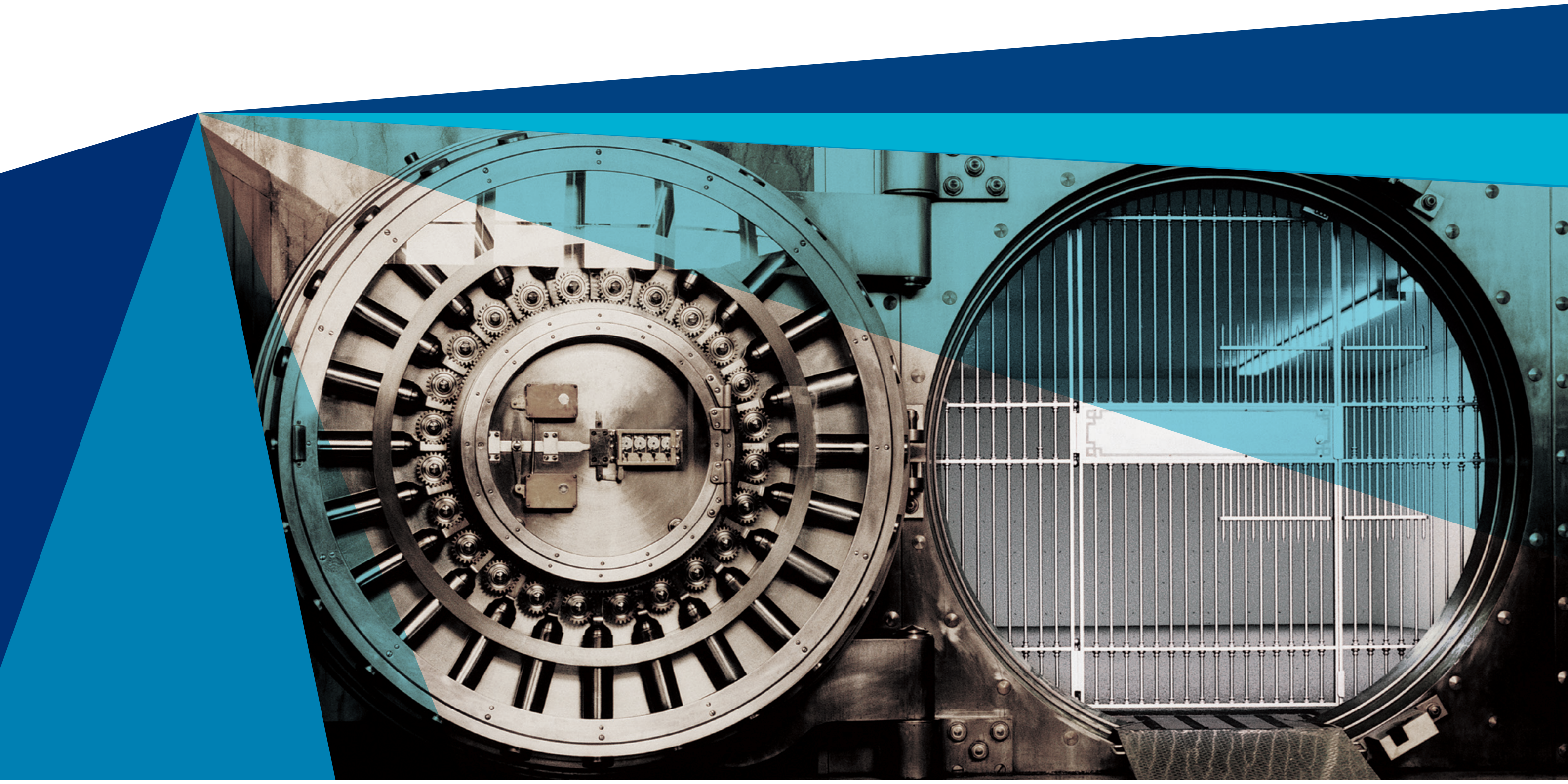
OLIVER WYMAN

UNLOCKING THE TRUE POTENTIAL OF ENTERPRISE RISK MANAGEMENT

SIX STEPS TO IMPROVE YOUR COMPANY'S FINANCIAL PERFORMANCE



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1. **Risk appetite:** Add greater discipline to decision making by aligning your company's ability and willingness to take risk
2. **Measurement of risk exposures:** Determine the top 10 risks that drive most of the volatility in key financial metrics
3. **Dynamic financial planning:** Deepen your company's understanding of the uncertainty embedded within your business plan to seize on new opportunities effectively
4. **Risk-adjusted portfolio strategy:** Integrate risk into strategic decision making to improve the risk-return performance of your company's business portfolio
5. **Data and reporting:** Draw better risk, finance, and strategy insights from data integrated from across all businesses
6. **Risk culture:** Foster increased risk awareness and a cultural transformation

MARSH & McLENNAN COMPANIES

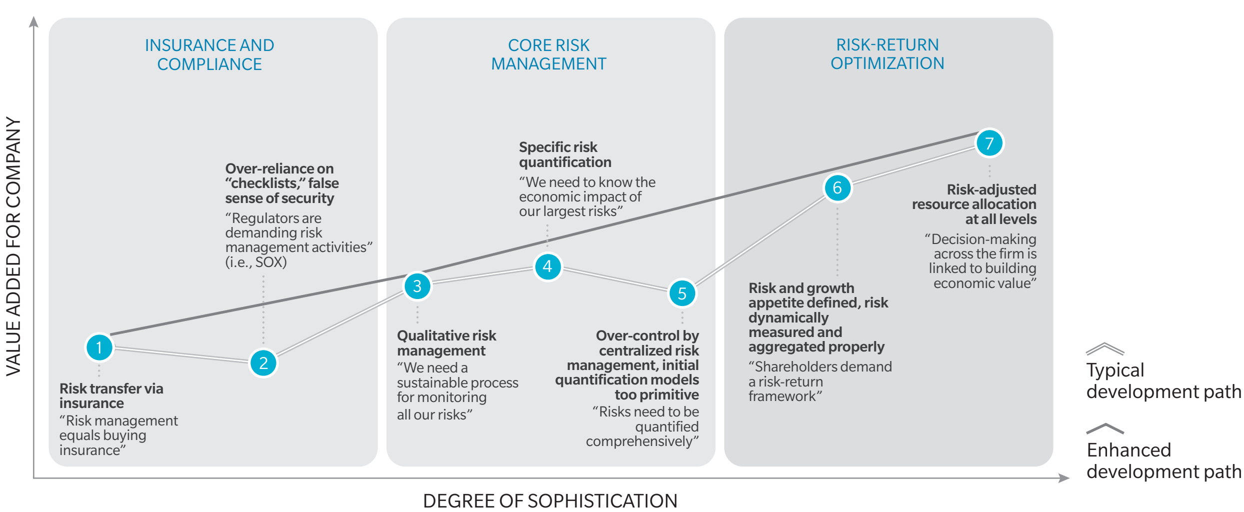
THE EFFECTIVENESS OF A CORPORATE ENTERPRISE RISK MANAGEMENT PROGRAM IS STARTING TO SEPARATE WINNERS FROM LOSERS IN THE EYES OF INVESTORS, B2B CUSTOMERS, AND RATING AGENCIES

Companies need more sophisticated risk management capabilities in a rapidly changing world of increasing uncertainty and challenges in processing mounting amounts of data. The risks that companies face are growing both in terms of magnitude and complexity, presenting challenges for traditional risk management programs. On top of significant uncertainty around the pace of the economic recovery, the evolution of key financial markets, the regulatory environment, and consumer preferences are evolving at an ever faster pace. Product cycles are also becoming shorter due to advances in technology, globalization, and the use of social media.

The recent *2013 AFP Risk Survey* conducted by Oliver Wyman and the Association for Finance Professionals reported that 59% of corporate executives were experiencing higher earnings volatility than five years ago. They identified customer satisfaction and retention (44% of companies surveyed), regulation (37%), and GDP growth (35%) as the top risks, all of which, they perceived to be complex in nature and difficult to integrate in corporate planning.

At the same time, the effectiveness of a company's enterprise risk management program is becoming a more important consideration for institutional investors, rating agencies, and large business-to-business customers. There is increasing recognition that risk management delivers not only more stable but also greater returns. For example, risk management investment in the area of occupational health and safety has been estimated to provide, in addition to the incalculable benefits of protecting employees' well-being, a return of $3-5 dollars for every dollar invested. As a result, risk management practices

EXHIBIT 1: EVOLUTION OF RISK MANAGEMENT TOWARDS RISK-RETURN OPTIMIZATION



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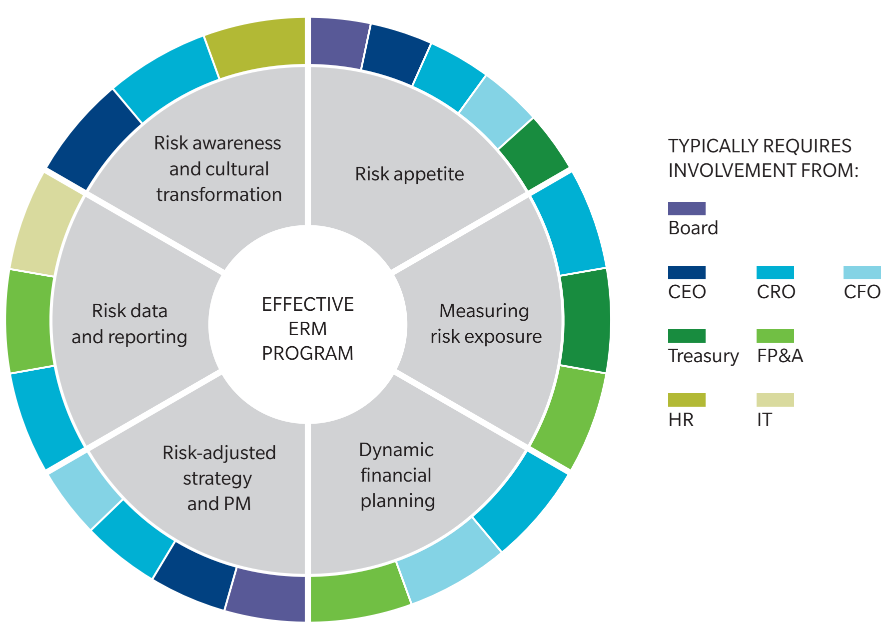
are being placed on an equal footing with measures of profitability, growth expectations, and cash flow generation. Asset managers seeking companies that can guarantee with a high degree of certainty the ability to meet dividend commitments are reluctant to invest in companies which have made only token risk management efforts. Rating agencies such as Standard and Poor's consider ERM effectiveness as part of their evaluation process.

Recently, S&P evaluated the risk management programs of over 2,190 US companies and published the top 125 rated as "strong" and bottom 64 rated as "weak" as part of their credit review process. Meanwhile, large B2B clients increasingly concerned about the reliability of their supply chains. These clients are refraining from entering contracts with companies that cannot answer hard questions about their processes to manage operational and financial risk.

In response to these pressures, companies are increasingly investing in the people, processes, and IT systems necessary to improve the performance of their ERM programs. In industries such as oil & gas, the majority of leading players are currently using sophisticated risk management processes to evaluate investment opportunities and to improve the predictability of their future cash flows. Players in other industries are rapidly catching up. With jet fuel reaching 30-40% of their operating expenses, some airlines have developed increasingly advanced programs to manage their exposure, reducing both risks and costs at the same time. Delta Airlines recently went so far as to purchase a refinery to achieve competitive pricing and increase their market share even during times of increased market volatility.

However, when ERM is executed without a clear roadmap and end goals in sight, it can often result in significant added cost while providing limited strategic benefits as shown in Exhibit 1.

EXHIBIT 2: SIX BUILDING BLOCKS OF AN EFFECTIVE ERM PROGRAM



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There is a better approach. In our experience, companies that integrate ERM into their existing processes for strategic decision making, financial planning, and treasury can realize the full potential of ERM by making more efficient use of available data. By focusing their ERM program on six key areas, companies can significantly improve their revenues, operating margins, and returns on capital. These comanies are better able to devise and carry out corporate strategies that minimize losses, capitalize on opportunities, and improve the stability of their financial performance. Below are the six key areas on which we advise companies to concentrate their ERM programs:

1. **Risk appetite:** A clear risk appetite statement helps the board of directors, management, and shareholders to reach agreement about the company's ability and willingness to take certain risks. When cascaded throughout the organization, it adds discipline to risk-taking inherent in day-to-day operating decisions.
2. **Measurement of risk exposures:** For most companies, a few top risks drive the majority of earnings volatility. By focusing efforts on top risks, companies can improve the efficiency of resources utilized for their ERM programs and generate better strategic insights.
3. **Dynamic financial planning:** Integrating ERM into financial planning is one of the most powerful ways for risk management to create value. Dynamic financial planning improves a company's ability to assess the uncertainty of its future financial performance. This knowledge enables companies to respond rapidly to changing market conditions in order to avoid pitfalls and to take advantage of opportunities.
4. **Risk-adjusted strategy and portfolio management:** ERM can be utilized to evaluate better risk-return trade-offs inherent in strategic decisions and investment projects. The result is improved performance management of the business unit and product portfolio, as well as enhanced capital allocation, resulting in improved risk-return performance.
5. **Data and reporting:** Companies often allocate extensive resources to collecting risk data. Their biggest challenge is to prioritize the information, disseminate the data across functional areas, and draw actionable strategic insights from it.
6. **Risk culture:** The ability to foster increased risk awareness and a cultural transformation is a determining factor in the long-term success of ERM programs. The benefits are improved decision making at all levels, bottom-up identification of mitigation opportunities, and a higher likelihood of meeting financial targets.

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1. RISK APPETITE

ADD GREATER DISCIPLINE TO DECISION MAKING BY ALIGNING YOUR COMPANY'S ABILITY AND WILLINGNESS TO TAKE RISK

KEY QUESTIONS:

- What risks do we want to take?
- How much earnings variation are we willing to risk in a quarter, or in a year?
- How much added risk can we afford?

A corporation's risk appetite can mean many different things to different stakeholders, business units, and levels of management. Even if executives believe there is an implicit agreement on the corporate willingness to take risk, lower levels of management may not be in agreement. Indeed, 70% of board members say their companies have not properly defined their risk appetite, according to a recent survey conducted by the National Association of Corporate Directors.

A top-down articulation of a company's appetite for risk can align different stakeholders' interpretations of a company's risk appetite and strengthen the risk management culture throughout the organization, leading to more effective decisions. A risk appetite statement also leads to more meaningful discussions about risk at the executive level and a benchmark against which to evaluate various corporate strategies. As a result, managers are empowered to move more quickly when investment opportunities arise within desired risk appetite levels. A new risk appetite statement can thus lead to a transformation in a company's approach to taking risks, ensuring the protection of key financial commitments as well as an improved ability to take advantage of growth opportunities.

In order to be effective, a risk appetite statement must be based on a balance between a company's willingness to take risk (agreed upon by executives and the board) and the company's ability to do so (based on its financial capacity, limitations of existing financing arrangements, and historical variation of key financial metrics). A company's risk appetite takes into account both quantitative risk considerations such as cash flow volatility, debt covenants, and hedge ratios, as well as qualitative ones such as brand management, health & safety, and IT security.

Specific boundaries of risk tolerance need to be established for the key types of risk that the company faces. For example, maintaining cash flows at a level which permits a company to continue to meet dividend payments may be a boundary for many companies. A company's tolerances for specific metrics depends on its strategic advantages in taking certain types of risks. For example, a company may have superior capabilities, sources of information, or assets. Setting specific boundaries can then provide guidance for operating decisions and shape discussions between managers at various levels, as well as with the board.

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EXHIBIT 3: RISK APPETITE DEFINED WITH RESPECT TO KEY FINANCIAL COMMITMENTS

Source: Oliver Wyman

DEVELOPING A RISK APPETITE STATEMENT FOR A MULTI-BILLION DOLLAR INDUSTRIAL COMPANY

A large industrial company faced significant risk exposure due to the volatility of its commodity inputs and pressure from large clients. The company lacked a clear understanding between the board, executives, and managers on acceptable risk levels within large contracts on both sides of the supply chain.

The company's risk management team developed tools to quantify risk exposure based on various risk drivers within the organization. The resulting insights served as the basis for discussion with the board to determine acceptable risk tolerances for each driver.

As a result, executives received clear guidance on how much company-wide uncertainty to key financial metrics would be acceptable and managers knew how much risk they should tolerate within a particular contract. A range of changes to existing practices led to improved certainty of meeting financial goals, dividends and debt rating targets.

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2. MEASUREMENT OF RISK EXPOSURES

DETERMINE TOP 10 RISKS WHICH DRIVE MOST OF THE VOLATILITY IN KEY FINANCIAL METRICS

KEY QUESTIONS:

- What are the top risks facing our company?
- What is the bottom line exposure that each risk creates?
- Are net exposures in line with our strategy and risk appetite?

Measuring risk exposures is one area in which ERM can be utilized to generate strategic benefits and not only preserve but also grow shareholder value. The goal is to provide a detailed understanding of the drivers of uncertainty across the organization as well as specific business units. Further, as the exposure of key financial metrics to specific risks is quantified, managers become able to quickly evaluate the impact on corporate performance of a range of market scenarios. For example, they can nimbly evaluate how cash flows will react to an economic slump, coupled with a credit downgrade, higher interest rates, and more volatile commodity prices.

Executives can understand where the vulnerabilities of the company lie and what could cause it to breach its risk appetite. This information can be used to develop targeted risk mitigation efforts which limit exposure in a cost-efficient fashion. At the other end of the spectrum, risk measurement can also identify potential barriers to growth when risk drivers move in a favorable direction. Again, targeted actions can be taken to remove barriers while ensuring sufficient protection remains.

To measure risk exposures properly, however, companies need to go beyond the status quo of updating crowded risk maps and lengthy risk reports, as the reports often fail to provide concise, actionable insights and do not respond quickly enough to changing market conditions. Comprehensive risk inventories for most organizations can include hundreds of risks. As a result, many potential insights for corporate strategy are often buried in mountains of data. In our experience, more than 80% of volatility in earnings and financial results comes from the top 10-15 highest-impact risks facing a company. Focusing on managing those risks and integrating information across functional areas (procurement, operations, finance, sales) improves the strategic benefits and can reduce the cost of an ERM program.

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EXHIBIT 4: MEASURING RISK EXPOSURES

MAGNITUE OF FINANCIAL IMPACT

80%

GDP growth
Regulation
Customer preferences
Commodity prices
Operational & supply chain risk
Financing costs
Pension obligations
Healthcare costs
Employee turnover
IT risk

20% *Other*

Source: Oliver Wyman

MEASURING RISK EXPOSURES FOR A MAJOR INDUSTRIAL COMPANY FROM AN EXPANSION IN A NEW MARKET

A large industrial company recognized that a planned shift in its business portfolio toward a traditionally non-core market (energy and fuel) would result in much higher earnings uncertainty. This conflicted with another imperative – continuing to meet financial commitments and earnings targets.

The CFO led an exercise to evaluate potential risk exposures from a range of drivers including those from the new market. This involved building a tool that measured risk levels under a range of potential expansion scenarios and examining what was achievable, taking into account the level of certainty in meeting financial targets. It used the findings as a basis for making changes in its performance management framework.

As a result of this work, the senior management team decided to concentrate on financial stability and refocus near-term investments on more stable, core activities, to increase the certainty of meeting shareholder expectations.

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3. DYNAMIC FINANCIAL PLANNING

DEEPEN YOUR COMPANY'S UNDERSTANDING OF THE UNCERTAINTY EMBEDDED WITHIN YOUR BUSINESS PLAN TO SEIZE ON NEW OPPORTUNITIES EFFECTIVELY

KEY QUESTIONS:

- How will my strategic plan impact the risk and return of my business portfolio?
- Is my plan for capital expenditures realistic under different economic and industry scenarios or will it endanger our financial obligations?
- Should the capital budget be reduced or remain the same to provide a buffer?

Dynamic financial planning is one of the most promising ways to improve the effectiveness of ERM and quickly generate tangible benefits. It provides the tools to be able to respond more quickly and effectively to increasing risks from economic growth, regulation and rapidly changing consumer preferences (as reported in the *2013 AFP Risk Survey*).

By providing greater visibility on the uncertainty embedded in a company's future financial performance, dynamic financial planning brings focused strategic insights. The main drivers of downside risk to a business plan become clear in each of the forecasted periods become clear by allowing management to take targeted actions for reducing exposure without creating overly restrictive policies or limiting upside opportunities for the rest of the company.

Furthermore, the tools that are developed as part of the dynamic financial planning process provide an ability to quickly evaluate the impact of changing market conditions and new strategic opportunities, reducing response time and increasing the confidence for taking action. This increased flexibility and speed can make companies in industries ranging from transportation to manufacturing to consumer goods to technology more competitive.

Dynamic financial planning also creates value by reducing the execution risk in large projects. A single large project which represents an outsized portion of corporate investments can often make or break a company or a CEO. Multi-billion dollar projects are notorious for cost and time overruns which can adversely impact returns and corporate profitability. It is possible, for example, to identify the key drivers of project risk, estimate their volatility and bottom line impact, and then find cost-efficient mitigation options. Overall reductions in project costs of up to 20% have been observed as compared to other projects executed with less effective risk management practices.

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The best way for companies to gain a detailed understanding of the potential financial impact of risks in a wide range of market conditions is to examine the impact of both known sources of uncertainty such as supply chain delays and tail risk events such as natural disasters on their long-term financial performance. The specific exposure of each risk by period should be estimated.

Next, they should develop the capability to evaluate how different strategic decisions or "what if" scenarios change the level of uncertainty or the level of expected performance. For example, a company should assess how a new factory overseas will influence its exposure to risks involving commodities, its supply chain, foreign exchange and geopolitics. Its management team should ask themselves if the investment in the new factory is worth the extra return.

Finally, they can consider a range of potential risk mitigation options: both standard ones such as hedging and insurance, as well as innovative approaches such as conditional capital or loss-sharing arrangements. The tools should allow managers to evaluate the impact of both strategic alternatives and risk mitigation plans on their company's projected financial performance, so that they can achieve the highest level of expected returns on with the lowest amount of risk.

EXHIBIT 5: THE DYNAMIC FINANCIAL PLANNING PROCESS

Source: Oliver Wyman

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DYNAMIC FINANCIAL PLANNING TOOLS (ORDERED FROM LEAST TO MOST SOPHISTICATED)

TOOL	DESCRIPTION	APPLICATIONS AND CONDITIONS
Expert or management surveys	Polling a set of managers, internal or external experts on likelihood and impact of select risks	• Quantifying risks with high degree of uncertainty and limited information (e.g. regulation) • Gathering qualitative feedback to identify and evaluate drivers of select risks
Stress-testing	Conduct "What if" analysis; calculate financial impact of specific market events or values for key risk drivers	• Evaluating capacity to bear risk from few specific sources • Modeling of low probability, high impact market events (e.g. black swan events) • Utilized when limited historical data exists
Reverse stress-testing	Establish boundary level for a financial metric. Reverse-engineer the market event or set of values for key risk drivers which can cause it	• Identifying realistic market events which can cause a particular adverse change in financial performance (e.g. breach of covenants) • Improved understanding of business vulnerabilities and corrective actions
Scenario analysis	Analyze performance under specific market scenarios. A range of market factors, interdependence and causality is examined.	• Developing a deeper understanding of market forces and high likelihood scenarios • Evaluating the strategic implications of a realistic scenarios including combinations of key risk drivers • Utilized when high interdependence exists among risk drivers examined (e.g. GDP growth, commodity prices, interest rates)
Monte Carlo Simulation	Determine a range of results for key variables by running a large number of trials with randomly generated values for key variables	• Detailed estimate of volatility and confidence intervals around key financial metrics, or project NPV • Modeling market variables or risks for which significant data is available in the past (e.g. commodity prices, interest rates) • Quantifying complex portfolio diversification impacts and risk interdependencies

IMPROVING STABILITY OF CASH FLOWS FOR A FORTUNE 50 INDUSTRIAL COMPANY

A large industrial company wanted to understand at a financial statement level of detail the uncertainty in performance based on a set of macroeconomic and financial market variables.

The CFO led an initiative to forecast earnings, cash flow volatility, and capital needs under a set of realistic macroeconomic scenarios. The capital structure and financing arrangements were evaluated to determine the resulting credit rating impact and cost of capital in each scenario.

As a result of this work, the senior management team re-evaluated capital needs and financing arrangements to gain greater stability in expected performance. This ensured protection of the company's credit rating and reduction in the cost of capital.

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4. RISK-ADJUSTED PORTFOLIO STRATEGY

INTEGRATE RISK INTO STRATEGIC DECISION MAKING TO IMPROVE THE RISK-RETURN PERFORMANCE OF YOUR COMPANY'S BUSINESS PORTFOLIO

KEY QUESTIONS:

- What is the risk and return performance of our business units and product lines?
- What businesses should we "feed" vs. "starve" from a capital allocation perspective?
- How can we evaluate the trade-offs between the expected return and added risk of new investment opportunities?

Integrating ERM into corporate portfolio management and investment analysis improves the stability and predictability of a company's financial performance, and increases its returns over time. Cash flows typically become more stable, leading to greater financial strength and a lower cost of capital. As a result, companies that integrate managing risks into strategy tend to outperform their competitors over time, especially in periods of increased economic and financial volatility.

The fundamental reason that these companies outmaneuver competitors is that they have developed a perspective on their portfolio's risk performance. As a result, these companies can nimbly modify incentives, alter business plans, and adopt cost-efficient risk mitigation strategies for those parts of the portfolio which create an outsized risk exposure compared to their return on capital or an outsized opportunity. Typically, a range of "low hanging fruit" opportunities are identified leading to rapid improvements in performance.

Greater information on the risk-return profile of new investment opportunities also enables executives to modify capital allocations among projects to target a specific desirable mix of return and risk. For example, they may favor a more conservative investment mix in times of increasing market uncertainty or a more aggressive one when conditions improve.

Unfortunately, many companies still struggle to integrate ERM into their strategic decision-making processes. The primary focus continues to be on compliance, which is important, but should be a by-product of an effective ERM program as compared to other core benefits. Given that the largest risks that companies face are strategic in nature, this lack of ERM inputs in strategic decision-making hinders a company's ability to manage them, according to the *2013 AFP Risk Survey*. When it comes to strategic risks, limiting exposure is not necessarily the best decision as this could lead to corresponding declines in revenue and profits. What is more important is having the ability to strike the right balance between risk and return, by evaluating the corresponding trade-offs among various strategic alternatives.

Instead, management teams should use ERM to develop a detailed perspective on the risk-return performance of the corporate business portfolio. Metrics such as return on capital versus cash flow at risk or volatility in returns can be estimated and compared across units or products.

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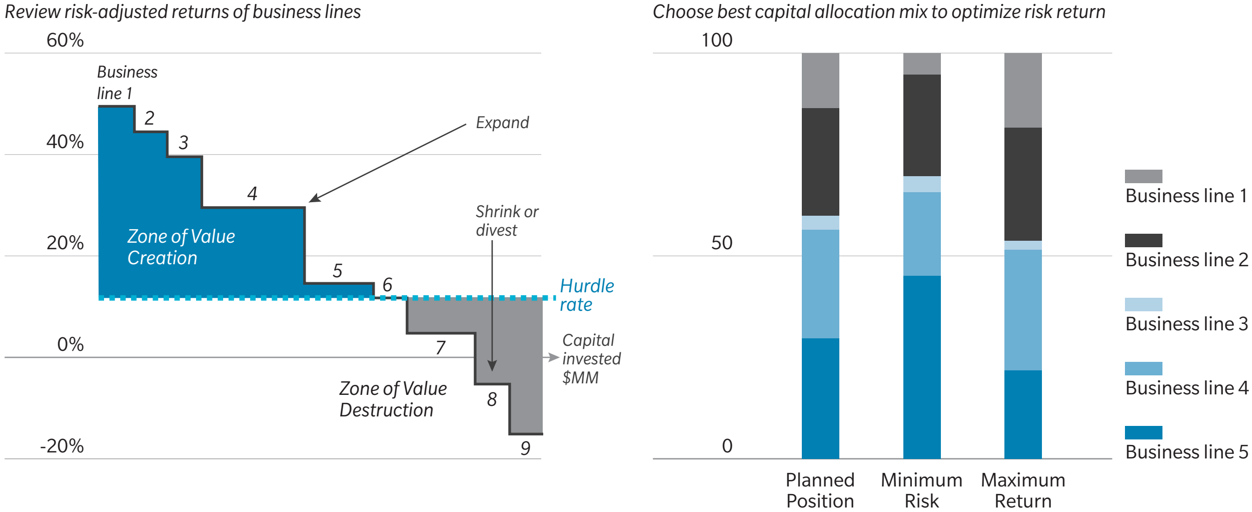
An even more sophisticated approach is to estimate risk-adjusted returns by unit based on the capital at risk that is required, a concept applied in financial institutions. A range of practical tools exist but the goal is one – determining which parts of the portfolio are top performers in terms of their risk-return ratio.

Companies should also adopt processes and tools to develop a risk perspective when evaluating new investment opportunities. Projects should be evaluated based on an estimated risk-adjusted return or net present value confidence intervals, rather than on single base case net present value estimates. Such additional risk insights result in a significantly more informed and disciplined investment allocation process. It creates the ability to answer questions like: What is the probability that the project breaks even? How likely is it to endanger corporate financial commitments if it does not perform according to plan? Are there any tail risks that are not captured in the base case estimate?

EXHIBIT 6: RISK-ADJUSTED INVESTMENT STRATEGY

Review risk-adjusted returns of business lines | *Choose best capital allocation mix to optimize risk return*



Source: Oliver Wyman

IMPROVING PORTFOLIO RISK-RETURN PERFORMANCE FOR AN INTERNATIONAL OIL & GAS PRODUCER

The international business units of an oil & gas producer experienced repeated challenges in meeting financial targets as well as significant volatility in cash flows. The company was looking for a way to improve the stability of performance.

The company's strategic team quantified the uncertainty around performance around each unit's performance based on a range of risk drivers. Then the team identified a range of risk mitigation opportunities and evaluated them based on trade-offs that existed between cost and risk reduction. The team prioritized capital spending for the best opportunities.

As a result, the team was able to reduce risk exposures across business units significantly and improve the company's ability to meet its targeted returns. Executives also gained greater visibility into the business portfolio performance which was used to guide capital allocation and portfolio management decisions.

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5. DATA AND REPORTING

DRAW BETTER RISK, FINANCE, AND STRATEGY INSIGHTS FROM DATA INTEGRATED FROM ACROSS ALL BUSINESSES

KEY QUESTIONS:

- Do we have the right information to manage risk?
- Are we maximizing the benefits of our available data?
- How do we bring together insights across different teams into a company-wide risk perspective?

By becoming smarter about risk data analysis, companies can develop leaner and more insightful ERM processes. With the decline in the price of processing technology and digital storage space, businesses are collecting exponentially increasing amounts of data. The average company in 15 out of 17 industrial sectors in the United States stores more data than the United States Library of Congress (>235 terabytes). As a result, companies increasingly struggle not with too little available data but rather too much: databases become too large and unstructured to perform proper analysis. The same is true for risk data as some companies track hundreds of risk indicators. Analyzing all of this data takes resources and produces limited insights.

So it should not be surprising that developing stronger data analysis capabilities across teams significantly improves the quality of risk reports. With more sophisticated data analysis, executives can rely on more concise and focused risk reports. These reports can provide a company-wide perspective on risk levels which, in turn, can inform a larger set of actionable strategic insights.Moreover, risk analytics that utilize existing financial reporting systems such as SAP Hyperion eliminate the need for expensive new risk IT. Instead, data sources can be automatically linked to risk measurement and dynamic financial planning tools, further improving the efficiency in ERM processes.

The key to improving data usage and reporting in ERM is to focus efforts on the risks with the largest potential impact on the bottom line. Priority should be given in data collection efforts on providing inputs on top risks. It is important to collect a combination of historical data for performance management purposes, as well as a set of leading indicators in order to estimate risk exposure to key financial metrics and the long-term business plan. For example, a consumer goods industry client was able to better manage production levels and cash flows after it treated oil prices as a leading indicator. The company discovered that every 1% increase in the oil price in a given month led to 3% decline in the demand for its products in following months, because consumers reduced discretionary spending. Using oil prices as a leading indicator, they were able to manage production levels and cash flows better.

Information should be aggregated across functional areas (procurement, operations, finance, sales) which otherwise typically operate in silos. By pulling together

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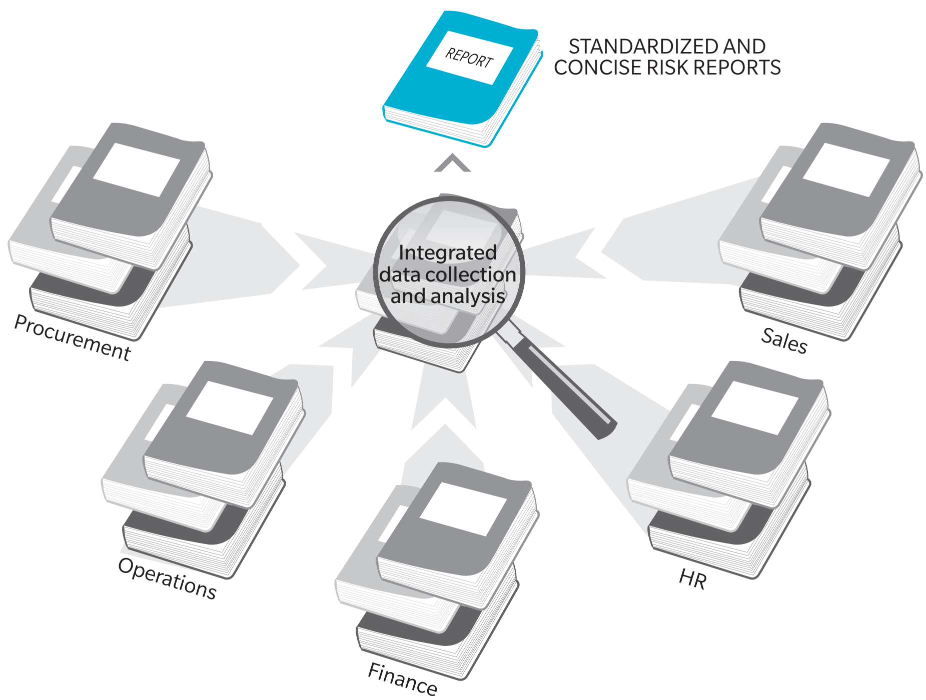
cross-functional information, companies can set risk management strategies at a company-wide level rather than just for individual functional areas or units, eliminating duplicative or contradictory risk mitigation policies. Formalizing a set of qualitative inputs or commentary from operating managers on risk results is also beneficial for the development of insightful risk reports.

EXHIBIT 7: INTEGRATING RISK DATA ACROSS FUNCTIONS



Source: Oliver Wyman

GENERATING RISK INSIGHTS FROM DATA FOR A FORTUNE 500 CONSUMER GOODS COMPANY

A consumer goods company with an extensive ERM program gathered a significant portion of risk inputs during business unit management workshops. However, the process involved primarily manual data collection based on non-standard meeting transcripts which was cumbersome and prone to error.

The company's risk team in combination with IT developed a tool for managers to enter risk inputs during workshops in a structured format. The tool automatically linked with a central database and provided inputs for corresponding risk management and financial planning efforts.

Due to the project, the company realized a reduction in time and resources required for data collection while increasing the level of quality of information gathered and engagement of managers involved in the process. Eventually, the company was better able to identify and respond to emerging risks across its business units.

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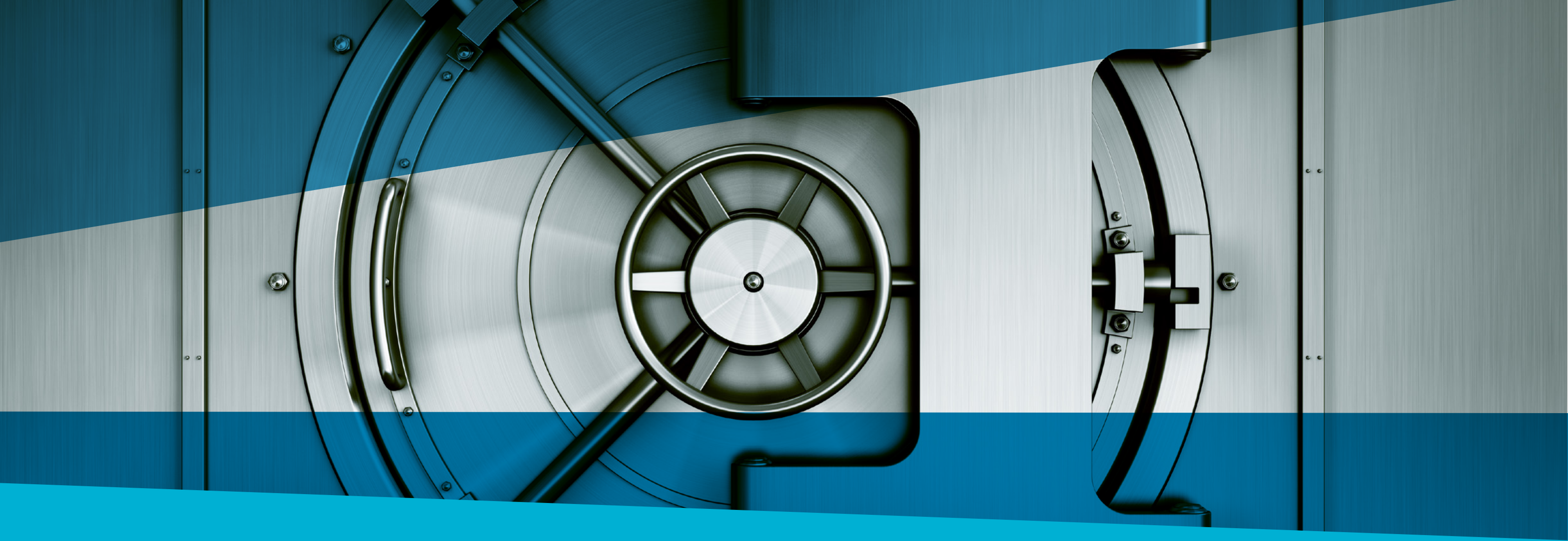

6. RISK CULTURE

FOSTER INCREASED RISK AWARENESS AND A CULTURAL TRANSFORMATION

KEY QUESTIONS:

- How can we foster a common and effective risk culture across the organization?
- What is the role of top management?
- What are the top outcomes of such a cultural transformation on which we can capitalize?

A strong risk culture is essential for the long-term success of an ERM program. The principles of effective risk management should be fully endorsed by top management so that they can be incorporated effectively across key organizational priorities. A senior executive, ideally the CEO or CFO, should endorse the ERM effort and sponsor the initiatives necessary to build a risk culture. It is also important to ensure that ERM is positioned as a continuous rather than a one-time attempt and that it is "here to stay." To deliver this powerful message, companies should incorporate risk management goals into performance targets, incentives, regular reporting, key executive discussions, and to reinforce it in periodic communications.

Buy-in from operating managers and line employees is also important for the measurement and implementation of key initiatives. By including relevant metrics for daily activities, companies can improve their operating and capital allocation decisions, making it easier to meet strategic goals and come up with more risk mitigation ideas from across the organization.

A robust risk culture also raises the awareness of risks facing the organization and improves a company's ability to respond to them. As a result, companies can manage risks more proactively and regularly monitor the appropriate leading indicators. Open dialogue which instills a free flow of information across teams and management levels combined with a desire to improve performance across the whole company and not just in an individual's own team or unit and are also important.

An equally critical component of developing a strong risk culture is a desire to achieve the optimal balance between risk and return, rather than seeking to eliminate risk. Some risk drivers such as commodity prices can often be the source of both financial downside and upside. If managers focus too much on the downside, they may adopt policies that are too restrictive and miss emerging profitable opportunities.

The effective implementation of ERM can quickly improve a company's financial performance and strengthen its competitive advantage. Establishing a strong risk culture also helps a company to realize higher and more stable returns over the long term because it improves a company's agility and speed to respond to emerging risks and changing market dynamics. As a result, companies outperform their competitors which have less effective risk management practices.

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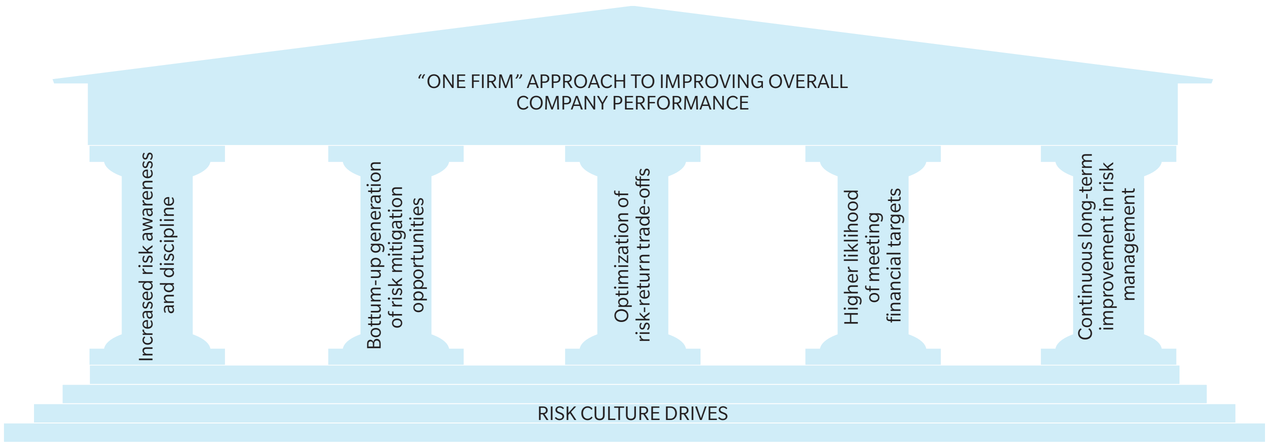
EXHIBIT 8: FOSTERING A RISK CULTURE



Source: Oliver Wyman

A GLOBAL OIL MAJOR IMPROVES ITS RISK CULTURE

A global oil major recognized that its current approach to risk management, especially related to safety, was causing it to fall behind its peers, as well as regulator and shareholder expectations. To address the performance gap, the company implemented a new program to improve its safety and risk management processes and culture.

After some early success, the company recognized that it needed to continue to push forward the organization's cultural maturity. So it designed and delivered a program to managers across the organization to challenge people individually and collectively around how they assessed and addressed risks. The program was aimed at:

- Encouraging leaders to feel alert around their risks (and therefore vulnerable) and empowering them to do something about it
- Instilling a corporate culture which challenged potential complacency if performance was good and encouraged people to own problems when they saw them.

The program specifically aimed to change the culture around risk assessment. Rather than focusing on clearing "red" issues off reports and ignoring the "greens," it encouraged people to become much more involved in understanding why "red" issues might be occurring and supporting their resolution. It also challenged people to understand whether performance was really as good as the "greens" suggested (if these areas were not understood fully this could be where the next incident might occur) instilling a culture with a healthy degree of paranoia into the company.

The culture change program successfully challenged the company's perception and approach to safety and risk management. As a result, its overall performance improved significantly as compared to its peers. Now, the organization is considered a benchmark for good performance by its peers who are extrapolating lessons from the company's experience and examining how might address their own challenges.

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CONCLUSION

In a world of great economic uncertainty, volatile commodity prices, and rapid shifts in global consumer preferences, companies need to grapple with increasingly complex risks. By developing more sophisticated risk management capabilities companies can better anticipate and position themselves in a changing market. Yet, challenges exist in ensuring that resources are deployed efficiently and that ERM is seamlessly integrated with existing decision-making processes.

A customized approach to ERM with targeted investments in select components results in the highest returns and the most sustainable improvements in corporate preformance. By combining ERM and financial planning processes, executives can improve the quality of investments and the stability of cash flows. This, in turn, gives companies a greater ability to execute against long-term business plans and to meet financial targets which will improve their competitive position and their reputation with rating agencies, investors, and customers.

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