CORPORATE counsel
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A Risk Worth Taking?

The Role of In-House Counsel in Enterprise Risk Management

Is in-house counsel a natural choice for Chief Risk Officer? Probably, and they certainly have a central role in designing methods of managing overall risk. Today there is a greater recognition of the variety, the number and the interaction of risks facing organizations. Many potential risks now facing organizations – avian flu, global warming, terrorist events, and globalization – are so new and severe as to require new thinking about the nature of risk. Most organizations now realize that the usual, segmented way of identifying and addressing risk should change.

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Advocates of Enterprise Risk Management or "ERM" suggest that it is a risk management system which is changing the way organizations look at risk and how they implement and take advantage of risk control procedures. ERM holds the potential promise to enhance shareholder value and decrease the cost of capital. ERM leadership may be a risk worth taking.

The Disadvantages of a "Silo" Approach to Risk Management

Traditionally, organizations have dealt with risk by identifying and prioritizing each risk and then treating that risk individually. Indeed, most companies are organized in what has been referred to as a "silo" structure, a configuration wherein each operational activity is undertaken independently and each department is responsible for assessing and responding to its own unique risks. Sansone, Calandro and Eagan, *Insurance Enterprise Risk Management:An Overview*, 70 Building an Edge 14 (2006). The idea behind ERM is that a fragmented silo approach does not produce optimal results. An ERM approach solves this problem by grouping together all of the risks encountered by an organization. The organizational risks are then treated as a whole through the use of insurance and financial mechanisms which help maximize interrelationships and competitive advantages thereby creating value.

As legal representatives to various corporate entities, in-house and outside counsel are responsible for letting their clients know the basic need for risk management, such as strong internal controls, state-of-the art accounting practices and robust corporate governance systems. The ERM approach — which ordinarily might originate with the risk management or financial function in a corporation — helps remove the segmented "silo" style of risk management. This structural change facilitates the operational efficiency and synthesis of information across the organization. In-house counsel naturally fit the role of central player in an ERM effort.

The ERM Approach

ERM is defined as: "A rigorous approach to assessing and addressing the risks from all sources that threaten the achievement of an organizations strategic objectives." Miccolis and Shah, *Enterprise Risk Management, An Analytic Approach*, (Tillinghast-Towers Perrin, 2000). Specifically, ERM differs from traditional risk management approaches in terms of its focus, objective, scope, emphasis and application. Instead of focusing on each department's individual risk, ERM has adopted a holistic approach in seeking to align all of an organization's departments, people, processes and technology together into one group to better understand the risks the organization faces. Under an ERM approach, management's attention is directed towards the uncertainties of the organization's entire asset portfolio, including specific and intangible organizational assets. This approach then focuses on creating value from an organization's risk profile.

Steps to Implement ERM

In-house counsel or outside legal counsel are becoming increasingly more responsible for the proper implementation of ERM in their organizations. There are a variety of methodologies to help implement an enterprise approach to risk management. While the specifics and quality of each method differ, each has the same overall objective.

There are five basic steps to the implementation of ERM from an in-house and outside legal counsel's perspective. First, conduct a complete overview of the company's organizational risk profile, defining each and every risk that the organization faces on a daily basis. Second, articulate the risk management vision of senior management and establish controls for independent monitoring of the control processes to ensure that they are effective. Third, implement the ERM strategy by focusing on a portfolio of all the organization's risks. Fourth, viewing the organization's risk portfolio, seek to treat those risks on a holistic basis, taking advantage of interrelationships and competitive advantages. Finally, evaluate the existing ERM infrastructure and look for ways to continually advance it. Again, in-house counsel may fill a number of roles in the ERM effort.

Can ERM Create Value?

Proponents of ERM describe it as an invaluable tool to provide an organization with the processes it needs to become more effective at managing uncertainties while creating value. Specifically, an ERM approach will identify and manage serious threats to growth and return while identifying risks that represent opportunities and interrelationships to exploit for above-average growth and return. By helping to establish a sustainable competitive advantage, optimizing the cost of managing risk and improving business performance, ERM will create value for your organization. This is important in today's marketplace, investors assign a higher value to organizations with more consistent earnings. Miccolis, Samir Shah, *Enterprise Risk Management, An Analytic Approach*, (Tillinghast-Towers Perrin, 2000).

In order to benefit from an ERM approach, in-house or outside legal counsel must be aware of the various ways to transfer risk and deal effectively with the organization's risk portfolio. Risks can be transferred using a variety of strategies, which include: business structure, strategy, obtaining insurance coverage, forming a captive insurance company, engaging in alternative risk management and/or using financial hedges. Organizations which are informed and knowledgeable about these options will have a decided advantage in managing their risk portfolio. Whether the market for traditional insurance products, or alternative mechanisms such as "captive" insurance adapt to fills the need identified by ERM studies remains to be seen.

The Future of ERM

Companies reportedly are more disciplined in their use of ERM today than ever before. Catastrophic events, capital efficiencies, globalization and competitive pressures have driven companies to adopt a more active and global approach to risk issues. Through the creation of the Chief Risk Officer "CRO" in board rooms across the country, companies are clearly realizing the importance of an ERM approach. Berinato, *Enterprise Risk Management, Risk's Rewards*, CIO Magazine, Nov. 1, 2004. A position suited to the skill set of in-house or outside legal counsel, the office of the CRO is responsible for providing the overall leadership position for ERM, establishing the framework and structure of ERM and optimizing the overall risk portfolio through a variety of business activities and risk transfer strategies.

While ERM promises to change the way organizations and in-house and outside counsel look at risk management, there is still a lot of room for improvement. Many companies generally are not satisfied with their current capabilities in many of the risk management areas they identify as important. *The 2006 Tillinghast ERM Survey* (Tillinghast-Towers Perrin 2006). In the future, it is likely that in-house and outside counsel will be called upon to implement ERM strategy.

Conclusion

ERM supporters maintain that the successful ERM approach will evaluate organizational risk on a global and overall basis so that diverse risks can be analyzed and treated, while at the same time creating value through interrelationships. Working with management, in-house and outside counsel can help transfer organizational risk through the use of business structure, strategy, insurance, captive insurance companies and financial hedges. In the new world of ERM, the informed and knowledgeable in-house and outside legal counsel likely will serve an important role.

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