

FERMA European Survey 2012
ERM Maturity Key Findings
Dominique Pageaud Ernst & Young



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and



Content



1. How business environment impact ERM ?
2. Maturity of Risk Management practices at a glance
3. How leading companies use Risk Management to fuel better performance?



1.

Risk management fundamentals

- Where do we stand and what's new ?
- What are the impacts of the EU 8th Directive?

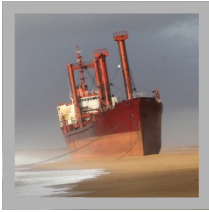


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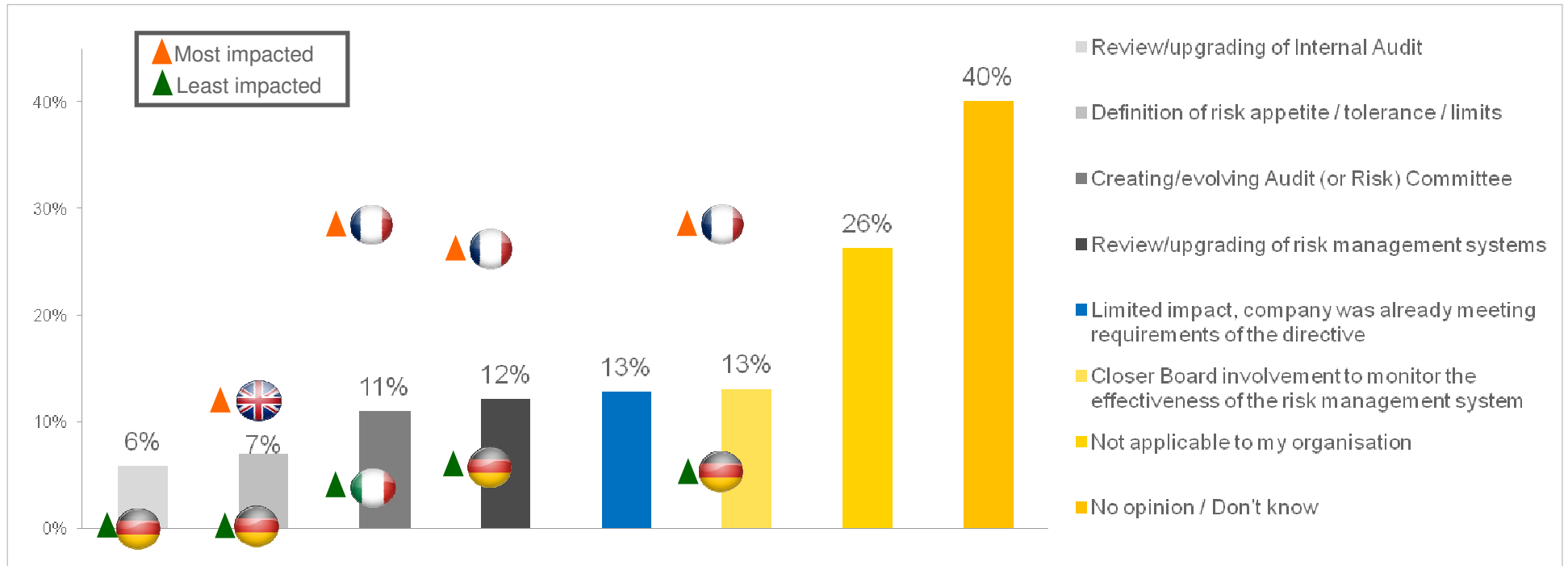
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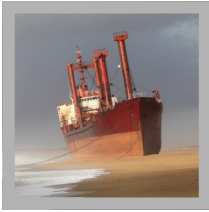
Impacts of the regulatory environment

Impacts of the EU 8th Directive on companies' Risk Management policy



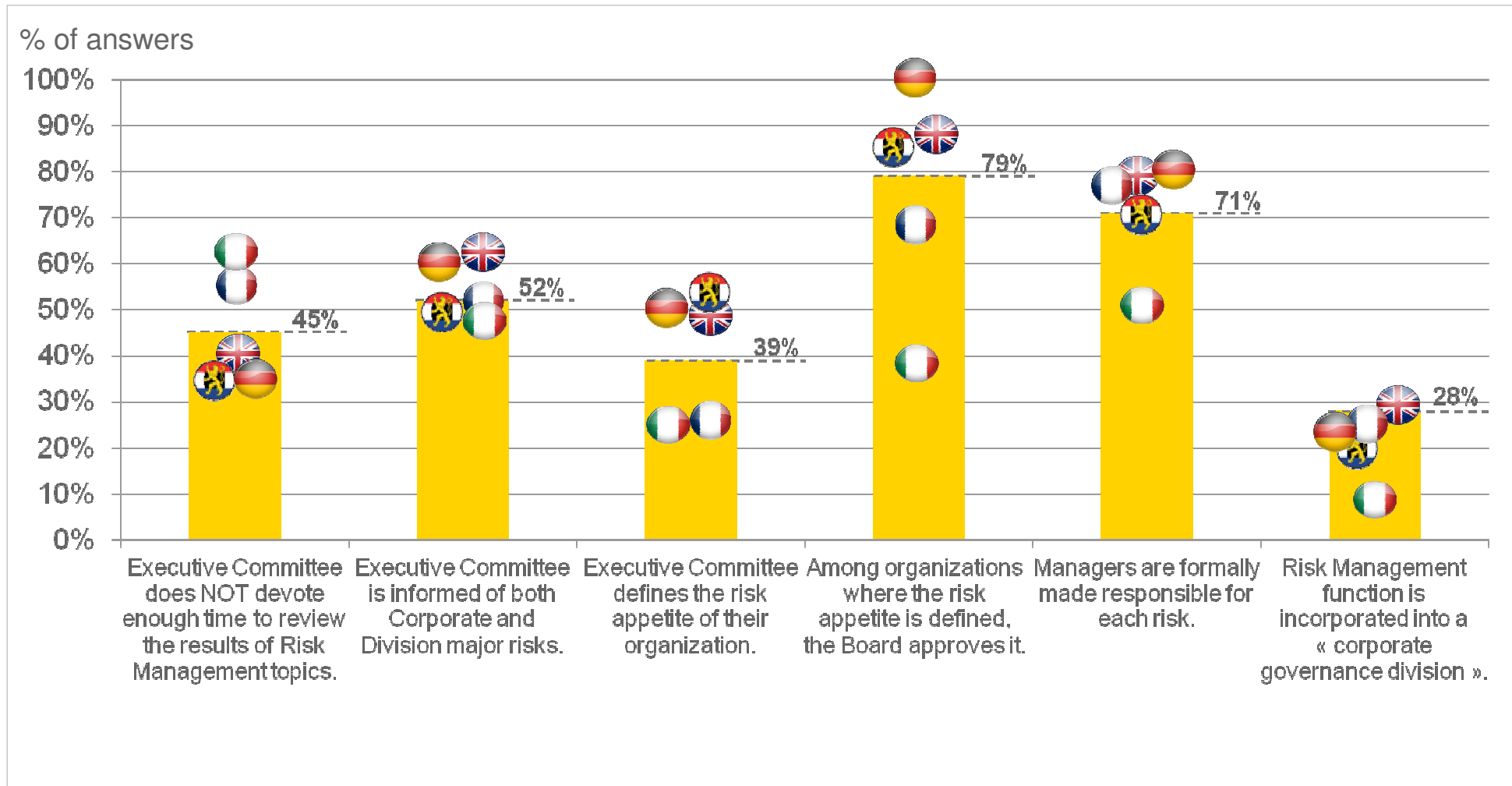
The impacts of the EU 8th Directive are still poorly assessed and understood by a large number of risk and insurance managers.

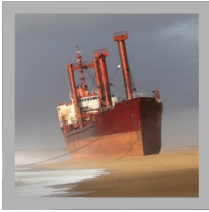
* Multiple choice question



Impacts of the regulatory environment

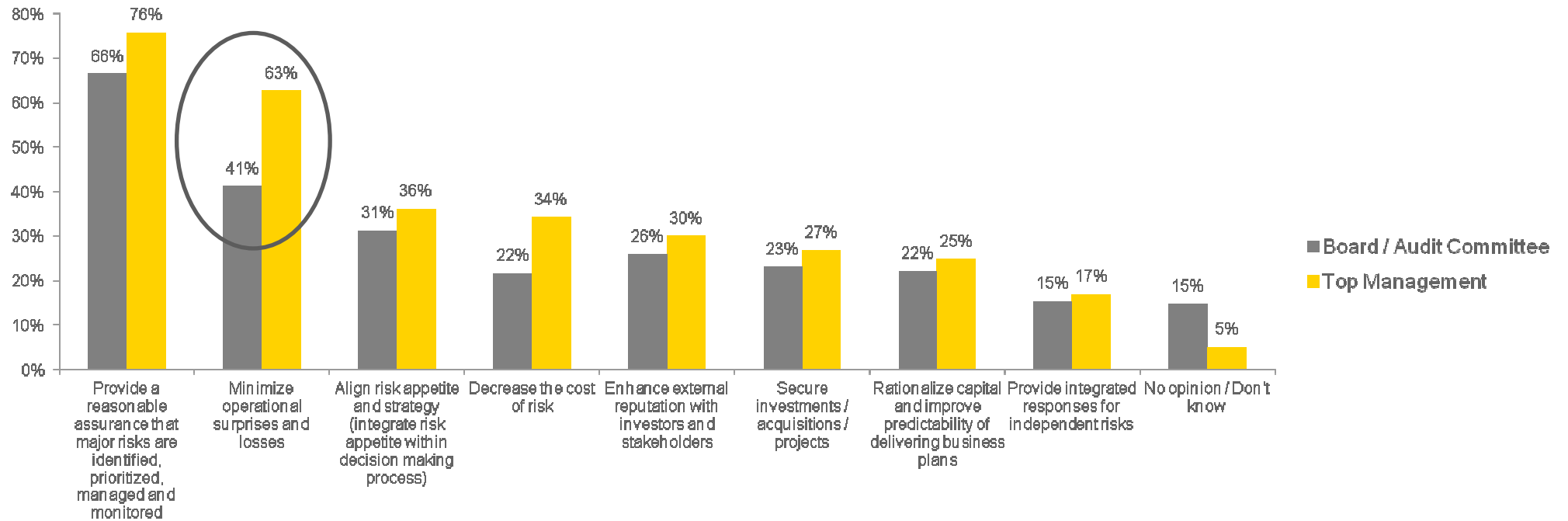
Detailed Impacts of the EU 8th Directive: zoom by country





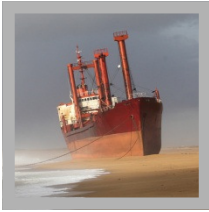
Stakeholders' expectations

Top Management and Board/Audit Committee same main objectives but different levels of perception



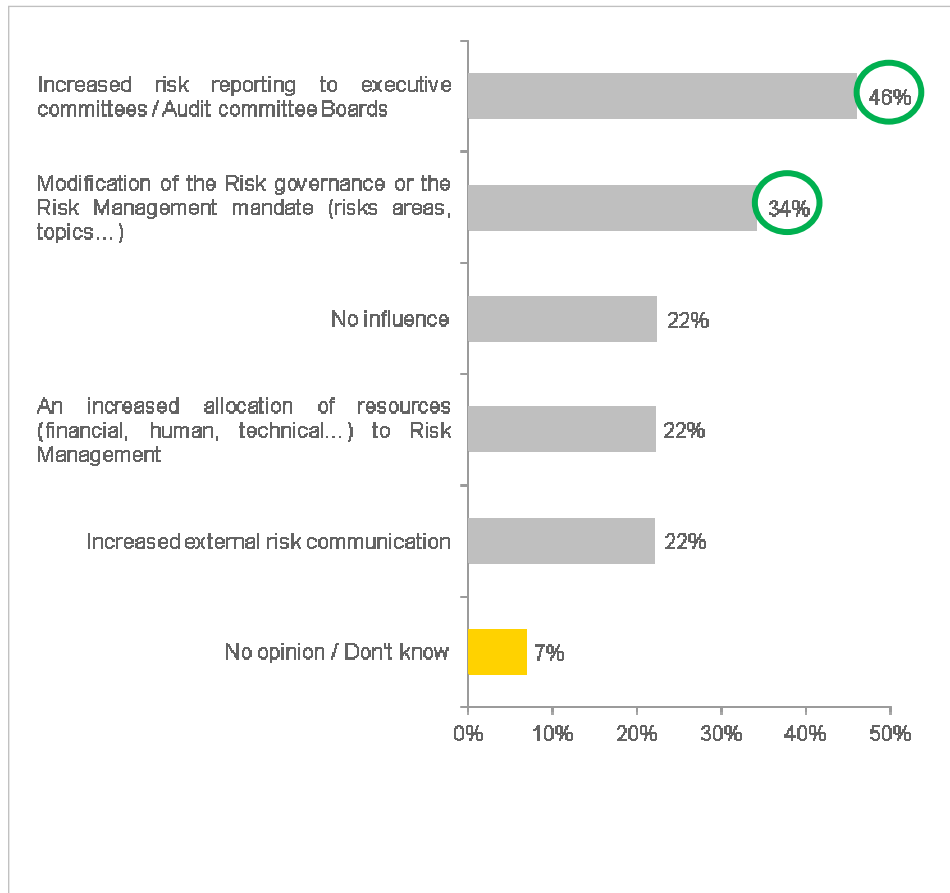
Top Management and Board/Audit Committee have overall converging objectives but respondents perceive a stronger interest at Top Management level.

* Multiple choice question



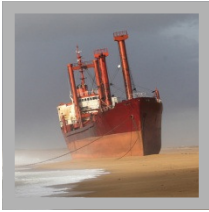
Stakeholders' expectations

Influence of the recent financial and economic situation over Risk Management



The difficult economic and financial situation led to an increased risk reporting to executive committees / Audit committee and to a modification of the Risk Governance or the Risk Management mandate.

* Multiple choice question



ERM environment

Key Findings

1. Business Environment impacts

- ◆ **Competition and compliance/regulation are still considered as the main two risk priorities**
Between 2010 and 2012, we note that only reputation risk and Market volatility are emerging.
- ◆ **The difficult economic and financial situation led to an increased reporting to executive committees / Audit committee, a formal discussion on the risk appetite & the Risk ownership**

2. Legal environment impacts

- ◆ As in the 2010 and 2008 study, **Sectorial compliance and legal requirements** remain the main **external factors triggering risk management** within companies....**But**
- ◆ **The impacts of the 8th European Directive are still not enough understood by a large number of risk and insurance managers and poorly integrated by Executive Committees.**

3. Stakeholders & Management expectations

- ◆ Risk managers consider **Top Management and Board / Audit Committee have the same three main objectives regarding risk management:** provide a reasonable assurance that major risks are identified and managed, minimize operational surprises and losses, integrate risk dimension within decision making process.



2.

Maturity of Risk Management practices

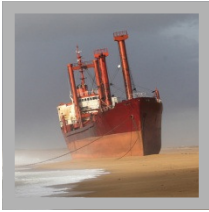


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Maturity of Risk Management practices

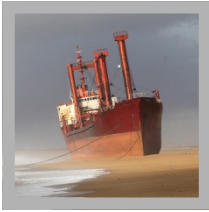
Introduction

■ Objectives

- ◆ Assess maturity level of Risk Management practices within European companies and compare with 2010 maturity level
- ◆ Illustrate maturity level of Risk Management practices regarding four main risk topics:
 - Risk practices and tools
 - Risk reporting and communication
 - Risk Management functions alignment
- ◆ Capture the diversity of Risk Management practices

■ Methodology

- ◆ Selection of 9 questions (see next slide) from the survey
- ◆ Definition of four levels of Risk Management maturity per question (see detailed graph captions):
 - Emerging: low or basic level of Risk Management maturity
 - Moderate: intermediate level of Risk Management maturity
 - Mature: good level of Risk Management maturity
 - Advanced: high level of Risk Management maturity



Maturity of Risk Management practices

Introduction

- **Risk Management maturity:** 9 questions extracted from the survey

Risk practices and tools

Q.2.5 : To what extent does the company map its risks ?

Q.2.6 : Approach used to measure / quantify the risks ?

Q.2.8 : Is risk analysis formally and systematically linked to decision making ?

Risk reporting and communication

Q.1.6 : Definition or communication of a formal Risk Management policy or charter

Q.1.9 : How is risk information currently used by the Board?

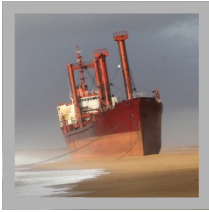
Q.1.12 : How does the company disclose its risks via external reporting?

Risk management functions alignment

Q.1.10 : Coordination of risk functions (*Risk Management, internal audit, internal control, environment, health and safety, quality, compliance ...*)

Q.2.2 : Relationship between Risk Management and Internal Audit functions

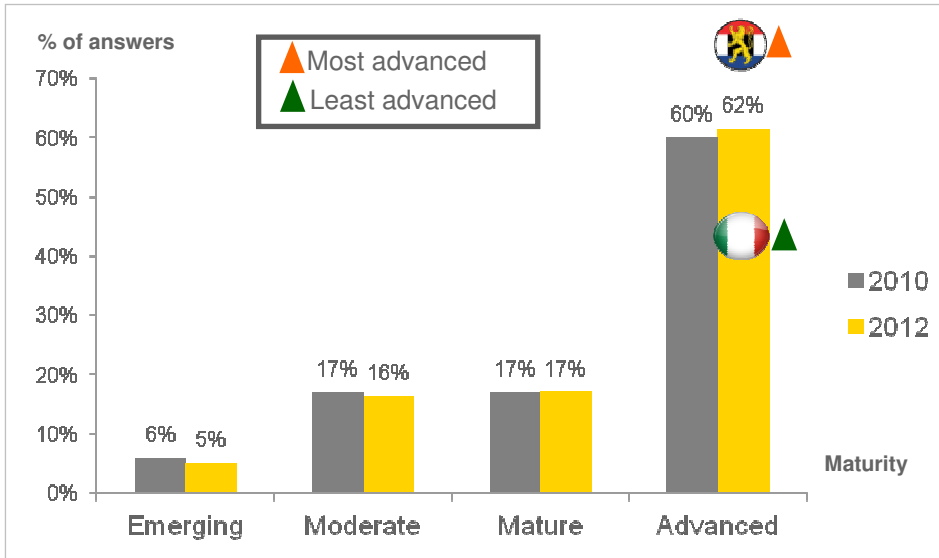
Q.2.3 : To what extent does the risk manager cooperate with the other functions / departments ?



Maturity of Risk Management practices

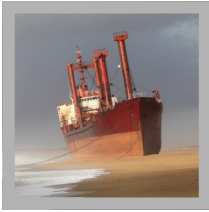
Risk practices and tools

Risk mapping exercise



GRAPH CAPTION			
Emerging	Moderate	Mature	Advanced
No risk mapping approach in place yet	Partial approach in place (certain business units/areas, risks...)	Approach in place at global corporate level (strategic, financial and operational)	Approach in place from Corporate level down to divisions and business units

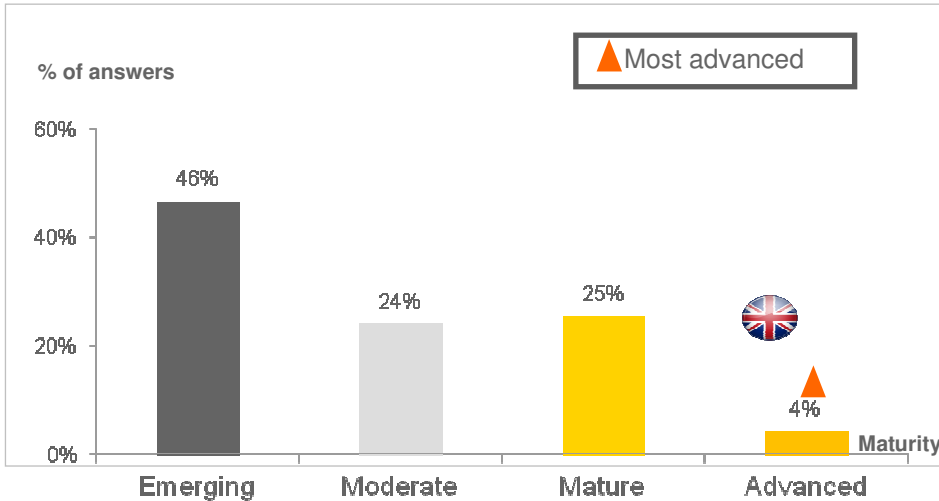
Risk mapping exercise is now considered as a Risk Management standard within European companies.



Maturity of Risk Management practices

Risk practices and tools

Risks assessment and quantification

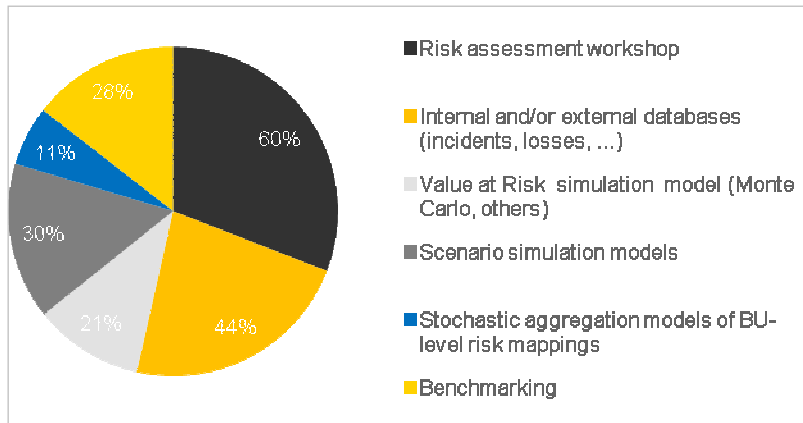


GRAPH CAPTION

The main risk measurement approaches are:

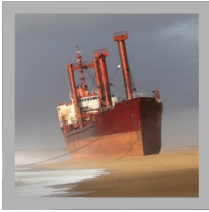
- 1) Risk assessment workshop
- 2) Internal or external databases (incident, losses...)
- 3) Value at risk simulation models (Monte Carlo, others...)
- 4) Scenario simulation models
- 5) Stochastic aggregation models of B.U / level risks mapping
- 6) Benchmarking

Emerging: use of 1 main risk measurement approach above
Moderate: use of 2 main risk measurement approaches above
Mature: use of 3 or 4 main risk measurement approaches above
Advanced: use of 5 or 6 main risk measurement approaches above



Basic assessment methodology in place but advanced quantification tools still poorly used

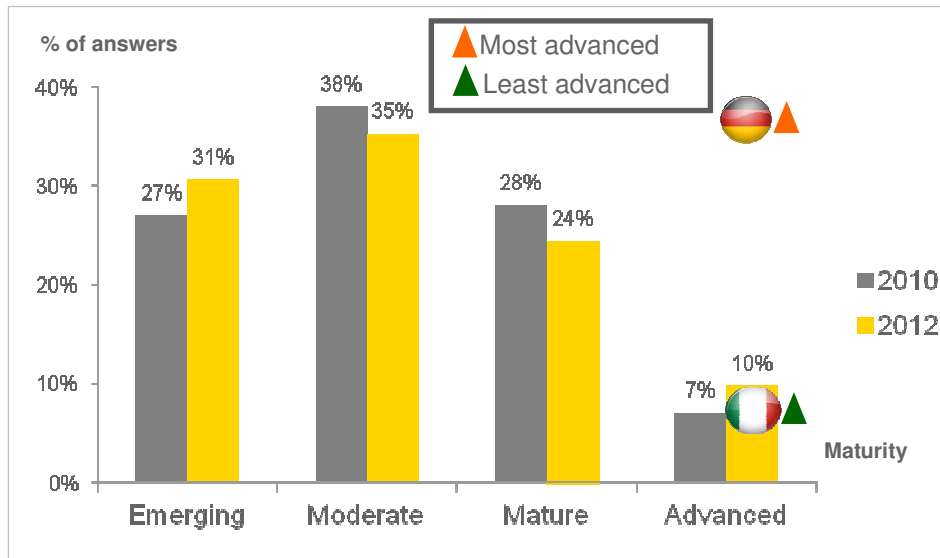
Risk assessment workshops are now used by 60% of European companies, a slight decline compared to 2010 when 66% of the respondents reported using this approach.



Maturity of Risk Management practices

Risk practices and tools

Decision making process



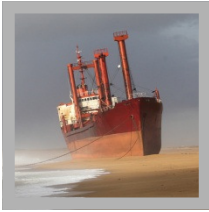
GRAPH CAPTION

- Six categories of strategic decisions identified:
- 1) Major projects
 - 2) Strategic planning
 - 3) Investment decisions
 - 4) Contracts/bids,
 - 5) Acquisitions/ transfers decisions
 - 6) Budget decisions

Emerging: risk analysis and decision making are linked for 0 or 1 criteria
Moderate: risk analysis and decision making are linked for 2 or 3 criteria
Mature: risk analysis and decision making are linked for 4 or 5 criteria
Advanced: risk analysis and decision making are linked for the 6 criteria

Major corporate decisions do not systematically include a specific risk analysis.

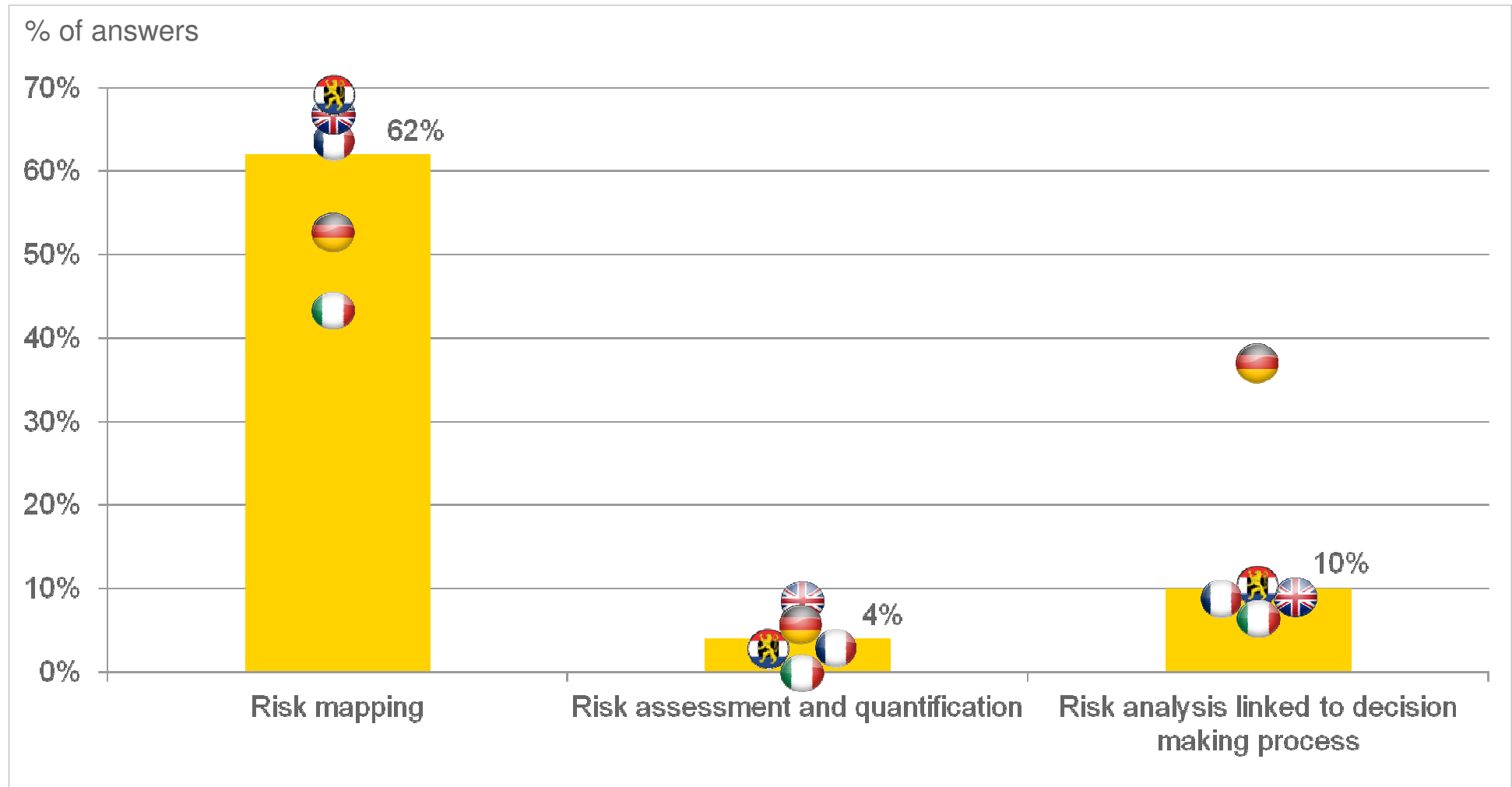
66% of the companies do not systematically perform a risk analysis (emerging and moderate levels) prior to major Corporate decisions.

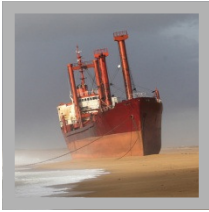


Maturity of Risk Management practices

Risk practices and tools

Advanced practices : zoom by country

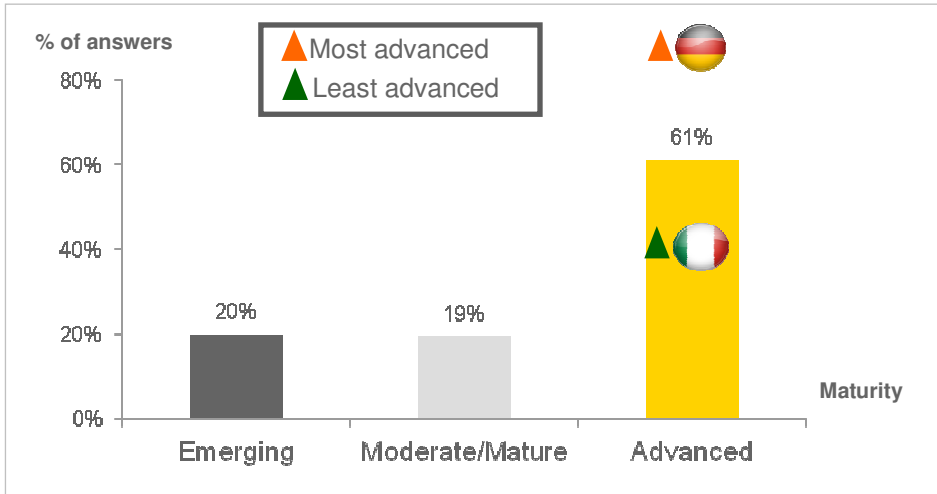




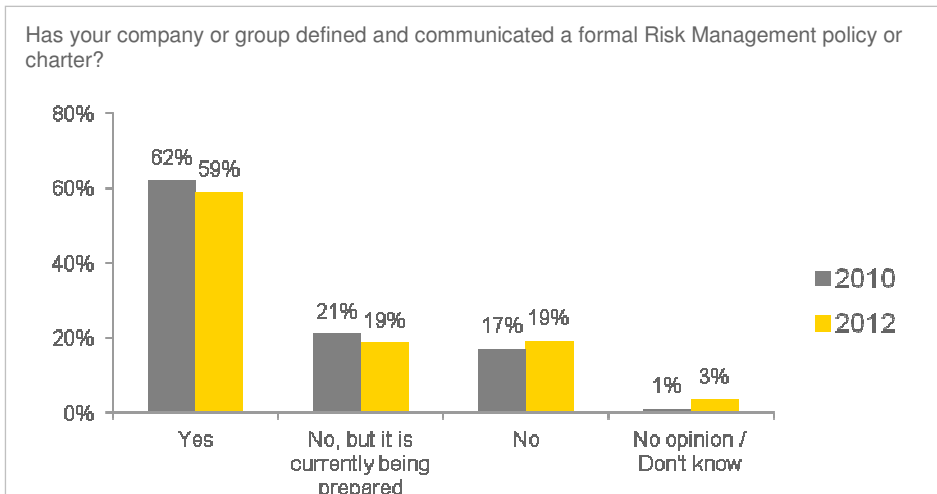
Maturity of Risk Management practices

Risk reporting and communication

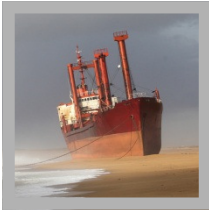
Risk management role and activities



GRAPH CAPTION		
Emerging	Moderate / Mature	Advanced
No Risk Management policy or charter has been defined	A Risk Management policy is currently being prepared	A formal risk Management policy or charter has been defined and communicated



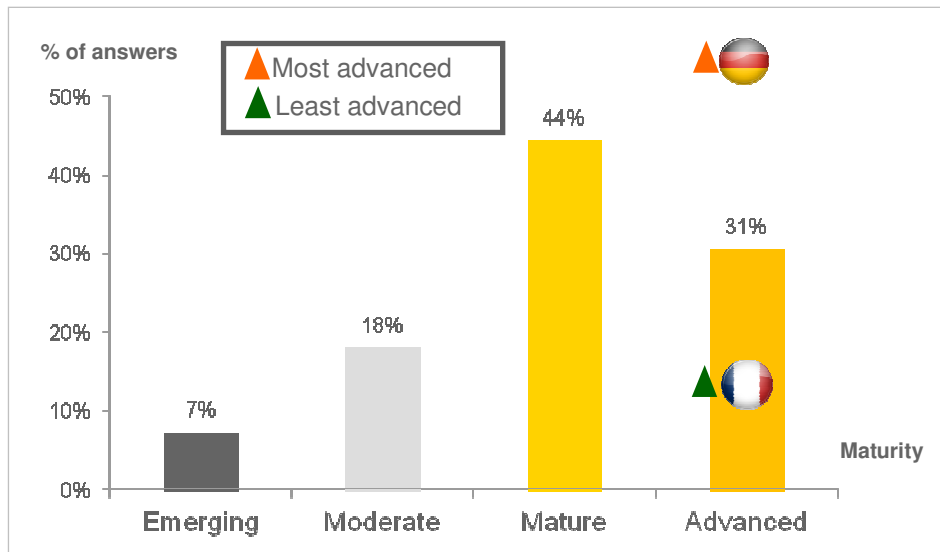
The role of Risk Management is now clearly defined, or in the process of being defined in most of the European companies.



Maturity of Risk Management practices

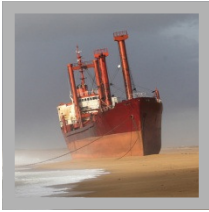
Risk reporting and communication

Board use and perception of risk information



GRAPH CAPTION			
<i>Emerging</i>	<i>Moderate</i>	<i>Mature</i>	<i>Advanced</i>
No mechanism in place to ensure risk information review by the Board	Risk management topic dealt with on an as-needed basis	The reported risk information is considered at least on an annual basis	Complete embedding of Risk Management in decision making at Board level

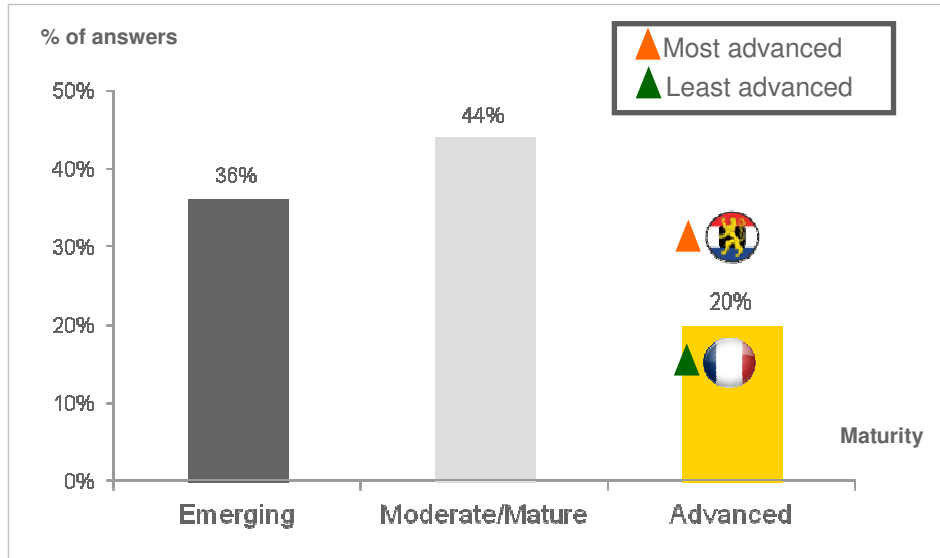
Boards have a regular use and a growing interest for risk information. We are moving towards an embedded mechanism



Maturity of Risk Management practices

Risk reporting and communication

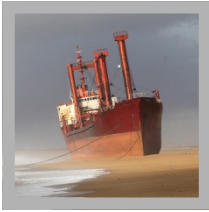
External risk communication



GRAPH CAPTION		
Emerging	Moderate / Mature	Advanced
<p>Communication is minimal or only carried out on general or generic risks of the sector</p>	<p>Communication carried out on major specific risks faced by companies, but does not disclose detailed information</p>	<p>Communication provided for major specific risks as well as assessment of their importance and management</p>

Risk external reporting remains very diverse from one company to another and deals with a large array of practices but ...

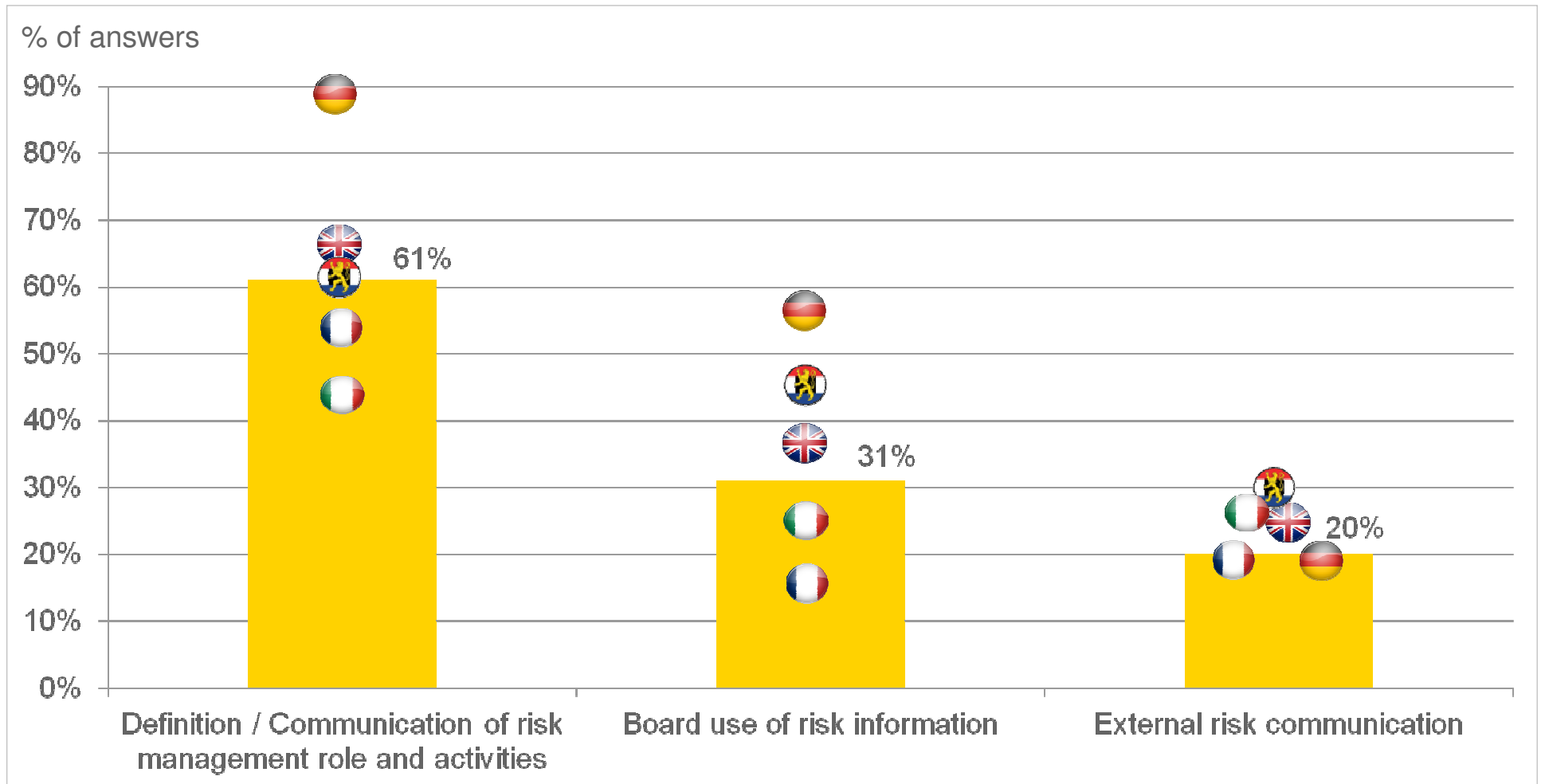
Risk communication tends to be more integrated with external reporting, 50% of companies were carrying out minimal communication in 2010 vs 36 % in 2012

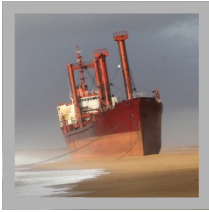


Maturity of Risk Management practices

Risk reporting and communication

Advanced practices : zoom by country

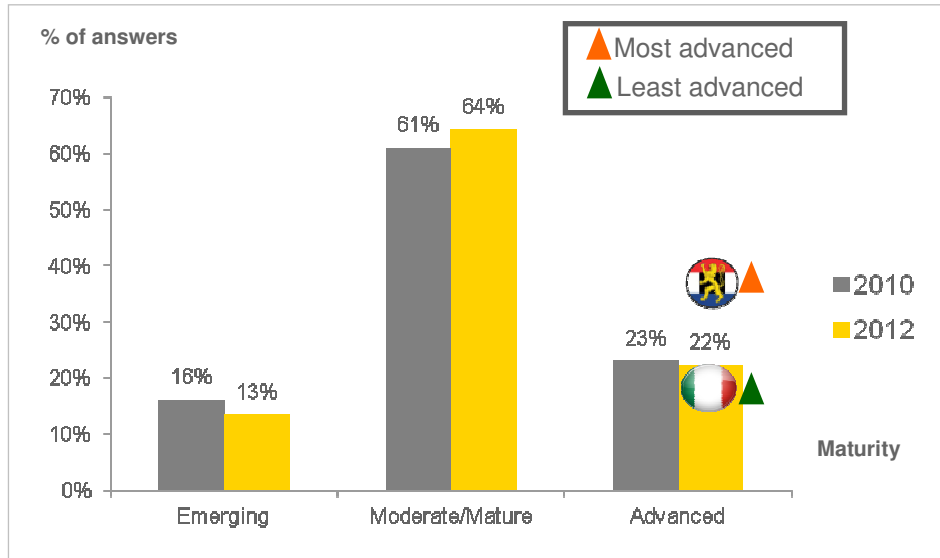




Maturity of Risk Management practices

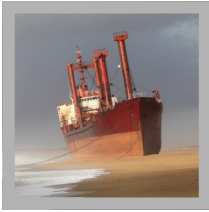
Risk Management functions alignment

Coordination between risk functions



GRAPH CAPTION		
Emerging	Moderate / Mature	Advanced
Risk functions (risk management, internal audit, internal control, environment, health and safety, quality, compliance...) are working independently	Some coordination exists between the different risks functions	Full risks functions coordination in place

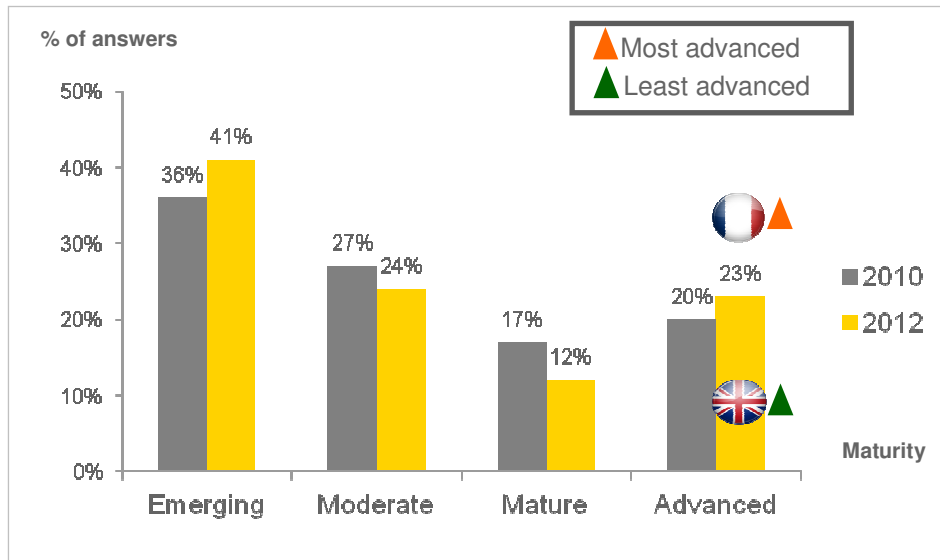
The different risk functions are no longer working “in silos”, however their level of coordination remains limited.



Maturity of Risk Management practices

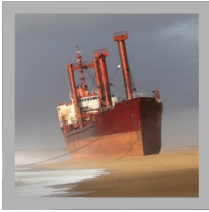
Risk Management functions alignment

Link between Risk Management and internal audit functions



GRAPH CAPTION			
Emerging	Moderate	Mature	Advanced
No particular relationship between Risk Management and internal audit functions and/or separate reporting lines	Mutual reporting – coordination / cooperation on a limited basis	Coordination and cooperation on the audit plan	Very close relationship between the two functions

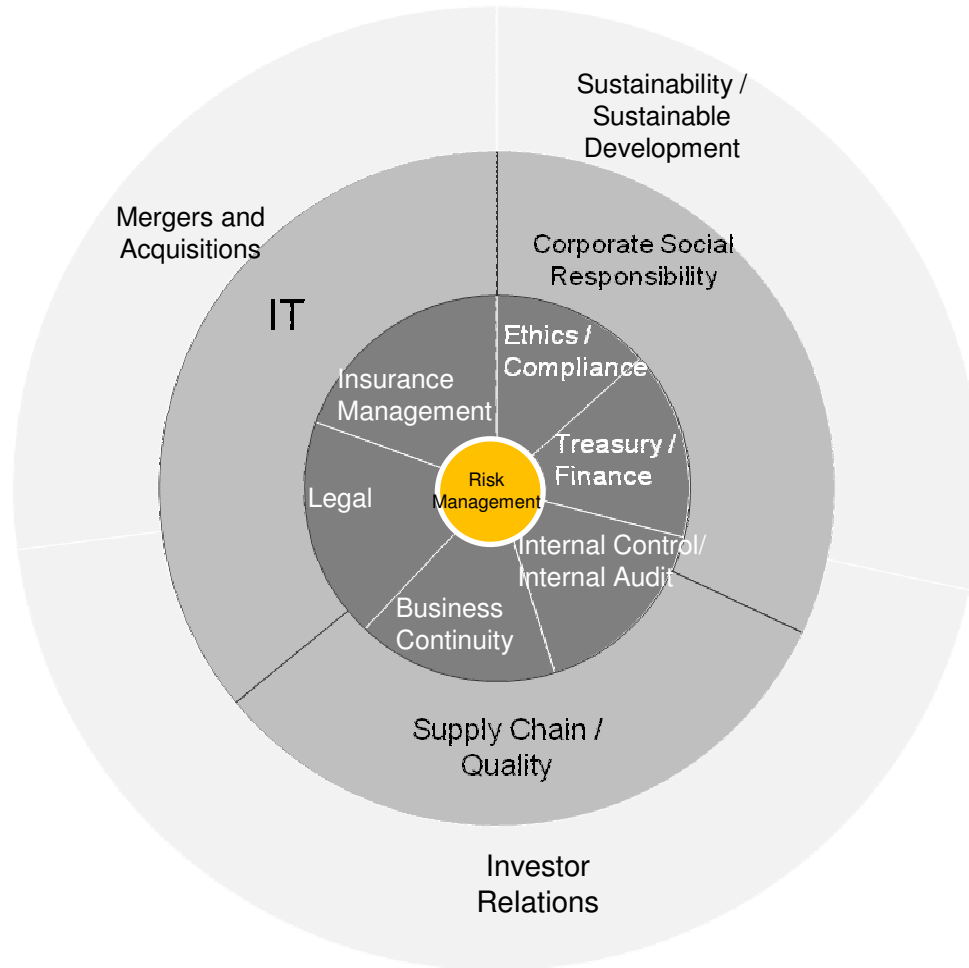
A minimum level of interaction between the two functions is now in place for most of the European companies.

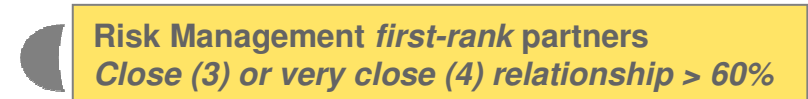
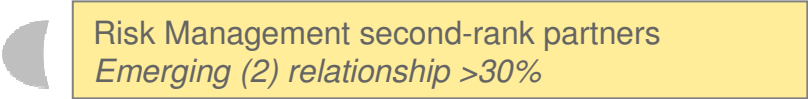
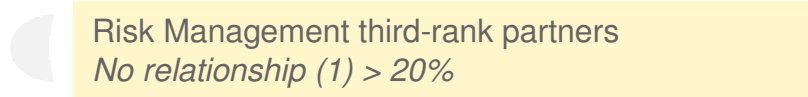


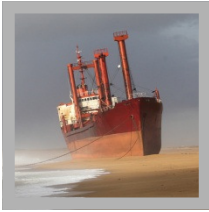
Maturity of Risk Management practices

Risk Management functions alignment

Relations between Risk Management and other functions: A Tier 3 approach



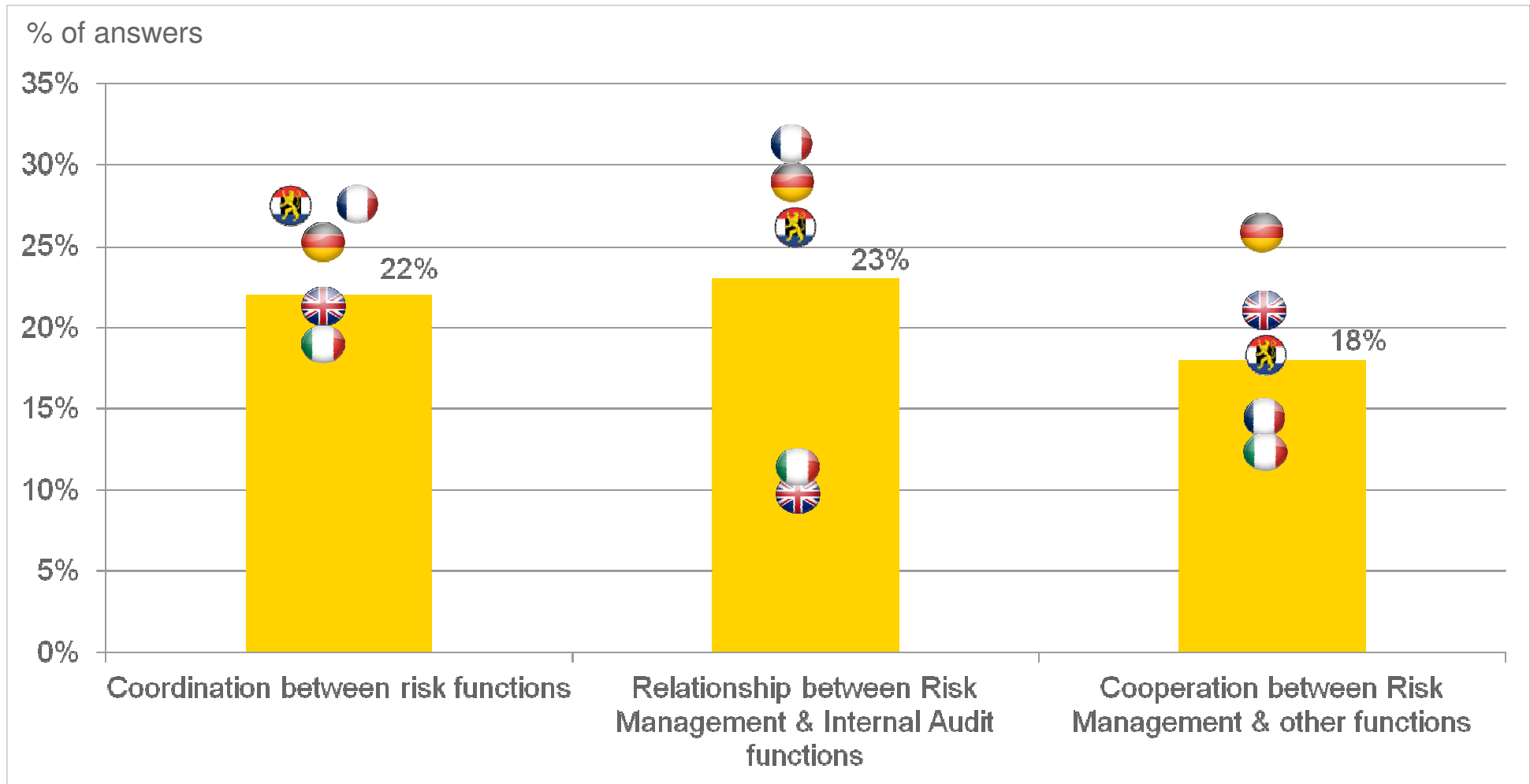
- 
Risk Management *first-rank* partners
Close (3) or very close (4) relationship > 60%
- 
Risk Management second-rank partners
Emerging (2) relationship >30%
- 
Risk Management third-rank partners
No relationship (1) > 20%

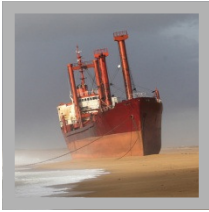


Maturity of Risk Management practices

Risk Management functions alignment

Advanced practices : zoom by country





Maturity of Risk Management practices

Synthesis: results by category and level of maturity

	Company's breakdown by category and level of maturity			
	Emerging	Moderate	Mature	Advanced
Risk Governance	11%	34%	28%	27%
Mandate of the board audit and/or risk committee	10%	55%	23%	12%
Interaction with the boards	8%	13%	37%	42%
Risk Management reporting	7%	40%	53%	
Risk Management system independent assurance	22%	51%		27%
Risk Practices and Tools	27%	25%	22%	25%
Risk mapping exercise	5%	16%	17%	62%
Risks assessment and quantification	46%	24%	25%	4%
Decision making process	31%	35%	24%	10%
Risk Reporting and Communication	21%	16%	26%	38%
Risk management role and activities	20%	19%		61%
Board use and perception of risk information	7%	18%	44%	31%
External risk communication	36%	44%		20%
Risk Management Functions Alignment	19%	26%	34%	21%
Coordination between risk functions	14%	64%		22%
Risk Management and Internal Audit functions relationships	41%	24%	12%	23%
Risk Management cooperation with other functions	23%		59%	18%



3.

How leading companies use Risk Management to fuel better performance?

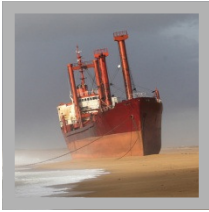


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Is there always a debate regarding the link between ERM maturity & performance ?

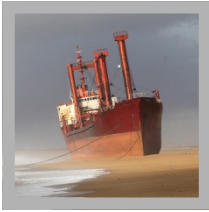
■ Objective

- ◆ Illustrate the correlation between the level of risk maturity of a company and its performance

■ Methodology

- ◆ Assessment of the performance of the studied companies based on two variables:
 - **Growth rate (EBITDA*) over the last 5 years:** negative; between 0 and 5%; between 5,1% and 10%; between 10,1% and 20%; more than 20%
 - **Growth rate (revenue) over the last 5 years:** negative; between 0 and 5%; between 5,1% and 10%; between 10,1% and 20%; more than 20%
- ◆ Based on the multi criteria analysis performed in Section 2, definition of four levels of risk maturity
- ◆ By company:
 - **Emerging**
 - **Moderate**
 - **Mature**
 - **Advanced**
- ◆ Cross analysis between the level of maturity by risk category (risk governance, risk practices and tools, risk reporting and communication, Risk Management functions alignment) and companies' performance (assessed through EBITDA and revenue growth over the last 5 years).

(*): Earnings before Interest, Taxes, Depreciation, and Amortization



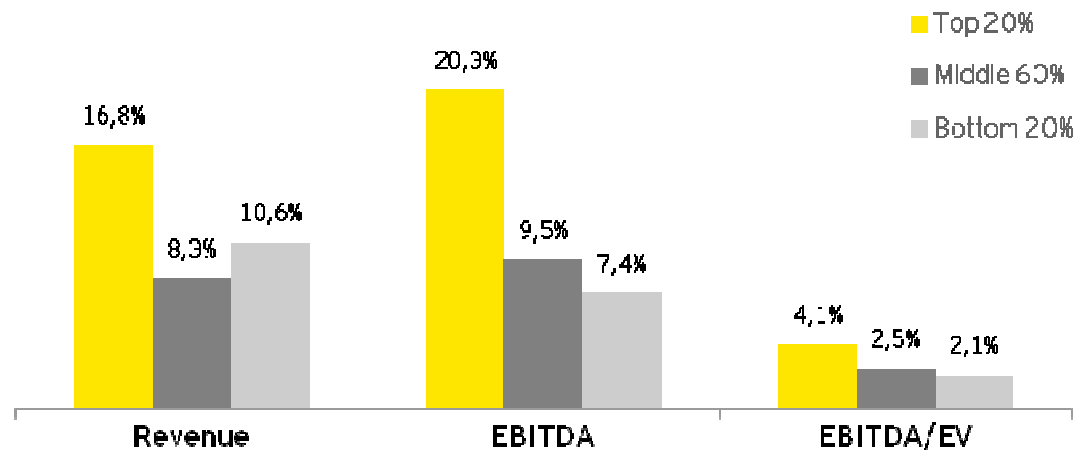
First evidence

Risk Management maturity drives Efficiency at a Worldwid level

Companies with more mature risk management practices outperform their peers financially. In our recent study, we found that companies with the most mature (i.e., the most sophisticated) risk management practices generated the highest growth in revenue, EBITDA and EBITDA/EV

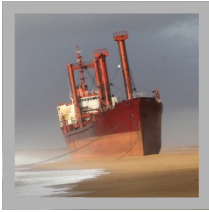
Using a global, quantitative survey (based on 576 interviews with companies around the world and a review of over 2,750 analyst and company reports), we assessed the maturity level of risk management practices and then determined a positive relationship between risk management maturity and financial performance.

Compound annual growth rates 2004 - 2011* by risk maturity level

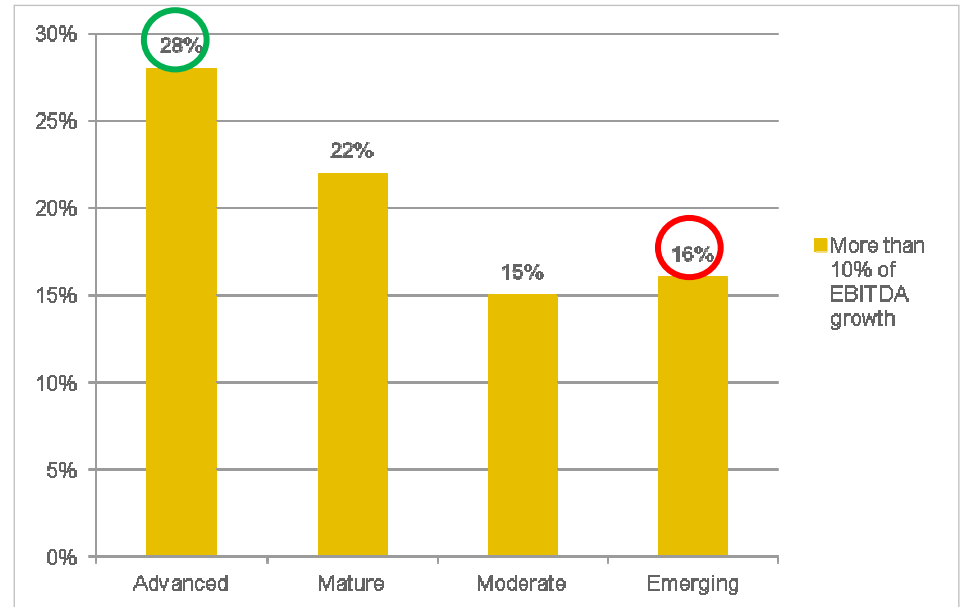
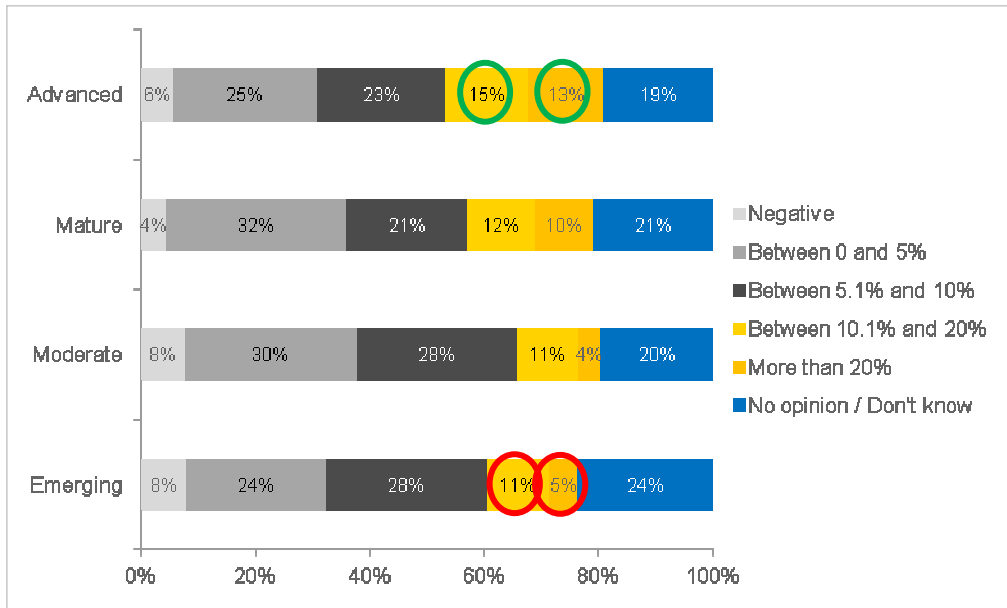


*2011 YTD reported as of November 18, 2011

- Financial performance is highly correlated **with the level of integration and coordination across risk, control and compliance functions**
- **Effectively harnessing technology** to support risk management is the greatest opportunity for most organizations

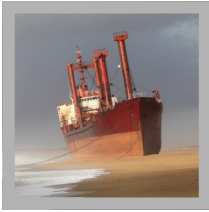


The Link between Risk Management maturity and performance (EBITDA growth rate) is confirmed by Ferma members

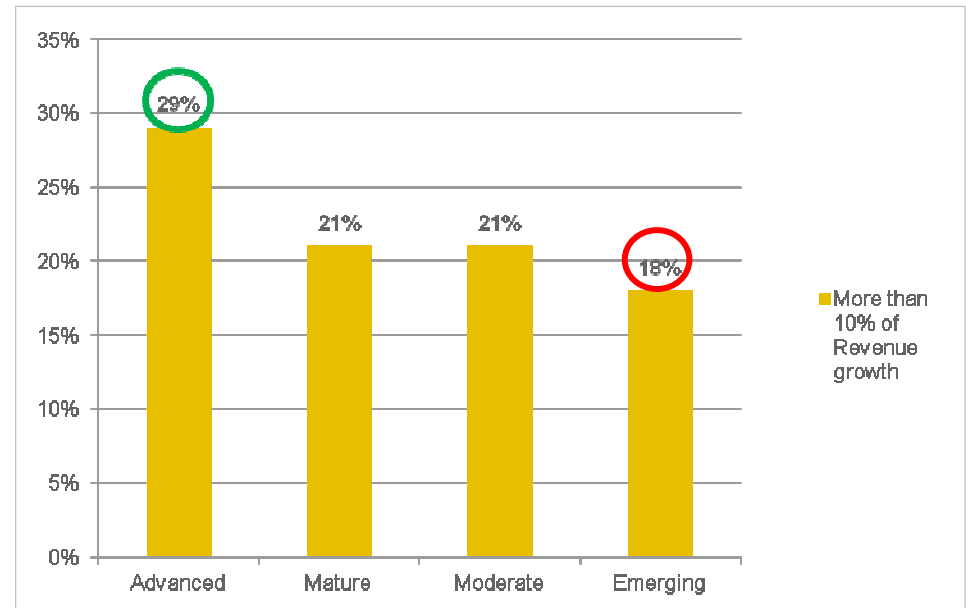
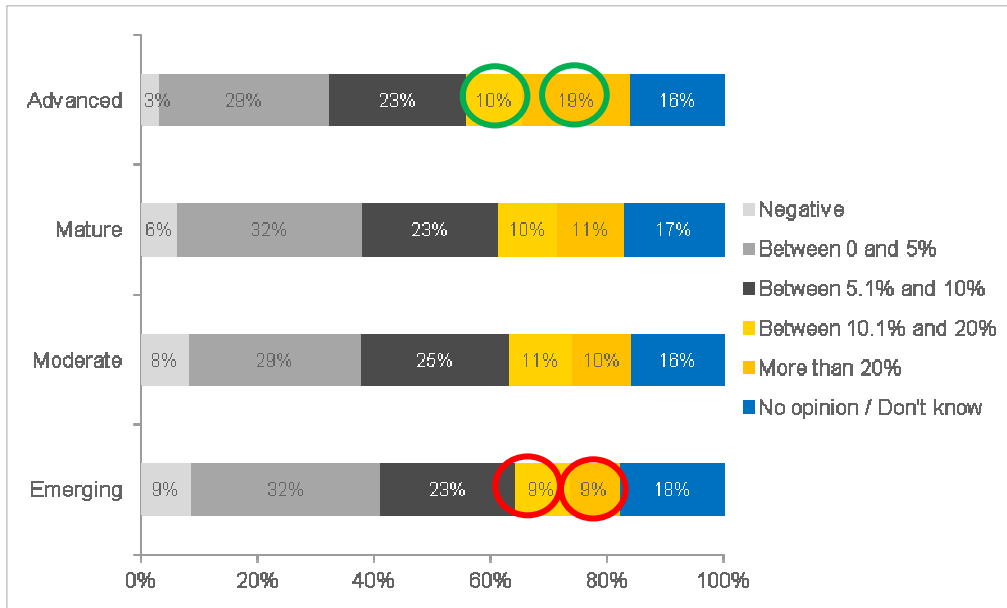


Companies with more mature Risk Management practices generate the highest growth in EBITDA.

The study reveals that companies with advanced Risk Management practices generate a stronger EBITDA growth. Indeed, 28% of companies with advanced practices have a growth over 10% whereas only 16% of companies with emerging practices present such a growth.

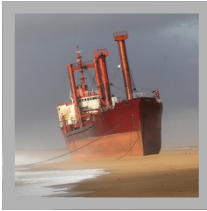


The Link between Risk Management maturity and performance (Revenue growth rate) is confirmed by ferma members



Companies with more mature Risk Management practices generate the highest growth in revenue.

The study reveals that companies with advanced Risk Management practices generate stronger revenue growth. Indeed, 29% of companies with advanced practices have a growth over 10% whereas only 18% companies with emerging practices present such a growth.



What differentiates top performer ?

