

Building a Box Around Murphy's Law

“If anything can go wrong, it will.”

Corollaries to Murphy's Law

- “If there is a possibility of several things going wrong, the one that will cause the most damage will be the one to go wrong.”
- “It is impossible to make anything foolproof because fools are so ingenious.”
- “If you perceive that there are four possible ways in which a procedure can go wrong, and circumvent these, then a fifth way will promptly develop.”

Corollaries to Murphy's Law

- “Every solution breeds new problems.”
- “Whenever you set out to do something, something else must be done first.”
- “Mother Nature is a bitch.”

Traditional Risk Considerations

- People
- Property
- Financial
- Operations/Products Hazards
- Professional

People Risk

- Lee's Law -- “It takes less time to do something right than it takes to explain why you did it wrong.”
- Corollary – “If you don't have the time to do it right the first time, what makes you think you have the time to do it over?”

People Risk

Most failures are based in the breakdown of a
PROCESS.

1. Safety, quality, consistency.
2. Who's who in the production chain.
3. Statement of Ethics and Values.
4. Sarbanes-Oxley as a dominant force.

Safety, Quality, Consistency

- ISO 9001, OSHA Star, Six Sigma, Integrated Capability Maturity Model
- Industry Standards and Expectations
- Common threads:
 - 1. Measure
 - 2. Identify Improvements
 - 3. Implement and Monitor

Rainmakers and Producers

- What are key functions to the enterprise?
- Who are the key persons to those functions?
- Disability is larger than Life:
 - Short Term
 - Long Term
 - Definitions – Know thy CONTRACT.

Ethics and Values

- Written Standards approved by Board/Sr. Mgmt and implemented top down.
- Formal training on all aspects of the statement and implications to the enterprise.
- Establish Ethics Office/Chief Ethics Officer (not necessarily the CEO).
- Anonymous Reporting critical and assured.

Sarbanes-Oxley (SOX)

- Corporate governance dominance.
- Private governance standard if sold.
- Murphy's Law antidote.
- Protection beyond SOX 1.

Property Risk

- MacPherson's Theory of Entropy – “It requires less energy to take an object out of its proper place than to put it back.”
- Murphy's Asymmetry Corollary – “It takes no time at all to break something, but it takes forever to have something repaired.”

Property Risk

- Valuation
- Business Interruption
- Extra Expense
- Contingent Business Interruption
- Intellectual Property
- Electronic data and equipment
- Records and Valuable papers

Property Risk

- Valuation

- Book Value vs. Economic Value
- Agreed Value vs. Co-insurance
- Blanket Limits
- Regular inventory and valuation of property

Property Risk

- Business Interruption
- Extra Expense
- Contingent Business Interruption
 - Contractual back-up for supply and product.
 - The “disability” coverage for the enterprise.
 - Risk Control and loss mitigation measures very important – pre-loss contractual arrangements.

Property Risk

- Intellectual Property
 - Assets
 - Liabilities
 - Advertising Liability

Property Risk

- Information Systems
 - Intrusion Detection 24/7/366, not 12/5/260
 - Records Theft – As good as MC is . . .
 - Internal Attacks more frequent

Financial Risk

First Law of Holes

“When you find you’re in one, stop digging.”

Financial Risk

- Risk Retention – A question of impact
- Income streams
- Balance sheet protection
- Cash positions and flows
- Retrospective Programs
- Special Purpose Mechanisms

Operations Hazards

Patton's Law –

“A good plan today is better than a perfect plan tomorrow.”

Operations Hazards

- Unique to each enterprise
- Property and casualty risk only fractional part of operations exposure
- Identify exposures that affect all areas of operations
- Assess/Develop methods to deal with each
- Implement methods and contingency plans

Operations Hazards

- Contractual Transfer of Operational Risk
 - ALWAYS include insurance requirements of your sub-contractors
 - BE AWARE and satisfy imposed insurance requirements in contracts you sign
 - MONITOR certificates of insurance issued to satisfy contractual insurance requirements
 - For certainty, request a copy of the policy endorsement satisfying the requirements

Operations Hazards

- Contractual transfer of risk is one of the most litigated areas of risk transfer in the industry.
- Someone inside the enterprise must be responsible for monitoring the exposure of both customers and suppliers.
- Agent review of contractual requirements for insurance coverage.
- You control the terms of the contract.

Professional Risk / Errors & Omissions

- Claims Made vs. Occurrence Forms – Which is Better?
- Specialized Markets and Brokers
- Design exposures vs. Products exposures
- Contractual Risk Transfer
 - Hold Harmless Agreement/Additional Insured
 - Insurance requirements of the customer

Enterprise Risk Management (ERM)

- It's not about insurance any more.
- It's not even just about risk management any more.

It's about leveraging and coordinating expertise that already exists within the enterprise and talent outside the enterprise across each silo of expertise to identify, manage and control all aspects of risk that affect the enterprise.

ERM Defined

“Enterprise risk management is a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”

Committee of Sponsoring Organizations of the Treadway Commission
(COSO)

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Traditional Risk Management Characteristics

- Risks as individual hazards
- Risk identification and assessment
- Focus on all risks
- Risk mitigation
- Risk limits
- Risks with no owners
- Seldom quantified
- Works best on financial and hazard risks

ERM Characteristics

- Risk in the context of business strategy
- Risk “portfolio” development
- Focus on critical risks
- Risk optimization
- Defined risk ownership/responsibilities
- Monitoring and measurement
- Stresses management of operational and strategic risks

External ERM Drivers

- Sarbanes-Oxley
- Corporate Fraud/Malfeasance
- Regulatory Authorities
- Stockholders
- Y2K, 9-11, Enron, Katrina, tbd
- Process Initiatives

Internal ERM Drivers

- Managing Earnings and Cash Flows
- Stakeholder Accountability
- Performance Objectives
- Regulatory Compliance

Risk and Insurance Management Society– Excellence in Risk Management II – A Qualitative Survey of Enterprise Risk Management Programs. September 2005

Predictions for Risk Management

1. ERM will become the industry standard for risk management.
2. Audit Committees will evolve into risk committees.
3. Risk transfer will be executed at the Enterprise level.

-- James Lam & Associates-- Enterprise Risk Management: From Incentives to Controls

Four Keys to Risk

- Prepare for Catastrophes
- Ensure Network Security
- Manage Enterprise Risk
- Guard against Liability Risks

--September 2004 Pitney Bowes survey

Benefits of ERM

- Identifies opportunities for new products
- Protects earning and cash flow
- Assists meeting objectives without crisis
- Anticipates and identifies oncoming crises
- Validates company priorities by assigning the level of risk attached to each
- Extends the planning horizon
- Successfully incorporates new products into mix

RIMS Survery Sept. 2005

ERM Recommendations

- Identify a champion for ERM
- Get Senior Management Buy-in
- Apply team approach to implementation
- Regular risk workshops and evaluation meetings with business-unit leaders
- Break down business processes to look for risk

ERM Recommendations (cont'd)

- List all risks for each business unit and prioritize top 10
- Leverage existing initiatives – such as Sarbanes-Oxley compliance, Six Sigma, internal audit or strategic planning
- Formalize the process with structured approach and lines of reporting

ERM Recommendations (cont'd)

- Keep it simple
- Maintain sensitivity to seismic events within the enterprise
- Treat ERM as an on-going, living-breathing process, not a one-time event

--Risk and Insurance Management Society, Sept. 2005

The Reliability Principle

“The difference between the Laws of Nature and Murphy’s Law is that with the Laws of Nature you can count on things screwing up the same way every time.”

Matz's Maxim

“A conclusion is the place where you got tired of thinking.”

Sinatra's Paradox Resolution

- “To be is to do.” ---Plato
- “To do is to be.” ---Sartre
- “Do be do be do.” ---Sinatra