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NEWSLETTER

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STANDARD & POOR'S ERM UPDATE

The Willis HRH Enterprise and Risk Finance Practice July 2008 Newsletter described how, among all of the credit rating agencies, Standard & Poor's (S&P) is taking by far the most specific steps to incorporate ERM into their rating process for "non-financial" corporate entities. S&P has released a number of papers over the past year outlining anticipated ERM rating criteria as well as their proposed timeline for implementation.

The financial crisis of 2008 combined with direct feedback received by S&P has influenced both the rating criteria and the implementation process initially described in earlier publications.

In January 2009, Willis HRH Enterprise & Risk Finance (WERF) representatives met with S&P to gain a more explicit understanding of their current plans respecting further roll-out of the ERM assessment program. The results of this discussion are summarized below.

AREAS S&P WILL BE ASSESSING

S&P's November 15, 2007 memorandum identified five key ERM measurement areas that would be included in their assessment.

- Scope and Process
- Culture and Governance
- Risk Controls
- Emerging Risk Preparation
- Strategic Risk Management

From our January meeting with S&P, we understand that two of these areas are now viewed as the priorities for 2009 and will be weighted more heavily: Culture & Governance and Strategic Risk Management. Included within these main areas of focus will also be Emerging Risk Preparation. The generic descriptions of these areas provided in S&P's 11/15/07 publication will still apply.

IMPLEMENTATION UPDATE

S&P is conducting interviews now on an omnibus basis with the intention of establishing criteria in each of the above areas that will apply across all industry sectors. In order to incorporate these into a formal rating process in the last half of 2009, S&P expects to publish formal ERM criteria for corporate entities around midyear. It is then anticipated that findings from ERM assessments will have an impact on credit ratings this year.

In 2010, S&P plans to create industry-specific assessment criteria that will likely be more prescriptive in terms of "best practices" and how risks should be measured, controlled and managed. (Certain businesses with significant hedging or trading activities are already being evaluated on this basis.)

OUR OBSERVATIONS

- ERM, for companies that are not financial institutions, can be challenging as there are risks which are catastrophic in nature, but are difficult (or impossible) to measure definitively. In recognition of this complexity it appears that initially S&P will evaluate a specific organization's ERM capability in relation to its peers rather than by applying a generic checklist. As the assessment process matures, we anticipate that companies will also then be evaluated based on their own track record and S&P's acquired understanding of best practices.

- Based on our discussions with S&P, we believe they are looking for substance over style. This suggests that glossy, elaborate presentations to their analysts will likely be less effective (and less appreciated) than informative dialogue that conveys an understanding of the key risks, lessons learned and an approach to ERM that makes sense within that organization and sector.

- S&P's principal interest in ERM is to help investors better assess the predisposition of a company to default on its bonds. From this perspective, we can reasonably conclude that ERM activity directly related to liquidity and cash-flow management will attract greater scrutiny.

- Another key driver of S&P's ERM rating program is to provide a more objective basis for measuring the quality of management.

- Companies with trading and hedging activities will be evaluated with an emphasis on management of risks related to these activities. This may result in more upgrades and downgrades than for companies with limited trading exposure.

OUR RECOMMENDATIONS

- Any organization rated by S&P (and those considering an S&P rating) should immediately initiate an ERM program if one does not currently exist.

- The common sense approach of S&P to ERM means that organizations should make sure that their ERM is grounded in substance rather than relying on just the appearance of managing risk.

- Organizations starting out with ERM should consider thoughtful, incremental implementation geared to making the process and output easy to understand and to embed.

- Particular attention should be given to the basic expectations of S&P's Strategic Risk Management, Culture & Governance and Emerging Risk Preparation criteria.

The Willis HRH Enterprise & Risk Finance Practice has extensive experience in ERM program design and implementation. This includes proprietary ERM risk assessment tools such as RAPID℠ (Risk Assessment Probability and Impact Diagnostic) which, based upon our experience, will meet and exceed S&P requirements.

CONTACT

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