation	RF
USA	State Street Corporation	STT
USA	SunTrust Banks, Inc.	STI
USA	The Bank of New York Mellon Corporation	BK
USA	The Hartford Financial Services Group, Inc.	HIG
USA	The Hershey Company	HSY
USA	The PNC Financial Services Group, Inc.	PNC
USA	The Travelers Companies, Inc.	TRV
USA	Trinity Industries Inc.	TRN
USA	U.S. Bancorp	USB
USA	White Mountains Insurance Group Ltd	WTM
USA	XL Capital Ltd	XL

CMINST-1492 *SSgA analysis of publicly filed documents as of March 1, 2010



NACD New England Chapter

Enterprise Risk Management

March 9, 2010

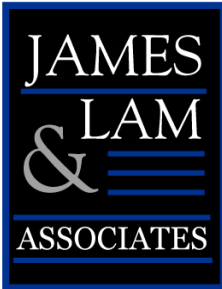
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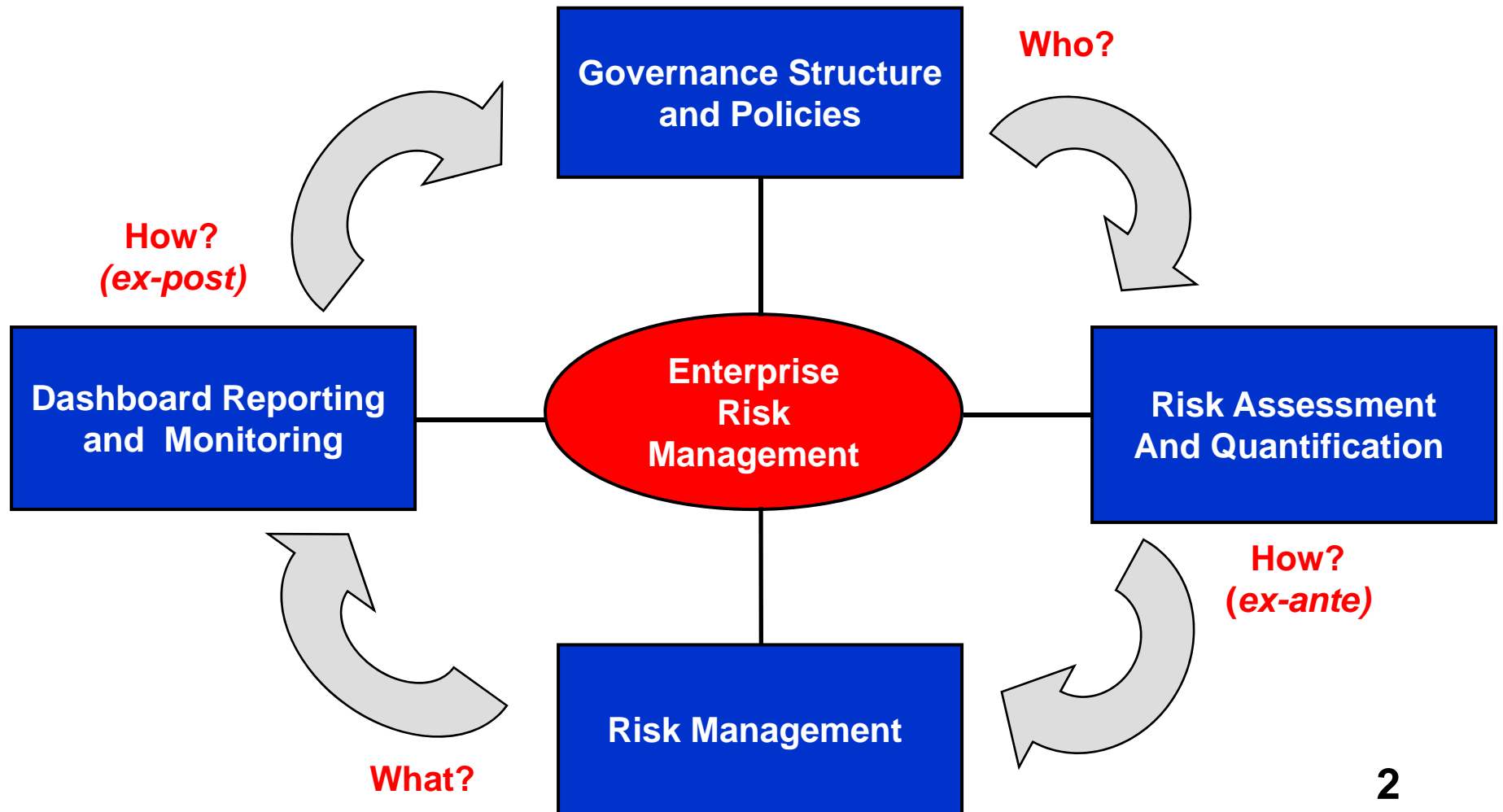
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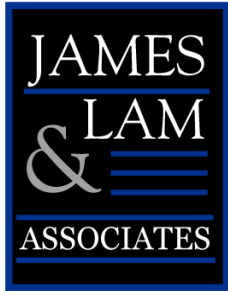


The business case for enterprise risk management

- **Consequences from the financial crisis.** At the World Economic Forum, it was estimated that 40-45% of world wealth was destroyed at the peak of the crisis
- **Weaknesses of silo-based risk management.** Highly interrelated risks cannot be isolated and managed independently. Published examples include:
 - “Confessions of a Risk Manager,” The Economist, August 9, 2008
 - “Behind AIG’s Fall, Risk Models Failed to Pass Real-World Test,” Wall Street Journal, October 31, 2008
- **Call for enterprise risk management.** Organizations are establishing ERM programs to address global risks:
 - Global supply chains and systemic risks
 - Country-specific challenges and best practices
- **New priority for corporate boards.** Recent surveys indicate that risk management has replaced accounting issues as the top concern for boards
- **More stringent requirements from key stakeholders.** Regulators, investors, and rating agencies are establishing greater and more explicit requirements for enterprise risk management

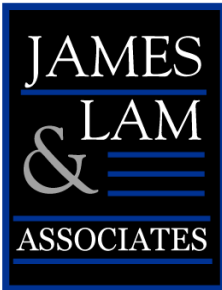
ERM Framework and Processes





One of the most critical questions facing boards and management today

“How do you know if your risk management program is working effectively?”

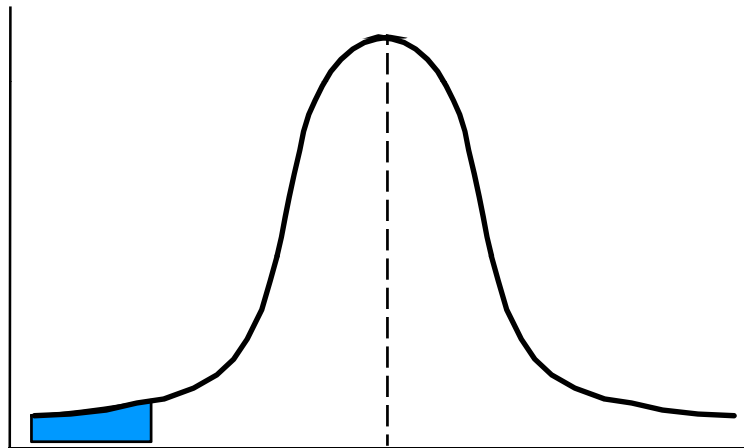


Earnings volatility analysis as an objective feedback loop

Earnings-at-Risk Analysis



Earnings Attribution Analysis



Worst Case EPS = (\$1.00) Expected EPS = \$3.00

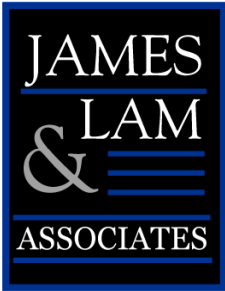
1. Business Plan:	\$2.00
2. Interest Rates:	\$1.00
3. Oil Price:	\$0.50
4. Regulatory Issue:	\$0.30
5. Other:	<u>\$0.20</u>
	\$4.00

Expected EPS :	\$3.00
Actual EPS:	<u>\$1.00</u>
Difference:	\$2.00

Business Plan:	\$1.00
Interest Rates:	\$0.50
Unforeseen Factors:	\$0.40
Other:	<u>\$0.10</u>
	\$2.00

Key Questions:

1. Did we identify the key risk factors?
2. Were our earnings sensitivity analyses accurate?
3. Did risk management impact our risk/return positively?



Three key ERM issues facing boards today (remember GPA)

1. Governance

- Board governance structure
- Oversight of strategy and risk
- Independence of risk management

2. Policy

- Risk policies with explicit risk tolerance levels
- Alignment between risk policies and incentive programs

3. Assurance

- Board reporting and monitoring
- Feedback loop(s) on risk management effectiveness



Using ERM to Enhance Governance and Decision Making

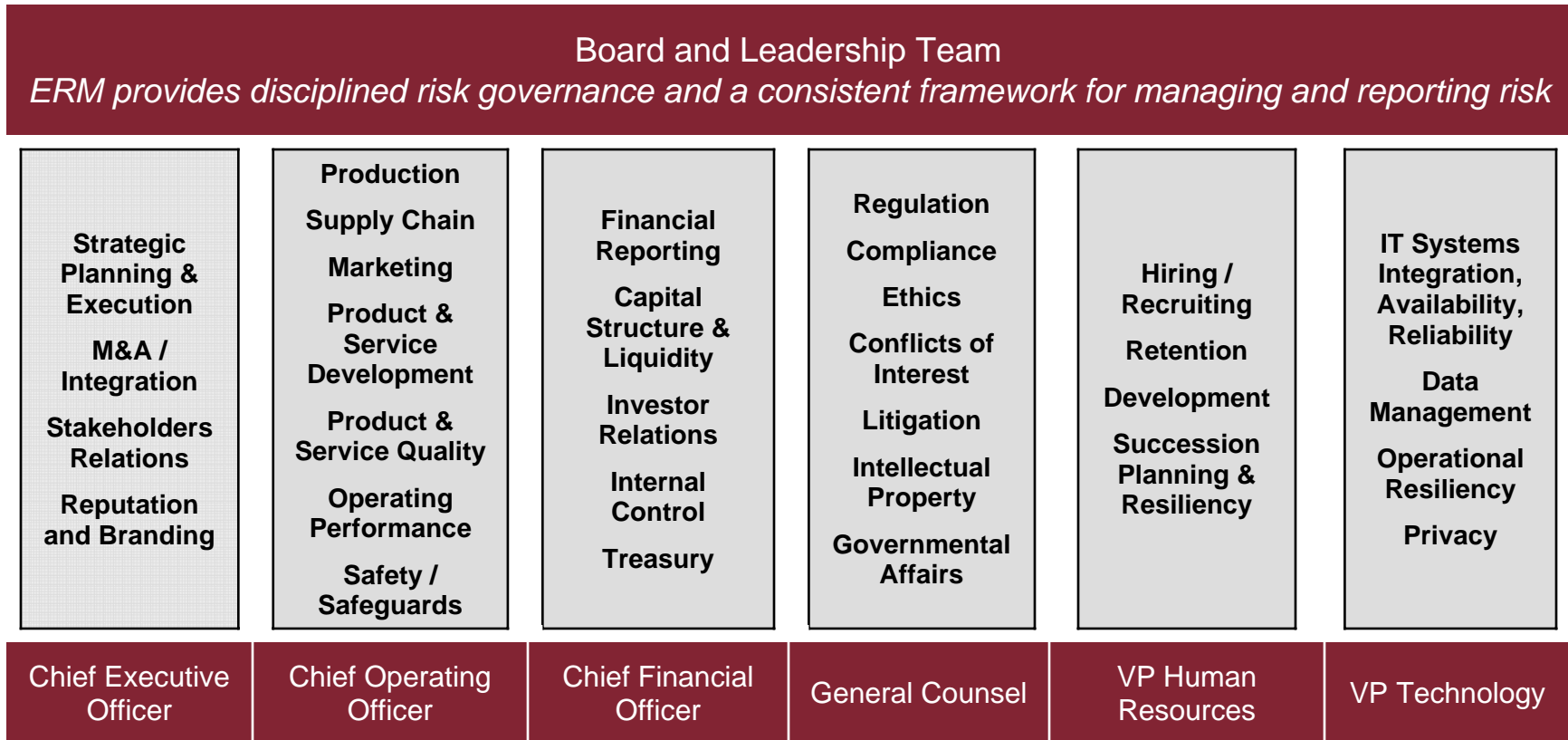
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Enterprise Risk Management

Leverage Subject Matter Expertise to Maximize Value



ERM **preserves subject matter expertise** and focus required to effectively manage specific risk areas (e.g. capital structure, market/commodity) while **establishing an effective approach to understand and manage both existing and emerging risks that require cross-functional solutions** (e.g. supply chain, quality)

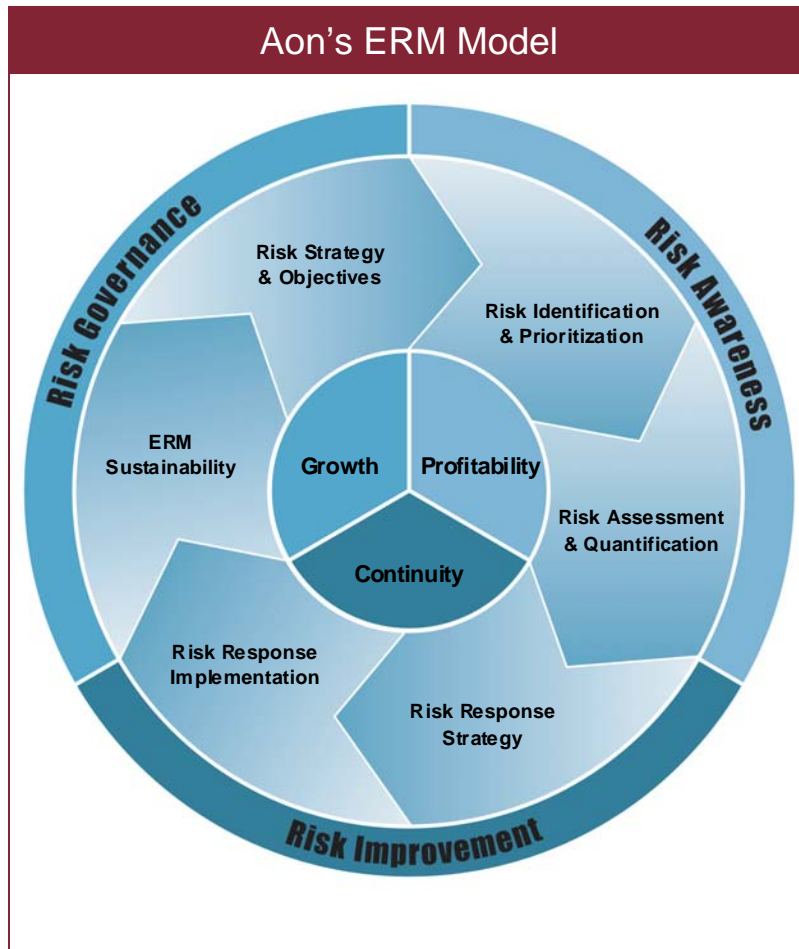
Typical ERM Governance Structure

Different Roles and Responsibilities at Each Level

A **mature ERM program requires an established risk governance structure** including clear expectations and accountabilities at Management and Board levels. This **clarifies roles and expectations**, while enabling Executive Management and Risk Owners to carry out their respective responsibilities.



Well-designed and implemented ERM frameworks improve decision-making, enhance governance and support the delivery of customer service



Improve decisions and demonstrate proactive understanding and management of risk

- Advance management and Board-level awareness of *existing and emerging* risks
- Understand the organization-wide cost of risk
- Allocate limited resources in most effective way to respond to risk
- Link risk information to strategic planning, budget, capital allocation, etc.

Improve organizational health and governance

- Ensure an effective risk management discipline
- Enhance communication across functional “silos”
- Streamline existing risk processes
- Support disclosure and reporting through better understanding of risks and planned responses

Support organization's competitive positioning and delivery of customer service

- Enhance credibility; promote transparency
- Respond effectively if a significant risk event occurs

Aon Client Case Study: Midstream Gas Company

“We want to be upper quartile in risk management”

Situation

A rapidly growing gas processor wanted to evaluate its existing risk management capabilities and develop a strategy to implement a sustainable ERM approach that leveraged the organization’s strengths and closed identified gaps. Aon was engaged by the organization’s CEO and VP Finance & Information Technology to assist the Leadership Team in designing and implementing a practical, customized ERM solution.

Phase 1: Understand ERM Capabilities & Develop Strategy (completed)

- Assessed existing risk management practices against risk management standards (e.g. COSO, Standard & Poor’s) and ERM best practices using Aon’s ERM Evaluation Scorecards
- Identified strengths in existing risk management practices and opportunities for improvement
- Detailed 7 recommendations to close identified gaps against the organization’s desired ERM rating
- Developed multi-year ERM implementation strategy that leverages organizational strengths, closes gaps and supports a sustainable ERM program

Phase 2: Develop Corporate Risk Profile, Implement ERM Framework (completed)

- Designed and implemented ERM tools and processes
- Built enterprise risk profile with “deep dives” on identified Key Risks
- Implemented ERM metrics and reporting
- Guided development of ERM database
- Transferred knowledge to the Company’s ERM Leader, ERM Committee and Leadership Team

Phase 3: Enhance ERM Capabilities (underway)

- Developing corporate risk tolerance and appetite
- Quantifying key risks
- Further enhancing ERM capabilities including risk reporting and communications for the Board

Aon Client Case Study: Consumer Products Company

“Help Us Understand Our ERM Strengths and Gaps, and Get More Value”

Situation

A well-known consumer products company has been engaged in ERM for 3 years, with a focus on understanding the company’s risk profile. Risk information is developed as part of the annual compliance risk assessment process, which begins with an online risk survey distributed to 500 employees. Survey results are analyzed by a core ERM group at VP level to develop the enterprise risk profile, which is reviewed by the Leadership team and the Board. Management wanted to understand how to get more value from the ERM effort, and the Board wanted an independent assessment of the ERM approach against external standards. Aon was engaged by the company’s CFO and General Counsel to provide an independent evaluation and ERM development strategy.

Understand ERM Capabilities & Develop Strategy

- Assessed existing risk management practices against risk management standards (e.g. COSO, Standard & Poor’s) and ERM best practices using Aon’s ERM Evaluation Scorecards
- Provided ERM education and identified the company’s ERM target
- Identified strengths that could be leveraged to take ERM to the next level
- Detailed 5 specific improvements that “fit” with existing management practices and culture
- Provided results to Board Audit Committee
- Collaborated with the ERM leaders (VP level) to design effective ERM tools and templates
- Coached ERM leaders through process improvement