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RIMS COMMENTS ON STANDARD & POOR'S (S&P) ENTERPRISE RISK MANAGEMENT (ERM) ANALYSIS FOR CREDIT RATINGS OF NONFINANCIAL COMPANIES

FEBRUARY 29, 2008

The Risk and Insurance Management Society, Inc. (RIMS) commends S&P's work over the past few years for the positive effect it has had on the risk management discipline by raising the visibility of ERM within organizations. Furthermore, we thank S&P for the opportunity to comment on its proposed ERM analysis for nonfinancial companies. While RIMS does not advocate the use of one ERM framework over another, RIMS congratulates S&P in its work to date and its forward-thinking approach for recognizing the value of ERM in evaluating the credit quality of a broad cross-section of companies.

As a basis for further discussion, RIMS believes that S&P could effectively introduce ERM criteria into rating nonfinancial companies, and is providing the following comments to help S&P in this effort.

[S&P1. Part 1] Is it worth the effort?

Based on the value RIMS members have reported from their respective ERM implementations, RIMS supports S&P's view that strong ERM practices embedded into an organization's culture is characteristic of a well-managed company. It also yields a stronger governance model that can be applied beyond financial institutions. In this respect, RIMS supports S&P's adoption of an ERM framework as a component of its ratings reviews because we believe that a well-implemented ERM program enhances credit quality.

From a practical perspective, S&P's ERM rating provides a tangible and externally assessed requirement for the implementation of ERM. The S&P rating approach drives ERM from a sometimes difficult-to-define concept to a management practice that directly and visibly impacts the organization. In addition, the framework will compel corporate decision-makers to explicitly consider risk. This is something many companies are probably doing on an informal basis, but S&P's focus on ERM and its independent rating will improve that process by driving management to a more formal methodology in order to address S&P's inquiry. Such improvement is good for both the respective organizations and the risk management discipline.

[S&P1. Part 2] For issuers, would an ERM review provide significant additional insight into the credit quality of your firm? For investors and market observers, would an independent opinion about ERM capabilities of a firm enhance the value of Standard and Poor's ratings analysis in your decision-making process?

While a number of circumstances may contribute to changes in a company's financial results, RIMS conceptually agrees with S&P's premise that weak ERM may be predictive of negative consequences in a company's published financial results, just as strong ERM programs may be predictive of positive results.

Given the shared focus on corporate governance in ERM objectives and the underlying nature of credit ratings, RIMS supports S&P's position that the consideration of a company's ERM practices in analysts' valuation of credit worthiness – from an independent source – would provide a more tangible measurement of credit quality to investors and shareholders. Our membership is interested in testing S&P's correlation between ERM and a company's ability to meet its financial obligations.

As S&P's experience with nonfinancial companies becomes established, other interested stakeholders, such as clients, customers and vendors, may gain insight into a rated company's ERM program. For example, an ERM rating from S&P that influences the company's credit-worthiness could improve the quality of information available to companies who wish to investigate the sustainability of its vendors. This, in turn, would lessen the burden of independent assessments.

[S&P2] Does the proposed framework capture a company's risk and how a company measures risk?

The S&P rating framework provides certain structural requirements for an ERM program. The document, while not specific, provides a list of example risks that S&P will be evaluating.

RIMS sees opportunities to improve the framework. Appreciating the developmental history of S&P's ERM model rooted in insurers and banks, one of the first opportunities to improve the framework is for it to address operational risk in a non-financial institution environment more explicitly. Management of operational risks is fundamental to driving a company's resiliency and sustainability, particularly for nonfinancial companies - but also for financial institutions.

RIMS agrees that use of a framework is critical to a successful ERM implementation. However, RIMS encourages S&P to incorporate flexibility in its approach to assessing the quality of ERM for each company under review, in recognition of the variety of frameworks and standards available for companies to utilize. The crucial evaluation that S&P needs to emphasize is not whether management has identified risks according to any specific framework, but rather that a company's management has an embedded and formalized process not only to identify risks, but also to assess, treat, monitor and report the risks it has identified. S&P's greater focus should be on the qualities of the company's risk governance model and ERM process, not the specific key risk areas. Perhaps more clarity should be given to issuers regarding S&P's policies, infrastructure, and methodologies (PIM) approach, referenced as applicable to energy companies, if that model is expected to be extended to other nonfinancial companies.

Based on RIMS' ERM practitioners' experience, RIMS cautions S&P, as it transitions from a financial institutions methodology and definitions to one intended for nonfinancial companies, to consider carefully the different operating perspectives of financial institutions and nonfinancial companies. As an example, insurance companies typically focus on inherent risk and residual risk as critical data points for measurement, whereas certain nonfinancial companies are focused solely on residual risk, both from a measurement and treatment perspective. S&P's flexibility in addressing nonfinancial companies from a principles-based approach, rather than a prescriptive approach that may work for insurers and financial institutions, will lead to a higher quality assessment of nonfinancial companies' ERM program without imposing undue burdens on these companies trying to fit "a square peg into a round hole".

[S&P3] How much of an effect on credit quality do the proposed sector-specific risks have? Are there others that should be added?

RIMS recommends that S&P remain flexible with respect to sector-specific risks. If S&P attempts to create an exhaustive, sector-specific risk list in advance of its assessments, it may unintentionally become a driver of risks rather than an assessor of them. On the other hand, S&P will be better positioned as an assessor of each individual company's approach to multiple risks if S&P relies on individual companies to provide their own specific risk inventories and definitions. As an example, a company may identify a risk it perceives to be unique to its operations (which may fall outside its "assigned" sector risks) for which management's focus is appropriately needed. If S&P views the risks within an organization in an artificial and prescriptive manner based upon the key risks S&P believes are associated with all organizational members of that sector, S&P loses a powerful opportunity to build a repository of risk data that could be quite useful to those same organizations. The collected data could reveal risk commonalities and anomalies within sectors, which itself could affect a company's, or even the sector's, credit quality. This "observation" methodology also supports S&P's approach toward emerging risk. Risk is dynamic, and a company's ERM process should be dynamic, as well.

[S&P4] Does the proposed rating system work for nonfinancial companies?

Quartiles may work well, initially. S&P reported that more than 80% of its ERM ratings of insurance companies landed in the adequate range, which is not surprising in an ERM environment that is not fully mature.

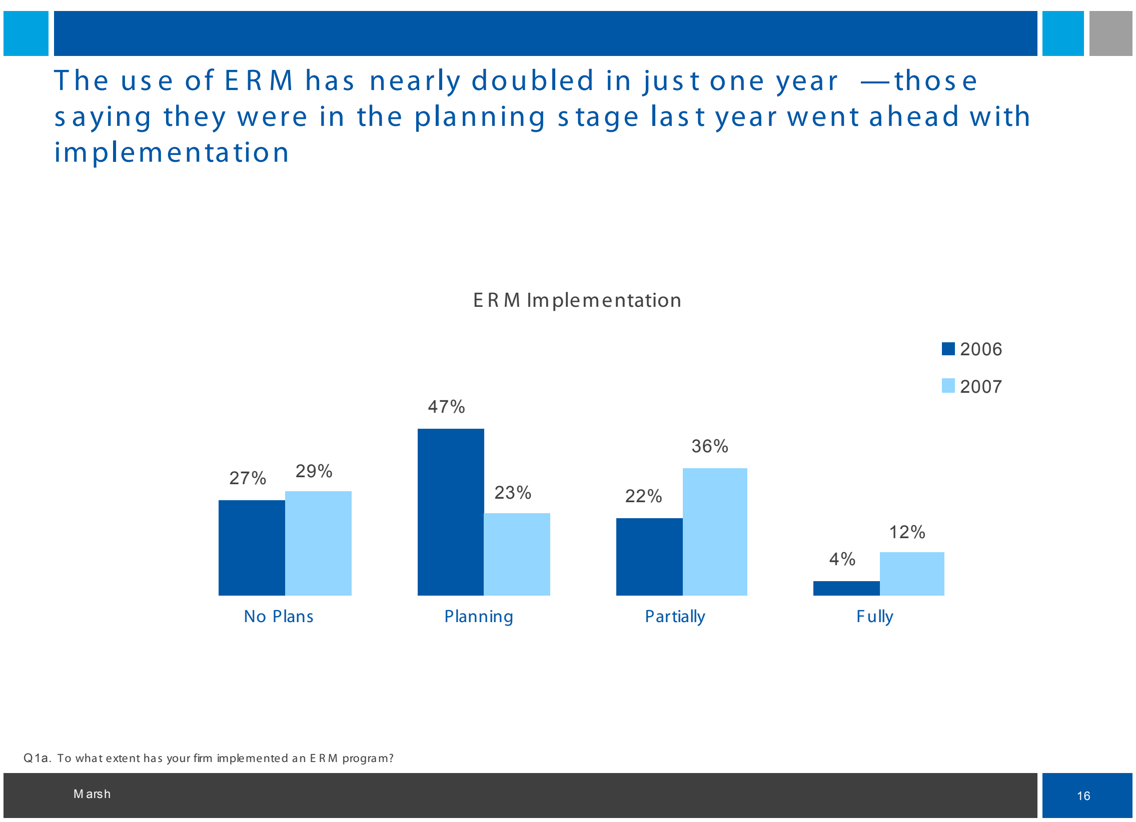
The criteria, as described, are very general. RIMS members are interested in how the assessments of weak, adequate, strong, or excellent are determined. Unlike a quantitative assessment of financial credit worthiness, there is concern about the potential for subjective assessments, based on seemingly unclear qualitative judgments and varying experience of personnel conducting the assessments.

RIMS suggests that S&P consider a continuum of ERM maturity in assigning its ratings, and offers its maturity model as a tool for S&P to use. S&P may find that the RIMS Risk Maturity Model (RMM) for Enterprise Risk Management is a reasonable and thorough discussion of the attributes evidenced by companies as ERM programs mature. As an example, one of the key values of an advanced ERM program is management's success in exploiting risk for organizational value. Therefore, a company that received an excellent rating should also be able to demonstrate tangible successes and value creation from exploiting its risks. This maturity attribute is one of many that RIMS captures in its RMM. It is also a focus that RIMS has taken in its Excellence in Risk Management surveys. This would be an important consideration for the investor community – particularly if S&P's intent is to reveal individual ERM ratings in the future. Based on our analysis of the S&P criteria and the RIMS RMM attributes, the two are closely aligned.

[S&P5] Are nonfinancial firms ready for the discussion?

RIMS has conducted several surveys related to ERM over the past few years. The surveys confirm that two-thirds of its members have either implemented, or are beginning to implement, of ERM programs. Based on these findings, RIMS believes that nonfinancial firms indeed are ready for the discussion, particularly if half of the 47% who were in the planning stage in 2007 have since begun implementation.

From the RIMS and Marsh sponsored Excellence in Risk Management IV survey, 2007:



Excellence in Risk Management IV

- A quantitative study based on interviews conducted from February 14, 2007, through March 23, 2007, with:
  - 297 risk managers;
  - 125 C-suite executives (CEOs, CFOs, general counsels, and chief risk officers (CROs); and
  - 66 associated titles (controller, accountant, claims manager, and similar titles).
- Interviews conducted by TNS, one of the world's leading market information companies, with $2 billion in revenues, operating in 56 countries.

[S&P6] Do you have any suggestions for the ERM evaluation process?

RIMS reiterates its concern, on behalf of its members, about S&P's potential migration of the current methodology used for financial institutions to nonfinancial companies. RIMS recognizes S&P's acknowledgment that it faces challenges in the transition, and that the methodology used for financial institutions may not fit nonfinancial companies. To that end, RIMS encourages S&P to consider whether its assessment framework and evaluation process is flexible enough to fit any given company's culture and management style, particularly with S&P's apparent focus on applying a sector-specific platform. Rather, we encourage the development of an approach flexible enough to recognize varying businesses and management styles adopted by nonregulated companies.

Additionally, RIMS suggests that S&P consider broadening its outreach to nonfinancial companies with regard to this proposed element of the rating process for nonfinancial organizations. RIMS would look forward to exploring opportunities to support such an outreach effort by using risk management practitioners as a sounding board for its ERM process and overall ERM best practices. Members of RIMS have expressed willingness to act in this capacity for S&P.

Certain sample questions appear to be quite focused, such as "What environmental scanning techniques do you use to anticipate emergence of extreme disasters?" RIMS believes that limiting such scanning techniques to "extreme disasters", while appropriate in assessing insurance companies' credit quality, may not reveal non-disaster events that could determine whether a nonfinancial company is able to meet its debt obligations over time.

Summary and Recommendations

First of all, RIMS does not advocate one ERM framework or standard over another. Rather, RIMS' focus is to advance the practice of enterprise risk management by helping its members develop, lead and sustain ERM programs and processes within their respective organizations.

RIMS compliments S&P in its work to-date and its forward-thinking approach to expanding analysis of nonfinancial companies by including ERM assessments in its credit rating analysis. RIMS believes that S&P's inclusion of ERM assessments in its credit ratings will help drive enterprise risk management from concept to best practice, resulting in stronger governance of the issuers.

RIMS supports S&P's position that the consideration of a company's ERM practices in analysts' valuation of credit worthiness would provide a more tangible measurement to investors and shareholders from an independent source.

RIMS sees opportunities to improve the framework. Appreciating the developmental history of S&P's ERM model rooted in insurers and banks, one of the first opportunities to improve the framework is for it to be more explicit about operational risk in non-financial companies. RIMS encourages S&P to incorporate flexibility in its framework in recognition of the variety of frameworks available for companies to utilize. The crucial evaluation that S&P needs to emphasize is not whether management has identified risks according to any specific framework, but that a company's management has an embedded process to not only identify, but to assess, treat and monitor the risks it has identified.

RIMS cautions S&P, as it transitions from a financial institutions methodology and definitions to one intended for nonfinancial companies, to consider carefully the different operating perspectives of financial institutions and nonfinancial companies, in addition to the separate business sectors. S&P should remain flexible with respect to sector-specific risks. If S&P takes an observational approach to learning what a company's self-reported risk profile is, rather than making assumptions about what the key risks should be for a sector, the data that S&P collects becomes quite powerful.

RIMS members are interested in how the assessments of weak, adequate, strong, or excellent are determined. RIMS suggests that S&P consider a continuum of ERM maturity in assigning its ratings, and offers its maturity model as a tool for S&P to use. RIMS suggests that S&P consider broadening its outreach to nonfinancial companies by using risk management practitioners as a sounding board for its ERM process and overall ERM best practices.

Based on the findings in its various membership and other surveys, RIMS believes that nonfinancial firms are ready for the discussion proposed by S&P.