

IMPLEMENTING ERM



VALUE CREATION AND THE RCV FRAMEWORK

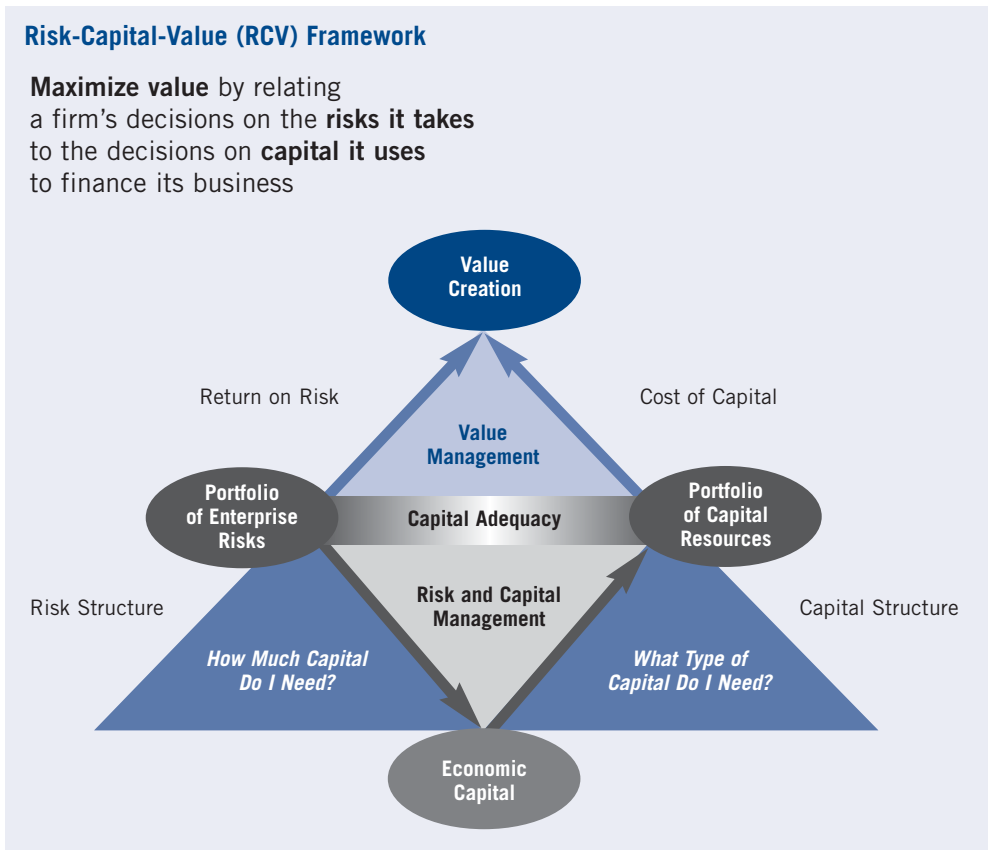
Towers Perrin applies its proprietary Risk-Capital-Value Framework to help leading corporations create value through the techniques of enterprise risk management (ERM).

The RCV Framework begins with the understanding that a company’s management must focus on two fundamental “portfolios” when striving for value creation — its portfolio of businesses and related risks, and its portfolio of capital used to finance its businesses. At the conceptual level, these two portfolios are all that management has to worry about — everything else is detail.

RISK AND CAPITAL MANAGEMENT

In the finance world, the concept of capital adequacy reveals the strong relationship between capital and risks. The nature and scope of risks dictate how much capital the firm requires, and the amount of capital determines how much risk the firm can take to grow its business and profitability.

Although tightly linked, the worlds of risk and capital quite literally do not speak the same language. The risk world is dominated by the language of statistics and actuarial science, and the capital world is dominated by the language of corporate finance — and it is not often easy to get practitioners to make the link.



Our RCV Framework uses the concept of economic capital to translate the language of risk into the language of corporate finance. The process begins with the question, “How much capital do I need?”

To answer this question, we help our clients establish and deploy the statistical measures of risk to define the risk structure of the firm — the type of risk, its properties, and how it unfolds over time and scenarios. Economic capital is a measure of that risk — a number that reveals how much the risk weighs.

Once our clients know how much capital is needed, we work with them to address a second question: “What type of capital do I need?”

Senior management is accustomed to answering the capital structure question but does not always consider risk transfer instruments as part of the capital mix. Capital efficiency can be enhanced by including such risk transfer instruments as insurance, reinsurance and hedging (which are essentially contingent capital), in addition to the various forms of equity and debt.

TOWERS PERRIN PUBLICATIONS AND COMMENTARY

We are ERM thought leaders who contribute to the development of the discipline with publications and commentary, including:

“Effective Management of Operational Risk,”
Emphasis, 2006

“The Chief Risk Officer — What Does It Look Like and How Do You Get There?”
Risk Management, 2005

“Enterprise Risk Management — From Compliance to Value,”
Financial Executives International, 2005

“Economic Capital: A Key Tool on the Fast Track for Risk-Based Decisions,”
Update, 2005

“The Growing Need for Effective Operational Risk Management for Wealth Management Companies,”
Institute of Actuaries of Australia, 2005

“CFO Survey: Managing Current and Future Demands on Capital,”
Update, 2005

“Adding Value Through Risk and Capital Management,”
Towers Perrin Report, 2005

“Managing Portfolio Growth Using Catastrophe Models,”
Emphasis, 2004

“Using Reinsurance to Drive Economic Value,”
Emphasis, 2004

“Economic Capital — Recent Market Developments and Current Trends,”
Financial Engineering News, 2004

“Measuring and Managing Operational Risk,”
IRMI Expert Commentary, 2002

ERM Practice Leader Prakash Shimpi is editor and principal author of *Integrating Corporate Risk Management*, 256 pages, hardback, published by Texere, 2001

VALUE MANAGEMENT

Each risk must earn a sufficient return to the firm to be worthwhile undertaking. At the same time, each capital instrument has a cost. Management’s objective, then, must be to ensure by its actions that the return on risk always exceeds the cost of capital.

A RECORD OF SUCCESS

Towers Perrin is recognized as an industry leader in the area of risk and capital management. We work with clients worldwide to:

- Understand the risk structure of their business and the consequent economic capital
- Evaluate a wide range of capital resources that can be used to finance their business, including use of captives, insurance-linked securities, reinsurance, derivatives, and other alternative and contingent funding instruments
- Reflect the perspectives of policyholders and investors to develop market-consistent measures of their business
- Create principle-based policies and procedures for management that reflect the appropriate returns for the risks that have been undertaken.

ABOUT TOWERS PERRIN

Towers Perrin is a global professional services firm that helps organizations around the world optimize performance through effective people, risk and financial management. The firm provides innovative solutions to client issues in the areas of human resource strategy, design and management; actuarial and management consulting to the financial services industry; and reinsurance intermediary services.

Towers Perrin’s Enterprise Risk Management practice offers clients the ability to understand the full spectrum of risks faced by their organization and to create additional value by actively managing their key risks. Clients can deploy ERM to upgrade business planning through better articulation, quantification and oversight of the risks that drive value, and improve their ability to assess and implement risk solutions — both operational and transactional — to achieve their business objectives.

To learn more about our RCV Framework and our approach to ERM, contact Prakash Shimpi, ERM practice leader, at prakash.shimpi@towersperrin.com.