

ERM VIDEO INSIGHTS

Transcript of Steve Dreyer and Don Pagach

Observations about the State of ERM: A View From S&P

Don: Hi, I'm Don Pagach. I'm the Director of Research for the Enterprise Risk Management Initiative here at NC State University. And in this video, we're going to be talking a little about the state of ERM with Steve Dreyer from S&P Global Ratings.

Steve you've been involved closely with the management and governance ratings which ERM is a part of over the last five years. What is your state, what do you believe is the state of ERM right now for large companies?

Steve: I'd say, it's sometimes getting there. We've been doing management and governance assessments on companies since 2013. During that period of time we've scored companies on a four point scale. And only 38% of the companies currently get the top two scores on that scale. But that's up from 34% just two years ago. And that's in an environment where overall credit conditions are getting worse. So as companies are more stressed we're actually seeing an improvement in their ability to manage the company, to see around corners. Still less than half the companies we're rating are in that top category.

Don: So less than half. So what are some of the characteristics of firms that are doing this well or maybe industries that are doing this well as supposed to not so well?

Steve: I think there is a different comfort level depending on what industries you're talking about. What we've seen is in the energy businesses and the regulated businesses, there's been more of a kind of a driver behind doing ERM more formally. But I would have to say that across the board, companies that do it well are employing methods and techniques that work for them. So they're, yes they may be using consultants, yes they may be borrowing frameworks, or yes they may be just following regulatory guidance. But it's kind of owning that and internalizing it and making sense for their companies, speaking their language. That's where it works. The opposite, not so much. You have companies that can tend to focus on the wrong things or try to adopt a framework that doesn't work with their organization, falls apart.

Don: Is there anything that really kind of helps a firm make move towards becoming more mature in ERM?

Steve: Well, bluntly, I think that the best motivator is a near death experience, something that sort of hits the company right between the eyes. Or better, a near death experience that happens to a competitor or a peer company where it's close enough to home where they sort of sit up and take notice. There's a cultural dimension to this, where incentives and motivation that have executives right down to the shop floor employees have, that sort has a time frame associated with it. And many of these

principles that we talk about with ERM extend beyond time wise the kind of incentives, compensation plans, the incentives that are in place that currently they are reacting to.

Don: Have some of the S&P ratings for the companies that are not doing such a great job with management and governance or ERM, has that really been helping them, an impetus, to get moving on ERM?

Steve: Hard to say. We have been looking at management as a discipline for many, many years in our credit ratings and even before we introduced a formal score on management and governance, we've embedded an assessment of how well management is going to be able to deal with adversity. So, in some senses, by formalizing this, we've made it a little more visible with company managements but we didn't see a lot of changes in ratings as a result. We didn't really expect to see that. But I think having more of a focus on it and having some kind of clarity around it instead of between the lines kind of exercise becoming something more explicit definitely helps the conversation.

Don: So is the momentum going forward and maybe next the five to ten years, do you see a steady improvement in ERM management and governance?

Steve: Well, that's interesting. I did one of these videos four years ago with your colleague, Bonnie Hancock, and she asked me basically that same question, "Where is ERM going to be in five or ten years?" And I think what I said then was that the discipline will grow but the name may disappear. And I think the name disappearing, you'll have to change your logo, ERM will disappear, but I think it would be a good thing because it would mean that it's more ingrained. It's part with what you do when you manage a company, when you do strategic planning. Of course you're looking at risk. You don't have to tell managements you should look at financial aspects of your decision-making, they know that. Ok, ERM ideally should be, should be that kind of a thing. When that happens, I'm still hedging the bets, but I do think it'll happen.

Don: Excellent. Thank you so much. I really appreciate it.

Steve: Sure. Thanks Don.