Special Advertising Section

ERM: The Future of Risk Management

By Bill Coffin

Over the last several years, the business world has seen an unprecedented succession of high-profile disasters that have forced companies large and small to reassess how they must manage their portfolio of risk. September 11 showed that even the most innocent of businesses can be destroyed or disrupted by terrorism. The accounting scandals that led to creation of Sarbanes-Oxley revealed to boardrooms everywhere how high the stakes were for entities lacking ethical best practices. The hurricane season of 2004, and Hurricanes Katrina, Rita and Wilma in particular, made it clear that killer storms could send shockwaves into daily operations that are hundreds or even thousands of miles from landfall. And the crusade by former New York Attorney General Eliot Spitzer to eliminate contingency fees in the insurance industry rocked some of the biggest players in one of the world's oldest financial industries. But more than that, it has encouraged other regulators and legislators who, emboldened by Spitzer, wish to carry on his work by rooting out corporate wrongdoing — real or perceived — regardless of the collateral damage it may cause to ethical businesses everywhere.

> *The key was to get every department, every manager and every asset at the organization's disposal involved in a kind of holistic crusade to integrate risk management into every daily operation. This is enterprise risk management, or ERM. And it is the future of the risk management discipline.*

For companies with strong risk management programs, the newfound appreciation coming from the boardroom was a welcome boost. But for just as many organizations, executives scrambled to realize just what risk management meant and what needed to be done about it. Strangely, both reactions led organizations to the same realization: that today's risks are simply too deep and diverse for any single department to manage with peak efficiency. The key was to get every department, every manager and every asset at the organization's disposal involved in a kind of holistic crusade to integrate risk management into every daily operation. This is enterprise risk management, or ERM. And it is the future of the risk management discipline.

Demonstrates Value and Impact

John Phelps ARM, CPCU, describes ERM as a collection of resources, processes and tools to better understand, evaluate and manage the threats and opportunities associated with the uncertainties of business decisions. Phelps is the director of risk management for Blue Cross and Blue Shield of Florida. He is also the chairman of the ERM committee for the Risk and Insurance Management Society, Inc. (RIMS), the world's foremost risk management trade association.

"ERM is a way to better and more precisely evaluate uncertainties that are associated with the risk-taking activities of a company," Phelps says. "Such a discipline had not been applied in many companies previous to the fairly recent advent of the ERM concept."

Once an organization has figured out what ERM standard best applies to it, there is still the challenge of bringing an ERM program from theory to actual implementation. For Carolyn Snow, director of insurance risk management for leading health insurer Humana Inc., ERM is in the early stages at her company, and like many other companies, Humana will continue to research it for some time. "Our planning process is a very collaborative effort of internal audit and insurance risk management with heavy involvement of IT, legal and other areas. For us, ERM will evolve and will include implementation of new software."

> *"ERM is a way to better and more precisely evaluate uncertainties that are associated with the risk-taking activities of a company."* — JOHN PHELPS

Because many companies define and implement ERM differently, it can be difficult to benchmark an organization's progress. This is where the RIMS Risk Maturity Model for Enterprise Risk Management comes in. Co-developed by RIMS and LogicManager, a leading developer of ERM-based solutions, the RIMS Risk Maturity Model provides a "road map" to a successful implementation of an ERM program. A key element of this is the Model's identification of seven key "attributes" that identify and measure the degree of quality and business value in an ERM program. These include variables such as ERM process management, risk appetite management, uncovering risks, and business resiliency and sustainability. The degree to which a company has developed the key ERM attributes puts it on a five-level progression of ERM program maturity, from "non-existent" to "leadership."

Some of the defining aspects of those attributes would be, for example, how well the process for identifying, evaluating and managing risk has permeated the management of the organization, Phelps says. Without an enterprise-wide methodology, people within an organization will define and measure risk according to their own experience and perceptions. That, in turn, makes it very difficult to meaningfully manage risk across the enterprise.

"The RIMS Risk Maturity Model is not an ERM standard or a framework," Phelps cautions. "I still hear people referring to the different standards of ERM, and include the Risk Maturity Model as an example. It is not a standard. It sits on top of all of those frameworks, so no matter which standard you use, you can measure your development progress."

To Aggregate Risk and Allocate Resources

While ERM is still an emerging methodology, it is seen as one vital to the future of effective risk management. "Historically, risk management departments have focused on negative risks and looked for ways to mitigate or transfer the impact of a potential loss, generally through the use of insurance or other contracts," says Snow. "Risks that were more easily measured got the majority of the attention. Enterprise risk management brings in all facets of the corporation and the business people who run the markets and departments. They may have already been practicing good risk management, but ERM will allow companies to better aggregate risks, both positive and negative, and allocate resources."

> *While ERM is still an emerging methodology, it is seen as one vital to the future of effective risk management.*

Phelps agrees, but for him, it might be better thought of as good, old-fashioned best practices. "Some would argue that ERM is simply what risk managers should have been doing 25 years ago. But they had not evolved to the strategic roles that many risk managers have today," Phelps says. "I use ERM to distinguish what I used to do compared to what I do now, so people in the company won't see me and automatically say, 'Oh, it's the insurance guy.' I now offer much more value than that."

Bill Coffin is the publisher and editorial director of Risk Management Magazine, *a monthly publication of the Risk and Insurance Management Society, Inc.* (www.RIMS.org)