



**Enterprise Risk Management:**  
*S&P Enhancement White Paper*

Learn how incorporating a strategic, enterprise-wide approach to risk can enhance your company's credit rating

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## Executive Summary

On May 7, 2008, Standard & Poor's (S&P) announced that the agency will enhance its global rating process for non-financial companies to include a review of their Enterprise Risk Management (ERM) programs.

S&P will begin to hold ERM discussions with rated companies in the third quarter of 2008 and will begin to include commentary in S&P reports in the fourth quarter 2008. Even though these discussions will begin in 2008, S&P's formal scoring of companies' ERM capabilities (e.g., "strong," "adequate," "weak," etc.) will not go into effect until the rating agency has conducted a sufficient number of reviews to permit reliable benchmarking and published evaluation criteria, which is unlikely to occur before 2009\*

The S&P reviews will focus predominantly on Strategic Risk Management and Risk Culture and Governance, two widely applicable aspects of ERM.

S&P's announcement provides a timely opportunity for effected companies to conduct an objective, third-party review of their ERM programs prior to the official S&P risk management reviews. Senior management of S&P-rated companies need to demonstrate an ability to incorporate risk information as a part of the strategic decision-making process in order to score well on the S&P ERM assessment. Addressing your organization's state of preparedness for the impending S&P ERM review could potentially drive meaningful financial benefits including a reduced cost of servicing debt, improved access to capital and the cost of capital, and increased investor confidence.

Aon's ERM consulting practice offers all clients, whether rated or not, an array of services that provide tangible value within the company and with external stakeholders. Aon's ERM solutions align with this new S&P ERM review process and will ideally lead to maintaining or enhancing the current S&P rating of our clients. Aon's global ERM methodology helps our clients build an overall framework to analyze, monitor, quantify and respond to key risks with appropriate flexibility for existing culture and process.

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\* "Standard & Poor's To Apply Enterprise Risk Analysis To Corporate Ratings" May 7, 2008, Steven Dreyer and David Ingram

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## 1.0 S&P's Approach to ERM Reviews

One of the stated goals of S&P's assessment process is to evaluate the extent to which companies approach risk management from an integrated, enterprise-wide perspective. S&P is particularly interested in two areas – Strategic Risk Management, and Risk Culture and Governance. The focus is therefore on how management addresses the risks to achieving strategic plans and embeds a culture of risk awareness across the organization. Processes that help management understand, manage, and communicate information about risks throughout the enterprise will be reviewed for effectiveness, along with management's ability to interpret and make qualitative judgments in response to various risk metrics.

S&P has said its ERM assessment process will not replace any current evaluation criteria, but rather enhance the appraisal of management's ability to manage key risks. Therefore, senior management of S&P rated companies need to demonstrate a strong risk management culture and an ability to incorporate risk information as a part of the strategic decision making process in order to score well on the S&P ERM assessment.

### **S&P's examples of risk management culture analysis include:\***

- risk-management frameworks or structures currently in use
- roles of staff responsible for risk management and reporting lines
- internal and external risk-management communications
- broad risk-management policies and metrics for successful risk management
- influence of risk management on budgeting and management compensation.

### **S&P's examples of evaluation criteria for strategic risk management analysis include:\***

- management's view of the most consequential risks the firm faces, their likelihood, and potential effect on credit
- frequency and nature of updating the identification of these top risks
- influence of risk sensitivity on liability management and financing decisions
- role of risk management in strategic decision making

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\* "Standard & Poor's To Apply Enterprise Risk Analysis To Corporate Ratings" May 7, 2008, Steven Dreyer and David Ingram

## 2.0 Aon's Response

Successful companies generally have processes and staff in place to manage their most significant known risks; however, risk is often managed in silos, resulting in lack of continuity across the organization and a tendency to manage risks independently, and sometimes differently, from business unit to business unit.

Companies that adopt ERM do so because it offers greater potential for success through better awareness and control of risks, improved resource efficiency, and enhanced ability to take additional business risk.

Companies that have implemented successful ERM programs often find improved consistency in risk management practices and better response to escalating corporate governance requirements, regulatory pressure, capital availability and cost, capital deployment, and market pressure through improved understanding of risk and mitigation options.

Aon's experience indicates that there are seven attributes of an effective ERM program that can be implemented in stages to advance an organization toward more effective risk management. These attributes align with S&P's criteria for assessment:

- **established goals and oversight structure**
- **understanding of existing risk management processes**
- **effective risk identification and prioritization**
- **a disciplined approach to quantifying the most significant risks**
- **an effective approach to identifying and evaluating risk response solutions**
- **successful implementation of risk response solutions**
- **appropriate risk governance, culture and disclosure**

Aon's global ERM clients represent a range of industries including energy, manufacturing, financial services, entertainment, consumer products, and chemicals and pharmaceuticals. Aon's ERM consulting team helps clients achieve maximum value from their ERM investment through a disciplined and efficient approach to design, implementation and ongoing management of ERM programs. Typical benefits include:

- **increased senior management awareness of critical risks**, potential impact on financial performance and organizational health, and risk response options
- **improved predictability of financial performance through better risk taking**, forecasting and reporting
- **improved real-time** understanding of balance sheet risks
- **enhanced strategic planning and business planning** processes
- **improved corporate governance**, including increased transparency about risk for internal and external stakeholders (board of directors, investors, creditors, regulators and rating agencies)
- **better allocation of resources and increased operational efficiency** including risk-based decision processes
- **more efficient risk management decisions**, including whether to transfer, mitigate or avoid the risk, and better understanding of impact of risk on reputation

### 3.0 The Way Forward

As senior management prepares for upcoming 2008 ERM reviews with S&P, a first step will be to understand the existing ERM program in general and in response to S&P's two areas of focus: Strategic Risk Management, and Risk Culture and Governance. Once areas of strength and weakness are known, it will be important to develop and document plans to close gaps in the ERM program, as well as any gaps in risk understanding and response, within a reasonable timeframe. The gap closure plan should align with the company's commitment to a potential S&P ERM score (e.g. "strong," "adequate," "weak," etc.) in 2009.

S&P's announcement provides a timely opportunity for S&P-rated companies to conduct an objective, third-party review of their ERM program prior to the official S&P risk management reviews. Addressing your company's state of preparedness for the impending S&P ERM review could potentially drive meaningful financial benefits, including a reduced cost of servicing debt and an increase in investor confidence.

In addition, although S&P has stated that its reviews will focus on Strategic Risk Management, and Risk Culture and Governance, there is an opportunity to communicate a range of successes achieved through existing risk management programs.

Aon's ERM risk consulting practice offers an array of services that align with this new S&P ERM review process.

### 4.0 Aon's ERM Consulting Practice

Aon's ERM process provides value to rated companies beyond ratings maintenance and enhancement, and also provides benefits to companies not rated by S&P.

At Aon, our objective is to efficiently partner with our clients to create and enhance the capabilities necessary for the company to manage risk on an ongoing basis. Aon's practical methodology enables clients to use ERM to drive value-based decisions regarding alternative risk strategies. Our ERM consulting practice helps clients achieve the maximum benefit from ERM programs from design through implementation and maturity.

To achieve success with our clients, Aon has developed a comprehensive and proven approach to help clients create and deploy an ERM program.

Our ERM team offers an array of services that are closely aligned with the S&P criteria for both Strategic Risk Management, and Risk

**Culture and Governance.** This approach enables our clients to quickly determine their state of readiness and identify any potential gaps.

Aon also helps clients put together program plans for addressing any deficiencies that are uncovered.



Although S&P brings additional attention to ERM, a successful ERM program creates benefits beyond the rating agency review. For example, quantitative analysis of risks provides the ability to link key risks to specific financial objectives and metrics, enabling improved strategic decision-making. An improved understanding of how risks are identified, managed and reported across the company enhances overall corporate governance, as well as existing business planning and strategic planning processes. Although S&P is not focusing on risk mitigation plans and implementation, ERM brings ongoing benefit to the operations by supporting identification, design and implementation of many types of risk solutions.

At a high-level, we engage with clients in the following areas:

### **Setting Goals and Determining Oversight Structure**

Aon works with client companies to determine risk management goals and enterprise-wide risk governance approach. Often client companies create a senior management panel (or formal ERM Committee) to guide this work, and in our experience no ERM program will be successful without senior management support. Aon conducts an assessment of each client's needs to help develop program objectives and oversight structure to ensure that our clients invest in what is right for their businesses.

### **Evaluate Risk Process**

Although client companies may not have a formal ERM program, nearly all have a variety of existing risk management processes that provide a good basis for development of an ERM program. Aon will work with clients to conduct a current-state assessment of the existing ERM process or risk management function. We use structured interviews, documentation reviews and knowledge of best practices to develop an ERM maturity scorecard across several dimensions.

### **Risk Identification and Prioritization**

Risk assessment is a critical component of a successful ERM program. Aon helps clients identify and prioritize key risks to the enterprise. Activities may include surveys, interviews and workshops with risk experts and senior management at the business unit, operating company and enterprise levels. The resulting risk prioritization is used to develop risk mitigation options and determine areas in which further analysis is needed.

### **Risk Quantification**

Aon uses advanced risk analysis techniques to provide quantitative assessment of the potential impact of selected key risks. This analysis can take various forms ranging from high-level to detailed analysis depending on the type of risk, the amount of data available, and the criticality of the risk. Results from these models are integrated with the company's risk appetite (at enterprise level) and risk tolerance (at business unit level) to highlight areas in which more or less risk may be desired.

### **Risk Response Solutions**

Using information developed throughout the project, Aon works with clients to develop and assess alternative risk mitigation strategies. This includes evaluation of risk-reward tradeoffs for the alternative strategies (in comparison to existing risk processes and mitigation strategies), which facilitates management decision-making regarding the best use of risk management capital to manage risk and increase enterprise value.

## Risk Management Implementation

Aon's risk experts help clients design and implement a wide range of risk management solutions, including:

- **Asset management** – including supply chain management, asset protection, business continuity planning, safety management, and risk control practices.
- **Liability management** – including claims organization design, claims strategy, risk financing solutions including insurance/reinsurance and capital market solutions, merger and acquisition support, and captives and risk retention groups.
- **Governance** – including risk management strategy and operations, risk governance control process, internal and external reporting, risk scorecards and performance metrics, and links to financial reporting and disclosure processes.
- **Human Capital** – including human resource strategies, performance management, training and development, organizational design, risk management staffing and outsourcing.
- **Data Management** – including risk management data and systems, acquisition of data from inside and outside the company, data and system controls, and reporting tools and processes.

## Governance, Culture and Disclosure

Aon's ERM experts work with management teams to improve risk governance practices. This often involves a review of risk management infrastructure and organizational structure. Deliverables may include organizational realignment, training and other risk management program improvements. Aon also helps identify and map existing risk ownership, determine where there are gaps in ownership, and develop governance solutions to close these gaps.

Additionally, Aon works with clients to determine the appropriate needs of the business, its management, and key constituents (for example, rating agencies, the board, audit committee, and external regulators) to assist in the design of meaningful communication processes and materials aligned with existing disclosure processes.

Aon's ERM consulting practice also offers development of performance and value metrics that will ideally lead to maintaining or enhancing the current S&P rating of our clients.

## 5.0 Case Studies

The following brief case studies are provided to demonstrate the breadth and depth of Aon's experience in helping clients develop and sustain advanced ERM programs, and communicate the results both internally and externally.

### Using an ERM program to realize untapped resources and opportunities

Aon conducted an ERM study for a global petroleum conglomerate. The project was focused on systematic identification and assessment of risk, and integration of risk management into the client's executive level decision-making process. Aon developed and documented the risk profile, prepared quantitative analysis of key risks using key performance indicators, helped its client improve financial planning and budget process, and produced a financial forecast showing a significant improvement in operating profit (\$400 million) based on this enhanced risk information. Through this project, Aon helped build understanding of correlations in macroeconomic and risk forecasts, resulting in higher profitability than had previously been forecasted, thereby freeing capital for additional internal and external investment opportunities.

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### **Risk quantification and decision support framework tied to strategic planning**

Aon helped a large manufacturing client develop advanced risk quantification models for key operational risks. This included a framework to update the models as business conditions change and new information develops. Aon consistently translated internal information from subject matter risk experts into a reliable quantitative framework. The project concluded with development of metrics to quantify the financial impact of key risks on enterprise value, and linkage of this information to the strategic planning process.

### **Improving risk culture through management decision-making and risk reporting**

Aon helped a multinational construction client develop an ERM framework and tools to incorporate risk information into executive and board-level reporting, as well as the company's business planning process. Aon developed a risk assessment framework and a risk prioritization and reporting approach that would work across more than 120 countries. Deliverables included development of a standard risk nomenclature and reporting tools to track more than 100 risks throughout the enterprise.

### **Enhanced transparency with external stakeholders**

Aon helped its financial industry client improve external disclosures about risk, including improved communications with rating agencies and equity analysts. This included analysis of prior risk disclosures and rating agency presentation, comparison with improved risk information and development of new risk reporting and communication tools. The resulting material helped the senior management team conduct strategic risk management reviews with the board and external stakeholders.

## **6.0 Aon's Commitment**

Aon is fully committed to providing clients with a practical, quantitative approach for optimizing risk performance and the ability to execute a wide range of risk solutions. We help clients improve financial performance through a full range of ERM services that will be tailored to fit each client's specific requirements.

With more than 2,000 risk consulting experts in 90 locations, Aon has the resources, processes and technologies to deliver an end-to-end solution including world-class quantitative analysis, ERM consultants, and risk technology expertise.