

**RIMS Strategic Risk Management Webinar**  
**August 4, 2011**  
**12:00 PM ET**

Carol Fox:

Good morning, good afternoon, and good evening. This is Carol Fox with RIMS. Welcome to our webinar on Strategic Risk Management, the New Core Competency, sponsored by the Spencer Educational Foundation, a not-for-profit organization dedicated to educating risk professionals for today and tomorrow. Spencer has awarded over \$250,000 in full and part-time master's scholarships this year, through the generous contributions of its donors. To learn more about the foundation, please visit the website noted on the screen.



Before we begin, I want to go over three housekeeping issues. First, if you have questions during the presentation, please send them to us through the tab at the bottom left of your screen. We have left time for Q&A at the end of the presentation, but you can submit your questions at any time.

Second, we will be utilizing polling during this event. Your feedback is important, so please participate. We will share compiled results with you towards the end of the presentation.

And last, if you have technical difficulties during the webinar, please use the questions box, if you are still connected, or email [pd@rims.org](mailto:pd@rims.org) for help.

I am pleased to introduce my colleagues, both of whom serve on RIMS Strategic Risk Management Development Council. You have full access to their bios, but I want to say a few words about each of them.

<b>Presenters</b>	
<b>Carol Fox, ARM</b> <i>Moderator</i> Director of Strategic and Enterprise Risk Practice RIMS	
<b>Hans Læssøe, M.Sc.</b> Senior Director, Strategic Risk Management The LEGO Group	
<b>Dr. Mark L. Frigo Ph.D., CPA, CMA</b> Director, The Center for Strategy, Execution, and Valuation and Strategic Risk Management Lab DePaul University - Kellstadt Graduate School of Business <a href="http://www.markfrigo.com">www.markfrigo.com</a>	

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Hans Laessoe has spent his entire career with LEGO in a number of areas, including portfolio management and as a business and strategic controller. In 2007, he was charged with establishing and managing LEGO's formal Strategic Risk Management function for which he has received several European awards. He has been described by a LEGO colleague as an extremely strong strategist with an analytical brain. Hans is very innovative, possesses high computer skills, and an aptitude for working with people. Also has a sense of humor and I can attest to that.

Dr. Mark Frigo is a director of the Center for Strategy, Execution and Valuation, and the Strategic Risk Management lab in the Kellstadt Graduate School of Business at DePaul University in Chicago. Author of six books and over 100 articles published in leading business journals, some of which he'll discuss today. Dr. Frigo is a recognized thought leader and an advisor to management teams and boards in Strategic Risk Management.

Let's get started with a brief overview of our agenda. After my short introduction about RIMS definition of Strategic Risk Management, Hans will provide us with insight on how this is practiced at LEGO. Dr. Frigo will then discuss his work at the DePaul Strategic Risk Management lab and his findings as to why SRM is a new core competency. We will then end with answers to your questions.

## Agenda

What is strategic risk management (SRM)?

SRM in practice at LEGO

SRM as the new core competency

Questions



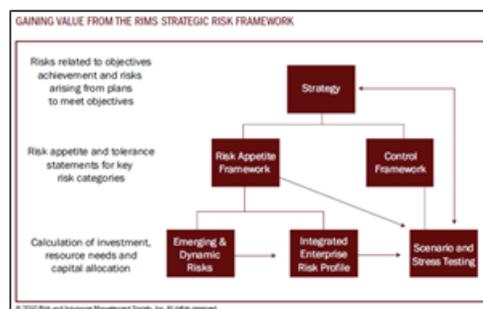
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So, what is Strategic Risk Management? RIMS defines both ERM and SRM as disciplines, not as punishment (which is but one definition of discipline), but as a mastery of risk competencies along a maturity continuum. SRM provides a framework and a process to address both the uncertainties and untapped opportunities defined at the outset of strategy setting and carried through strategy execution.

## What is Strategic Risk Management?

**Strategic risk management** ("SRM") is a business *discipline* that drives deliberation and action regarding uncertainties and untapped opportunities that affect an organization's strategy and strategy execution.



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While formal risk assessments may be made at different points along the value chain by different parts of the organization, the methods and processes for aggregating and analyzing strategic risks within an organization's appetite and tolerance against expected reward outcomes really appear to be in limited use.

Mitigation and control activities, including preventative measures, are still an important component of the framework. How the control framework is linked to the strategy, risk appetite and integrative risk profile can be examined through scenario and stress testing in ways that may allow an organization to pursue even higher targets.

Hans and Dr. Frigo will be talking about Strategic Risk Management as a competency for creating and protecting value in a world of uncertainty. So, let's start with that concept with respect to risk.

If you define risk as RIMS does in its workshops, that is, "Risk is an uncertain future outcome that can either improve or worsen our position", the world may be considered riskier than ever before. There is much more uncertainty given the complexity and speed of change in today's world than was the case 50, or even 20 years ago. The key is to understand that risk isn't only to be avoided or mitigated.

**Value Creation or Value Protection?**

1. How does the organization intend to create shareholder and stakeholder value?
2. How does the organization intend to protect shareholder and stakeholder value?



Risk = an uncertain future outcome that can either improve or worsen our position

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Risks really are to be understood in light of the organization's objectives for relevance, importance, and uncertainty so that the risks that can improve our position can be exploited and those that can worsen our position can be managed in other ways.

How an organization intends to create and protect shareholder and stakeholder value can be focused through a strategic risk management lens.

Today we will hear from LEGO Group, which is successfully managing risk from a strategic perspective. Before that, though, we have one simple question for you.

**Poll**

To what extent is the risk management discipline integrated with strategic planning at your organization?

1. Highly integrated
  - for example, risk practitioner(s) included as part of planning team
2. Moderately integrated
  - for example, risk practitioner(s) involved in strategic plan review
3. Partially integrated
  - for example, risk practitioner(s) identify strategic risks for planning
4. Not integrated at all
5. We do not have an explicit strategic planning process

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To what extent is the risk management discipline integrated with strategic planning at the organization? Highly integrated, moderately integrated, partially integrated, not integrated at all? Or, do you not have an explicit strategic planning process?

While we wait for the poll to close, you might be interested in one result from our recently released RIMS benchmark study. We asked what the primary value organizations obtained from their ERM programs. Nearly half of the respondents found the primary value to be in protection through risk mitigation and compliance. This isn't terribly surprising, since value protection is an historic board management expectation and an important contribution to value.

However, nearly a quarter found the primary value to be in increased certainty for achieving the organization's strategic and operational objectives. Hans, how would you answer this question for LEGO?

Hans Laessoe:

Well, good morning. To most of you, I'm the only one probably on the evening time, being in Denmark. But, anyway, in our case, Strategic Risk Management has been a strategic leverage for us. It has helped us be more aggressive and assertive in what we're doing. I'll get back to that, but before I do, let's just take a few things about the

company. I'm not going to talk a lot about what we do. I have the audacity to believe that most of you know what the LEGO Group is all about. We were founded in 1932 and the name is a combination of two Danish words, leg godt, which means play well. It's not about play, it's about good play, well played.

**LEGO SRM in Practice at The LEGO Group**  
**The Context**

<p><b>The LEGO Group</b></p> <ul style="list-style-type: none"><li>• Founded in 1932</li><li>• "LEg GOdt" = Play well</li><li>• Family Owned</li></ul> <p><b>Mission:</b> "Inspire and develop the builders of tomorrow"</p> <p><b>Vision:</b> "Inventing the future of play"</p>	<p><b>The Future Direction</b></p> <ul style="list-style-type: none"><li>• Increase market share in USA</li><li>• Increase market share in Eastern Europe</li><li>• Invest in emerging markets</li><li>• Expand "direct to consumer" activities</li><li>• Develop innovative new products</li><li>• Expand LEGO Education</li><li>• Develop digital business</li></ul>
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The company is family owned and it has always been family owned. The family is still involved in the company. The third generation owner is deputy chairman of the board and the fourth generation owner also serves on the board. The third generation owner used to be the CEO for a period of more than 20 years.

Our mission is to inspire and develop the builders of tomorrow, so this is about building and creating and developing a society much more than just selling bricks. And we are trying to invent the future play because we'll still go into new directions. The world is changing, and we will move in a defined direction.

So, we have chosen a direction that is based on a number of growth drivers. One is to increase the market share in the US. I know a lot of Americans think they buy a lot of LEGO products. Yes, but you still only buy a third of what the Germans are doing. So, we have still a way to go.

We also want to increase our market share in Eastern Europe, which is growing very rapidly, especially the middle classes. Then we want to invest in emerging markets, but we don't want to do a whole lot of it, because still the toy industry is not the first one to move in a new emerging markets, so we will just invest and be ready for when they are

ready to move. And then we will expand our direct-to-consumer activities, the online sales, the online activities.

On the product side, we will look at more innovative new products. We will see concepts that are developed under title "obviously LEGO has never seen before", and we intend to come up with concepts like that every second or at least every third year.

We will expand our LEGO education, which is the brand we have for working with schools and kindergartens. And we will develop our digital business because the children, the difference between the physical world and the digital world becomes more and more blurred and less and less relevant.

So, we will be looking at those, and those are our growth drivers. But all of that I'm not going to talk a whole lot about. I'll be talking more about our risk management and how that is working.



We have developed it over the past five years. I was asked to start this out in 2006, basically by our CFO I was part of the finance organization that point in time, I still am. Our then CFO asked me, to say, "We need some strategic risk management; can't you find out what it is and what we do about it? Look at the Internet." And this is where I started and I started with a box called Enterprise Risk Management, which is the third one.

Then I added on Monte Carlo simulation to put more nuance to it. And having done that, I went upstream in the decision process into what we call an AROP process, "active

risk and opportunity planning”, looking at business projects and before we went into preparing for uncertainty looking at strategies. I'll be going through each of these boxes as we proceed.

Looking at the Enterprise Risk Management, it has evolved over the past four or five years, but the first thing I found was actually we had a lot of risk management. Although operations about shipments not arriving in time or production equipment breaking down, stuff like that, we had that built into our planning system. We had that in our operational system.

**LEGO The LEGO Group ERM has evolved over the past 4-5 years**

- Most risk management, we have had for years
- We added strategic risk management late 2006
- We defined and implemented a consolidated ERM reporting from 2007
- We defined our risk appetite, and reporting up against that in 2008

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Employee health and safety, The LEGO Group is 18000 certified, so we have that. Insurance programs, they have been there for years. IT security, we have had that for years. Financial, which is currency -- in our case is currencies and credit risk, and it's not really borrowing money because we can do that from a holding company. But still currency has a huge impact on us. We have had that for years. Legal risk management, which in our case also includes trademark rights and other people's abuse of our trademark and our brand. We have had that for years.

What we didn't have was a systematic strategic risk management, management of those risks that impacted our strategies or the way that we worked with them and implemented them.

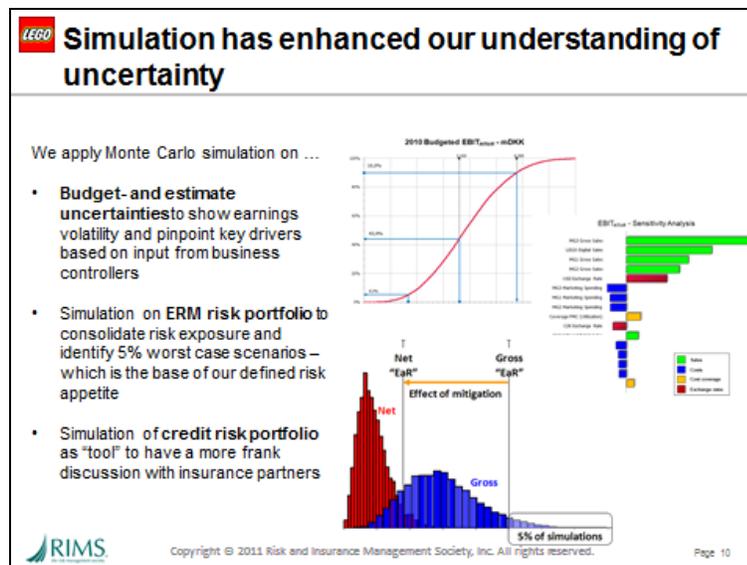
Not to say that it hadn't been done before, but that was more on a normal base where it depended on who was in charge of which strategy on which level they did it. And that is what I was asked to do, say, okay, can't we do this systematically?

We defined the first approach and started in 2006, late 2006, and started the first reporting in 2007, after which it became a full-time job for me in September, and then moved on from there. We defined our risk appetite and started reporting up against that in 2008.

So, my charge is to do the Strategic Risk Management, make sure that we have processes. I do not own the risk, I cannot own the risk. They are owned by the line of business. But I help the line management to have a systematic process to deal with it. Just like the budgeting functions do not earn the money nor spend the money, but still supports management to deliver on the budget or deliver performance up against the budget. So, that is one part of it on the Strategic Risk.

The other part is, I do the Enterprise Risk Management report. And in contradiction to the normal definition of Enterprise Risk Management, in our case we have decided that ERM is just the reporting. And that is mostly for internal reasons, because being a head of ERM, I am not the head of employee health and safety or hazard or financial risk management. They do that in the organization. So, we have decided that that is just a reporting, but that is our choice; it could be different in any other company.

We had that and we had that established by 2008. In 2008, also, we began to look at Monte Carlo simulation. Simulation by using the Monte Carlo technique, where you generate a huge number of scenarios is the only true way, or one of the few ways you can actually consolidate a risk portfolio. Because if you take the probability and the impact and multiply up for every risk and add the whole thing up, you will get an average exposure.



An average exposure will mean that if you run by that, you would never, ever buy an insurance. Because for insurances, average doesn't pay. It does for the insurance companies. So, you would never buy insurance, but it's not average; it's about covering for the extremes. So, we need some kind of consolidation that can tell us what's the 5%, what's the 1% worst case that can happen? How can we guard ourselves towards that?

And we needed that kind of understanding, and today I am using Monte Carlo simulations to look at our budgets and our financial estimates and see how they are going.

We are also looking at this exposure that we get from our Enterprise Risk Management portfolio and see, okay, what is our 5% worst case? What is it before we did anything and what is it with the risk mitigation, so we've done under the different risks?

Being a privately-held company, we do not look at stock values. We haven't the faintest clue about the real stock value of the company, but we do look at earnings. So, we are looking at how much earning are we liable to lose in case these are those scenarios or that many risks happen. They will not happen, all of them. Some of them are mutually exclusive, but a huge number of them may happen in any one year as we have seen the credit crunch. We can have systemic risks here just like anybody else.

And then we get net earnings at risk, and we have used that net earnings at risk to define our risk appetite to say, okay, and the risk appetite in our toy industry, which is rather volatile, we have decided that's a 5% worst case.

Based on that, we have said that the 5% worst case lost may not exceed, and then a certain percentage of our budgeted earnings. The percentage is not 100, by the way. But we have decided on that one, and that guides us towards directing whether we're taking too many risks or not taking risks enough. And it has helped us to take more risks than we were and be more aggressive than we otherwise would have dared to be, and grow faster, which I'll come back to in the end, than we otherwise could have done.

We are also using Monte Carlo simulations to look at our credit risk portfolio to make sure that we have a good conversation with our creditors and insurance partners about what we really want to insure, what we can't insure, what the price should be, and stuff like that. I'm not sure they are too happy with that discussion, but we are. It has helped us a lot to put perspective on that part of it.

This is a map, but looking at those two parts, this is just reporting part and this is managing the risks, the strategic risks that we already have accepted or already have

taken to some extent by defining which strategies we're going to follow and which projects we're going to implement.

Basically -- this is more or less damage control, and I got inspired at the point in time to say I want to move beyond damage control and be more proactive. And we came up with a process that we call Active Risk and Opportunity Planning for business projects.

**LEGO** We use Active Risk & Opportunity Planning for Project Business Cases

- Systematic process defined in collaboration with project "Process Expert Network"
- Standardized Excel-based tool developed and implemented
- Mandatory for strategic projects, lighter edition used for other projects – embedded in approval process
- Done as part of preparing the project business case

Across all types of business projects within the LEGO Group

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Whenever we implement a strategy, whenever we do a change, it always happens in terms of some kind of a defined project. And we have a process expert network, a network of project managers we have across the company from facilities to IT to product development, that are working together on how do we do projects well at the LEGO Group. I was working together with those guys and had a lot of help in developing a standardized tool for risk management, on how to do projects, and built that into the way that we do projects.

Today this approach is mandatory for projects that are supposed to be approved as major projects. We have some change requests that are smaller that we can do without them, but if it's decided to be a project and it has a project plan, it needs to come up with a business case, and that business case must include the risk management part of it, so it's been addressed before we decide to go on the project. So, we know the uncertainties, we have addressed the uncertainties, we addressed what we are going to do about them, both the risks and the opportunities before we sign off on the business case.

And then we move ahead, of course, and follow the project and follow through on what we're doing and see how we're doing, and trying to learn from the different projects to get that approach as well. But we have had a lot of support from our project managers on getting this sheet.

The one thing is, they get a systematic approach so they can use the same approach from Project A to Project B. The ones that they really like is having the data in a database or in a spreadsheet, it's not just a spreadsheet model they get, they get all the required reporting on risk management for free. All the reports are standard defined. That's nice for the project managers, but it's also nice for the people on the steering committees that now get a standardized reporting on risks so they don't have a change between the vertical and the horizontal axis between probability and impact, or somebody comes up with severity or whatever from project-to-project. They have the same kind of formula, the same kind of way of doing it. You can focus on the content rather than format when they see a risk report, and that has helped some of them, at least what they told me.

So, now we can implement projects, and we have implemented this approach. It's mandatory for all projects, as I said, and we're tracking how many of them should still fall behind and do not deliver because we're not better than anybody else. If you make something mandatory; 5% will not do it anyway. It's just like exceeding the speed limit, right?

We also going one step further in the process we call prepare for uncertainty. This is a strategy process and we're looking at the trends of the world. The industry is moving, the world is moving quite rapidly. I've just seen a presentation that indicated that the changes the world will see between 2010 and 2020 will be somewhere between 10 and 80 times the changes the world saw in the 20th Century, just comprised into a decade. So, we know the world is changing.

**LEGO We use strategic scenarios as mind-setters and resilience testing**

- Based on 12 mega trends from IMD/WEF we developed four strategic scenarios
- These were first used to open peoples minds before defining strategies for 2015/2022
- We then developed a process and framework for defining the issues of strategic resilience
- As well as a framework for prioritizing our handling efforts
- Systematic and validated testing is mandatory for a defined set key strategies as part of deep-dive preparation and discussion

The diagram consists of two main parts. The top part is a 2x2 matrix of strategic scenarios. The vertical axis is labeled 'Evolution' with 'Growth' at the top and 'Unpredictable' at the bottom. The horizontal axis is labeled 'Speed of change' with 'Slow' on the left and 'Fast' on the right. The four scenarios are: 'More of the same' (top-left, green), 'Brave new world' (top-right, green), 'Cut-throat competition' (bottom-left, yellow), and 'Murphy's' (bottom-right, red). Below this matrix is a table with three columns: 'More of the same', 'Brave New World', and 'Murphy's'. Each column contains a list of key issues and strategic responses. The bottom part of the diagram is an 'Overall Strategic Response' matrix. It has the same axes as the top matrix. The four responses are: 'Adapt' (top-left, grey), 'Act' (top-right, grey), 'Park' (bottom-left, grey), and 'Prepare' (bottom-right, grey). Below this matrix is another table with three columns: 'Adapt', 'Act', and 'Park'. Each column contains a list of key issues and strategic responses.

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We are looking at what are the trends, what are the developments that we can see, and we've gotten some of them from the World Economic Forum that they do for the preparation of the Davos meeting in Switzerland, and which are very well prepared.

We are looking at them and trying to build scenarios of what could plausible futures for 2015 or 2022, which in our case is a special year, what could that be? And we'll be looking at those and say, okay, we have different scenarios, different images of what the world can do. We are using these two scenarios for two purposes.

Before we decide on the strategy, we put those scenarios in the head of people to make sure that they look at 2015 -- when they are deciding on a strategy for 2015, it's going to be relevant for 2015, which means it cannot be based on how to 2011 is looking. That's not relevant. We know it's not going to be relevant. So, they need to be based on that, and we don't know which way it's going, so we secure ourselves by looking at multiple directions.

Then once you have decided on the strategy and defined what you're going to do, we test the strategy for resilience. We very simply go in and take that particular strategy and how it's defined, and together with the strategy owner we discuss, okay, if this scenario happens, what will happen to the strategy? Some of these issues will be highly probable and some of them will be less probable. Some of them will happen very fast, some others will happen very slowly.

And we put them in what we call a PAPA model. The slow things that will happen with a low probability, we park them. Don't -- forget about them. The slow things that we

know will happen, or are highly likely, we adapt to those trends. In our case, this is a lot by demographics. We know children's play is changing, we know demographics are changing, we know the buying power between the different realms or the different parts of the world is changing. We know children's play is changing, but we also know it doesn't happen fast. So, we adjust, systematically monitoring what direction it's moving in and following that trend.

The things that have low probability but are happening fast, being prepared for, and this is why we have most of our strategic risks. This is where we identify most of the risks that we need to put into a risk register, make sure that we have contingency plans for early warnings in whatever mitigation we can put in place to make sure that we can cover these should they materialize, but they are not expected to.

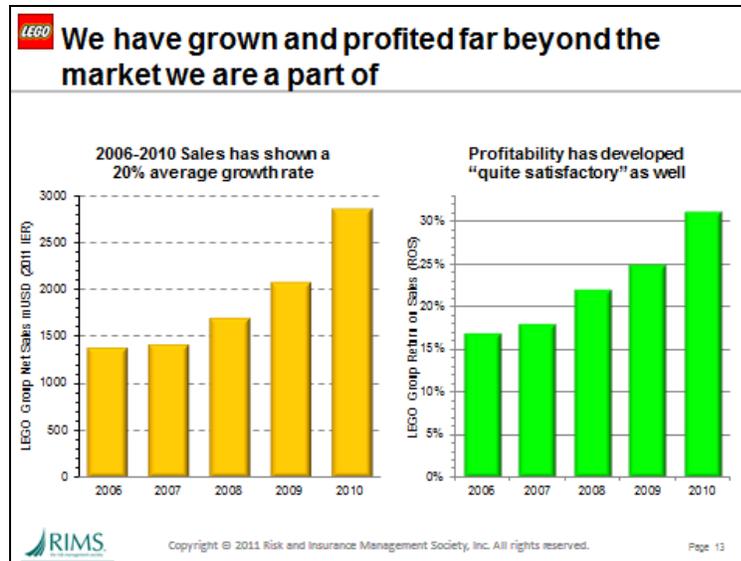
And then we have the high probability and fast moving things that we need to act on now in order to make sure the strategy will be relevant. In our case, anything that has to do with the concept of connectivity, mobile phones, Internet, that world -- if we can see it, follow it. Go ahead, move it, move on it, social media, anything, because we know that is changing so fast and it's changing the way kids play, it's changing their concepts and their look at the world.

My 4-year-old granddaughter came to me just a couple of months ago and say, "Granddad, why do you have a wire on your phone?" She didn't understand that. She's never seen a wire on a phone before, so we need to address that. And so anything we can see emerging on that front, we will act on and build into our strategy as much as we can.

In this way, we have a kind of prioritization model of what we do, because we shouldn't, of course, be betting on every horse in the race. That's not profitable and it's not even doable.

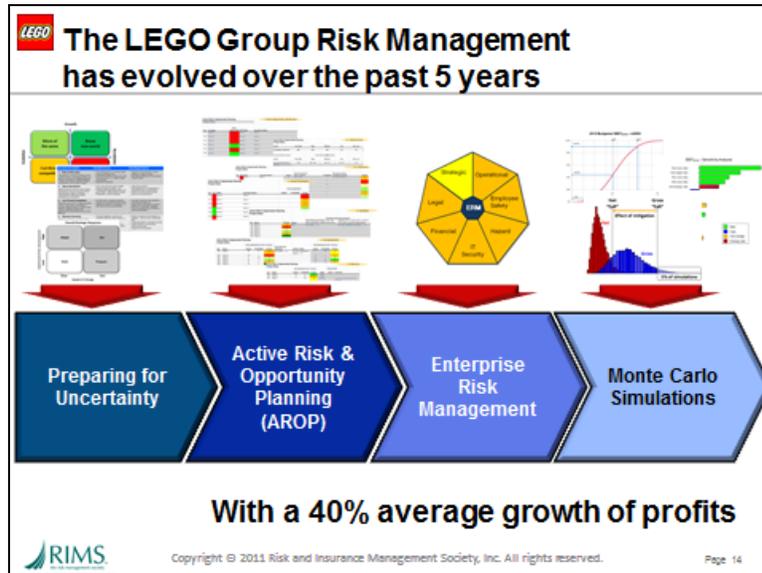
And that's the way we built that part, both as in inspiring for new, better, stronger strategies, and a test to make sure that we have the stronger strategies.

All of this has worked. It's worked quite well. If we see, these are actual data, except for the fact that I've translated into U.S. dollars, by using our standard internal exchange rate for 2011, which means that we don't have currency exchanges in here. If I put that in here, the growth would be even more dramatic. But we have had a 20% average growth from the period between 2006 and 2010, and that is in a market that grows 2% and 3% a year. Beyond that, our profitability has developed quite significantly as well. We've grown from a 17% return on sales to a 31% return on sales in 2010. And it goes beyond that. If you go back a couple of more years, in 2004, we were in dire straits and losing a ton of money; we were losing like 15% of return. We had a negative return on sales of 15%. We changed a lot of strategies in there.



Risk management is not the driver of these changes. It's not even the biggest part. I'm not even sure it's a big part. But it's one part. It's a part that has allowed us to take bigger risks, make bigger investments, than we otherwise would have seen. The Monte Carlo simulation has shown us what the uncertainty is, the risk appetite has shown us how much risk we can afford to take, and are prepared to take, between the board of directors and the corporate management team, which has meant that we have been prepared to make bigger supply chain investments than we otherwise would have done, have been able to accommodate or supply a bigger growth than we ever imagined we can have. And we are continuing on that track. I just saw Tuesday, the weekly report that we attack this year, on top of the development that you see, we are tracking 34% on top of 2010, year-to-date, and that's consumer sales sales out of the stores, so it's real sales, so to speak, with sales into the stores more or less intermedia, if you see it. If it's not sold out of the stores, it's not fun anymore.

So, this has really, really worked for us, and a part of that, and it's helped management a lot to drive the development. So the involvement we have done, we started out with taking the strategic risks, getting a grip on what they were, what could really happen to us strategically. Star Wars is a big IP for us, and we have a lot of product sales. That could drop. I mean, the six year-olds today were not born when Star Wars, Episode III was launched. They have never seen a Star Wars movie. But they're still selling twice as much Star Wars this year as we were in 2005, when the movie was launched. Why? When can that stop? What can happen?



We are nobody as a vendor to at WalMart. I mean, we have a very small market share at WalMart. What if they throw us out and want to sell rubber boots instead? Who's taking care of it -- those are the strategic kind of risks that we're looking into -- regulatory risks, changes in product safety, stuff like that.

When you add in the Monte Carlo simulation, to a nuance on what we do, gives us a perspective to the thing, so it's not just yes and no, but it's a true consolidation of a portfolio risk.

Then we have moved upstream into the decision chain, so to speak, and said, "OK, how can we proactively address risks when we are doing business projects and when we are doing strategic planning?" And it has worked, as I said. We have had a 40% growth in profits, in average, per year between 2006 and 2010, and 2011 seems to continue on that trend.

But this is all practicalities. This is all just something we have done, and we have had a lot of help from our management, from the entire management team, have been given all the time and resources I needed to do this. But it has not been based on insights and knowledge as such. I have no risk management background. I've been with the company for 30 years, with this company, for 30 years, so I know that one. But I'm an engineer by training and know nothing about risk management. So, part of being a member of RIMS, I thought it would be nice to get some true insights about what is the knowledge behind that, and on that part, I'm happy to put the ball over to Dr. Mark Frigo, who knows more about what the academics is.

Carol Fox:

Thanks, Hans. Dr. Frigo, would you provide some background, first, on the Strategic Risk Management Lab and walk us through some of your findings?

The slide features a header for the Strategic Risk Management Lab at DePaul University's College of Commerce. It includes a quote about the lab's role as an engagement platform. Below the quote are three items: a book cover for 'DRIVEN', a flowchart titled 'RETURN DRIVEN STRATEGY' showing a hierarchy from 'Strategic Risk Management' down to 'Operational Risk Management', and another book cover for 'Strategic Risk Management'. The RIMS logo is in the bottom left, and a copyright notice and page number are at the bottom.

**Strategic Risk Management Lab**

**DEPAUL** College of Commerce  
The Center for Strategy, Execution, and Valuation

*"The Strategic Risk Management Lab in the Center for Strategy, Execution, and Valuation at DePaul University is an engagement platform for thought leaders and business leaders to co-create and share leading practices in ERM and Strategic Risk Management."*

**DRIVEN**

**RETURN DRIVEN STRATEGY**

**Strategic Risk Management**  
A Primer for Directors and Management Teams

RIMS

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Dr. Mark Frigo:

Yes. Thank you, Hans. Thank you, Carol.

Hans just presented an excellent case study of the development of strategic risk management in an organization. The Strategic Risk Management Lab at DePaul University in Chicago is designed as an engagement platform for thought leaders and business leaders to co-create and share leading practices in Strategic Risk Management and ERM. And I direct the research initiatives as well as the education and executive development offerings of the lab, which we founded in 2007.

The insight from the latest developments in Strategic Risk Management come from the continuing work we're doing with management teams and boards, research in the Strategic Risk Management Lab, in our work with organizations, as well as collaborative research with other universities and professional organizations, such as RIMS.

To take a look at a key question that was raised at the Vancouver conference, this slide was shown at our presentation, our panel discussion, which is, you know, really questioned the idea of, is Strategic Risk Management a core competency and a necessary core competency? And to address that question, we take a look at the emergence of risk management, coupled with the catastrophic losses incurred during the financial crisis, and we see an emphasis by boards and management teams on trying to focus on the most significant risks to shareholders and stakeholders, and many boards are now directing attention of management towards strategic risk. Of course,

this brings a lot of questions -- what are strategic risks and what is Strategic Risk Management? So it's great that RIMS is taking a role in terms of developing this area.



I'll cite an Economist Intelligence Unit recent report, and it stated that "Strategic Risk Management remains an immature activity in many companies," and it also went on to say that there's a limited appetite for investment in risk functions in organizations, and this is caused obviously by the cost constraints and company budget freezes that are based in many organizations.

But this situation presents a very serious dilemma, which is that risk management remains relatively immature, and at the same time, concomitantly, constrained resources present a barrier for further development. So, the challenge for almost all organizations is how to do more with less, and that usually requires integration of strategic risk management and risk management within the organization, much as described by the case that Hans presented a few minutes ago.

So we take a look at some of the other findings from the Strategic Risk Management lab at DePaul University, and we tried to identify, what are some of the key reasons ERM fails, risk management fails, in organizations? And these are five of the most prevalent reasons why ERM fails that we found in many workshops and discussions that we've had.

**Findings: The Five Reasons ERM Fails**  
**Strategic Risk Management Lab – DePaul University**

1. Risk Management is not connected or integrated with Strategy and Strategy Execution.
2. Risk Assessments are focused on the wrong risks, not focused on strategic risks (“80/20 rule”).
3. Risk Management is not executed as a continual and repeatable process.
4. Risk Management “Silos” create barriers.
5. Risk Management is not viewed as value-added (ERM is often under-resourced and under-networked in the organization).

***“Strategic Risk Management is not a core competency”***

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The first is that risk management is often not connected or integrated with strategy and strategy execution. We list this number one, because we believe that's probably the most critical reason that ERM fails.

The second is that ERM risk assessments often focus on the wrong risks, that is, they're not focused on the strategic risks of an organization.

A third is that risk management is often not executed, in a continual and repeatable process, this prevents the process from getting better and the skills from getting better and the discipline of getting better.

The fourth is very common, which are the silos that create barriers. They create barriers for communication, developing ERM further, and also they create barriers for the value proposition of ERM.

And the fifth one is that risk management is often not viewed as value-added. ERM is often under-resourced and more importantly, under-networked within organizations, and notice I put both of those together, because they have-- you have to have that networking and integration with an organization to really make it valuable.

And so the conclusion is that in many organizations, strategic risk management is not a core competence, it's not something that can be used to be elevate risk management. And taking a look at the idea of core competence, because we're using that term quite a bit today, we go back to the 1990 Harvard Business Review article by C.K. Prahalad and Gary Hamel, who introduced the concept of core competence, and there's three ways,

three reasons, that we believe that strategic risk management is a necessary core competence today.

### Is SRM a needed Core Competency?

In their 1990 *Harvard Business Review* article, C.K. Prahalad and Gary Hamel introduced the concept of core competence and there are some striking applications to strategic risk management:

1. "core competence is about harmonizing..." (harmonizing risk management capabilities and processes)
2. "core competence is communication, involvement and deep commitment to working across organizational boundaries" (i.e., avoiding the silo problem which is prevalent in risk management) Silos create blind spots and redundancies, but they also present barriers to further developing strategic risk management as a core competence.
3. "core competence does not diminish with use. Unlike physical assets, which do deteriorate over time, competencies are enhanced as they are applied and shared" "core competencies are the collective learning in the organization...."

**Takeaway: Opportunity to develop SRM as a core competency and increase the value contribution of ERM**

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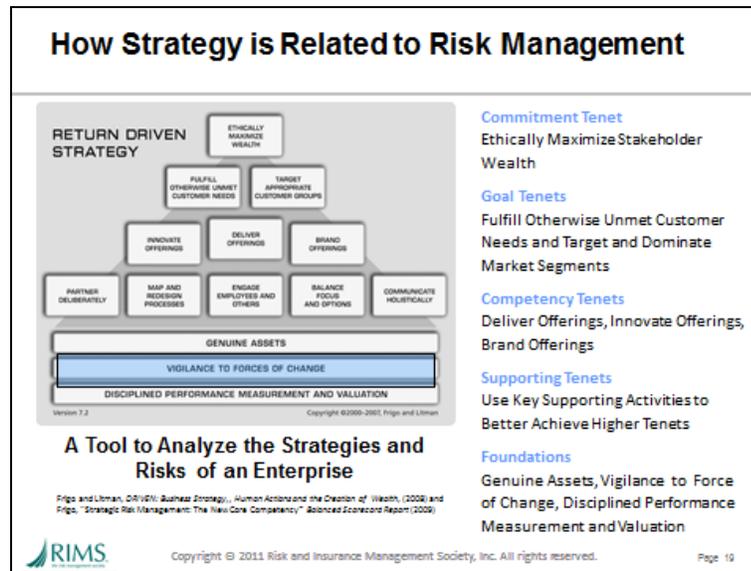
If you look at the quotes that I have on the slide, those are taken from the Harvard Business Review article from 1990, and a key concept of core competence is that a core competence is about harmonizing. In the context of risk management, it's about harmonizing the risk management capabilities and other processes and capabilities within an organization.

The second concept is that core competence is about communication. And it's about working across organizational boundaries. I think that really identifies the silo problem that is prevalent in risk management.

And probably the third and the most important dimension of why strategic risk management is a needed core competency is the quote that I have on the bottom of slide, is that a core competency does not diminish with use. Unlike a physical asset, which does deteriorate over time, core competencies are enhanced as they are applied and shared within the organization.

Strategic Risk Management and ERM, strategic risk management is probably a great pathway to do more with less, if you will, and also to elevate and increase the value of ERM and to make risk management a competitive advantage. So that's, the underlying concept that we find compelling to really look at risk management and strategic risk management, in particular, as a core competency.

Now, let's talk about the idea of how strategy is related to risk management. The framework that I have on this slide describes the Return Driven Strategy framework, which is based upon a study of high-performing companies described in the book *DRIVEN: Business Strategy, Human Actions and the Creation of Wealth*.



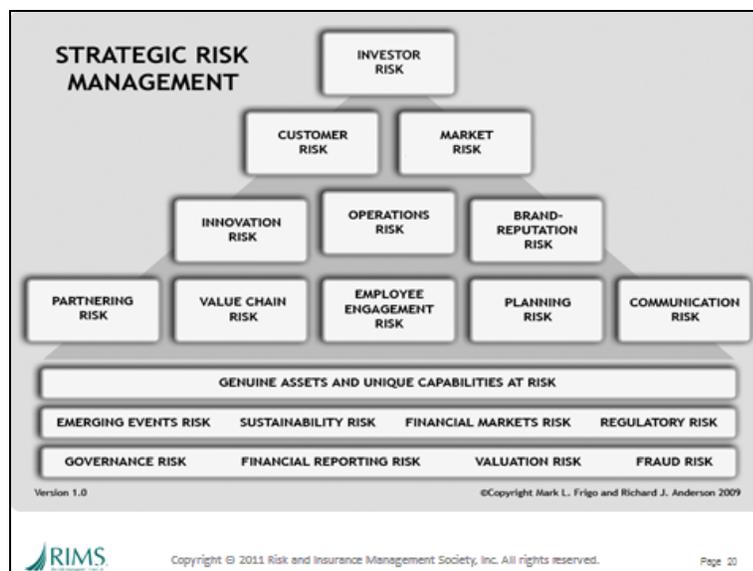
Michael Porter at Harvard Business School defined risk as “a function how poorly a strategy will perform if the wrong scenario occurs”. Well, what we found is that the pattern of high-performing companies, companies that have been able to achieve superior and sustainable return on investment and also grow the business concomitantly and also execute in an ethical manner, ethical business conduct manner, have been able to create sustainable value. And there's about 100 companies that we studied, public companies. Actually, the case that Hans presented for Lego, looking at this framework and having understood some of the strategies at Lego really is a great example of a private company really representing execution on the Return Driven Strategy tenets.

But if we look at the bar that's highlighted in this framework, it says the Forces of Change. We found that high-performing companies have superior capabilities to manage the opportunities and the threats in forces of change. And as Hans mentioned, those forces of change are mounting and happening very quickly today. So this has become more important in our continuing research on high-performing companies.

The pyramid itself, it looks like a pyramid in the framework, the pyramid, it's not really a pyramid, and it's really the delta symbol for-- which is the symbol in mathematics for change, which indicates everything is changing, is really representing as the risks and

uncertainties that Hans mentioned earlier. So, taking a look at strategy from a perspective of, first, understanding the strategy, and then understanding the risk in the strategy, how can we look at, how can we view, strategic risk?

And take a look at this next slide -- here's a Strategic Risk Management framework that we use in the Strategic Risk Management Lab to help management teams and directors connect and link risk with strategy, and also connect different risk elements within a particular strategy to one another, because we all know that risks are inter-related. They're not separate and distinct, and I think that's what usually ends up being some of the biggest impact risks in most organizations.



This framework is used by organizations and adapted by organizations to help them build their own hierarchy of strategic risk that they would focus on, and it's been something that has been developed from the returns of strategy framework, it has been used, embedded, by a number of management teams and boards in helping them look at risk.

One of the things that I had mentioned earlier is the idea of a repeatable and continual process of risk management, and one of the approaches that we have found, management teams find useful, is to use this type of approach, which we refer to as a Strategic Risk Assessment, as a first step for developing Strategic Risk Management. And it involves seven steps, but the first three steps are the most critical, and the ones that can give the most value in terms of establishing strategic risk management moving forward.



So if I can just go through the first three for a moment. The first step is to understand the strategy of the organization, and this can actually be, taken at a micro level, to take a specific strategic initiative and use that as a pilot, if you will, for applying the strategic risk assessment.

The strategic risk assessment process was designed for any organization, whether they have a high maturity in risk management or they're just starting, to help them build and augment their risk assessment processes. So most organizations have risk assessment processes in place in various parts of the organization, but this helps them to have an explicit, continual process for strategic risk assessment.

Step two is developing views on strategic risk. And then step three is to develop a strategic risk profile, which we're going to discuss in the forthcoming strategic risk management implementation guide, by RIMS.

So, taking a look at the next slide, we take both of those pyramids, both of those frameworks together, the one on the left describes the strategy, describes the strategic activities necessary to create sustainable stakeholder and shareholder value, and the one on the right describes the inter-related risks and how they can impact stakeholder and shareholder value. So looking at those side by side, you can really see they're inter-related. So, organizations that continually innovate their offerings, to fill otherwise-unmet needs, and in their strategic framework avoid innovation risk and customer risk. Innovation risk means inability to innovate, customer risk means losing customers.

## The Strong “Resilient” Organization

### What can we learn from High Performance Companies?

**RETURN DRIVEN STRATEGY**

ETHICALLY MAXIMIZE WEALTH

FULFILL (OTHERWISE UNMET) CUSTOMER NEEDS | TARGET APPROPRIATE CUSTOMER GROUPS

INNOVATE OFFERINGS | DELIVER OFFERINGS | BRAND OFFERINGS

PARTNER DELIBERATELY | MAP AND REDESIGN PROCESSES | ENGAGE EMPLOYEES AND OTHERS | BALANCE RISKS AND OPTIONS | COMMUNICATE HOLISTICALLY

GENUINE ASSETS

VIGILANCE TO FORCES OF CHANGE

DISCIPLINED PERFORMANCE MEASUREMENT AND VALUATION

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**STRATEGIC RISK MANAGEMENT**

INVESTOR RISK

CUSTOMER RISK | MARKET RISK

INNOVATION RISK | OPERATIONS RISK | BRAND-REPUTATION RISK

PARTNERING RISK | VALUE CHAIN RISK | EMPLOYEE ENGAGEMENT RISK | PLANNING RISK | COMMUNICATION RISK

GENUINE ASSETS AND UNIQUE CAPABILITIES AT RISK

EMERGING EVENTS RISK | SUSTAINABILITY RISK | FINANCIAL MARKETS RISK | REGULATORY RISK

GOVERNANCE RISK | FINANCIAL REPORTING RISK | VALUATION RISK | FRAUD RISK

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**Return Driven Strategy Framework**

Describes the strategic activities necessary to create shareholder value

**Strategic Risk Management Framework**

Describes the interrelated risks of an organization and how they impact shareholder value

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We found in terms of- the study that we had done was based on a study done before the global financial crisis in 2008. We did find that companies in our study were resilient toward fading, meaning fading in returns, profitability, and also fading in terms of growth and value. We were able to take that framework and be able to chart the rise and decline of businesses and business units in terms of their ability to adapt to the changing environment.

## Return Driven Strategy

**RETURN DRIVEN STRATEGY**

ETHICALLY MAXIMIZE WEALTH

FULFILL (OTHERWISE UNMET) CUSTOMER NEEDS | TARGET APPROPRIATE CUSTOMER GROUPS

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GENUINE ASSETS

VIGILANCE TO FORCES OF CHANGE

DISCIPLINED PERFORMANCE MEASUREMENT AND VALUATION

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- High performance isn't permanent. Every high-performance company we studied faces the risk of fading. Some have already begun to fade in either returns or growth or both.
- In every case, the reasons for fade can be charted to how the tenets of Return Driven Strategy were neglected or could not be executed.
- Meanwhile, the rise of these companies' performance and the sustainability of high performance can be attributed to attention to these tenets.
- Companies with mediocre or poor performance demonstrate significant gaps in their business models when viewed through the lens of Return Driven Strategy.

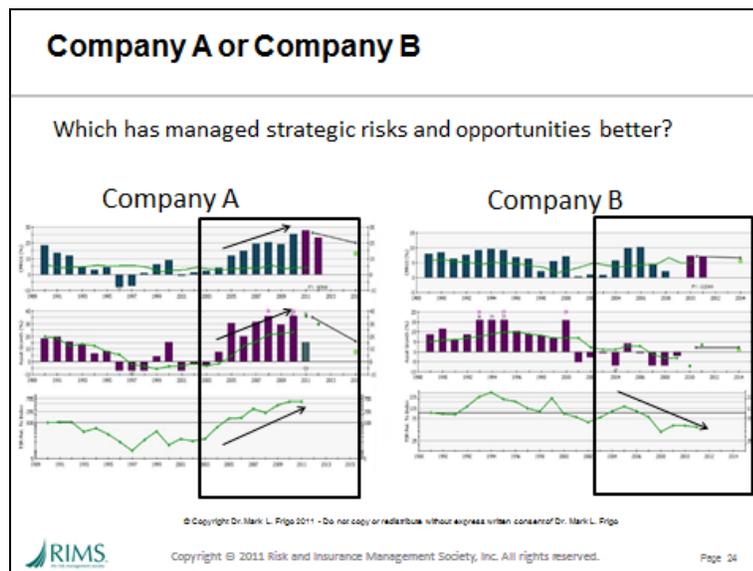
**Understanding the Rise and Decline of Companies and Business Units**

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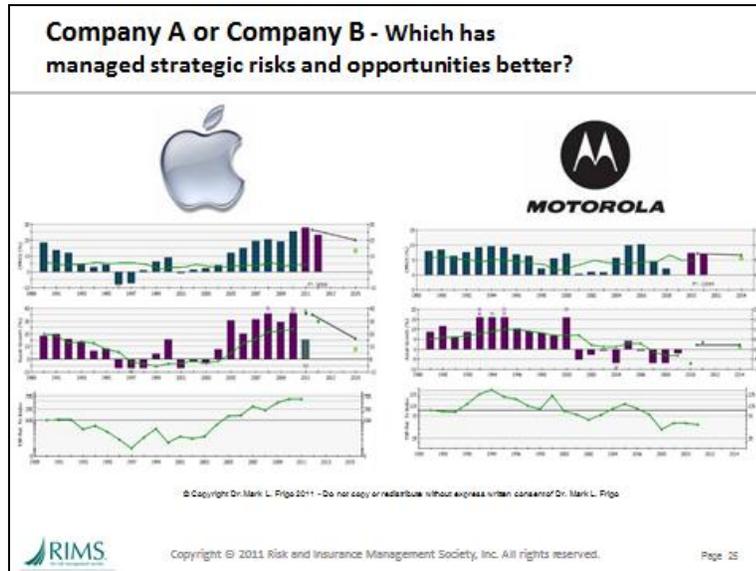
Let me present two companies side by side, company A and company B, on the next slide. And let me explain these panels for a moment. I have boxed out a certain time

segment, the same time segment for both companies. For company A, the top panel is return on investment, ROI. So that company, as the arrow is showing, is increasing its ROI, it has ROI of about four or five times the cost of capital, the green line on that graph is the cost of capital. The second panel is asset growth, meaning they're reinvesting in the business. The third panel is relative total shareholder returns -- dividends and stock appreciation of that company. As you can see, this company is increasing ROI, grown the business, also outperformed the market in terms of its value creation.



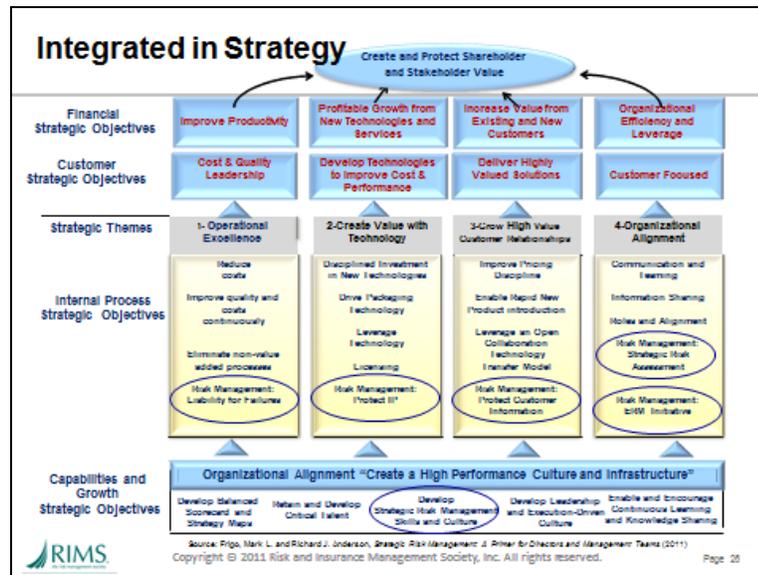
Company B has had sporadic ROIs, has had negative growth, and has underperformed the market.

The question that we pose is, which company is managed the strategic threats and opportunities better? Well, obviously, company A has, and you probably wouldn't be surprised, that company A is Apple. Apple-- and the second company is Motorola. Apple has been able to transform the music industry with its iTunes and iPod, transform the mobile phone industry with its iPhone, and transform the personal computer industry with its iPad. This has allowed Apple to be able to achieve ROIs, growth, and superior total shareholder returns. Motorola, on the other hand, which was the market leader, and invented cellphones, had Six Sigma, had a leading brand, faded in the same market space.



We can take a look at those frameworks we looked at earlier and research teams in my research lab actually studied these companies, based on public data, and look at types of risks and types of strategy that each company has identified to do a side by side comparisons of companies that are either rising or falling in their particular industry.

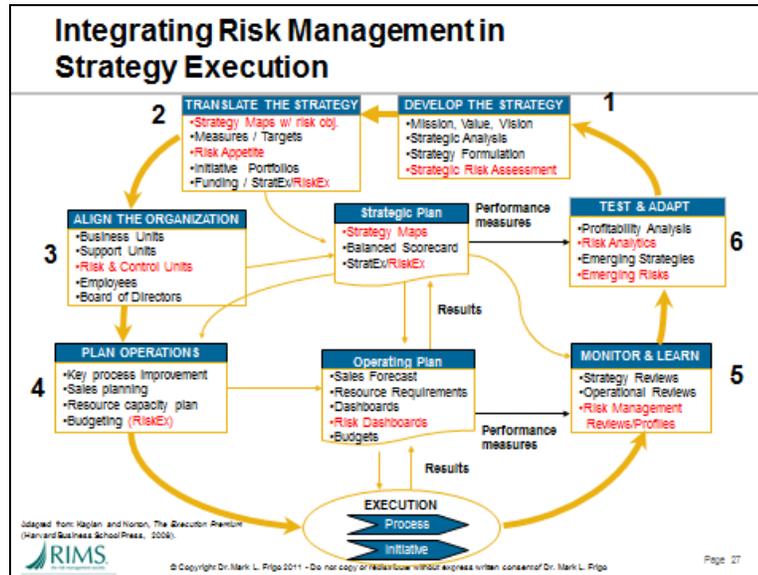
Now, I'd like to just present two examples of a couple of things we've done recently with management teams to help integrate risk management in strategy and strategy execution. This next slide shows a strategy map. It's adapted from a strategy map we helped an executive team develop when they developed their strategy for the organization. It has four strategic initiatives that are listed in the middle four bars, and if you notice within each of those, there is a circled strategic objective. The strategic objectives that are circled are strategic objectives that relate specifically to Strategic Risk Management. This particular company used Return Driven Strategy in developing a strategy, and they used this strategic risk assessment process to identify strategic risk and then embed within this strategy.



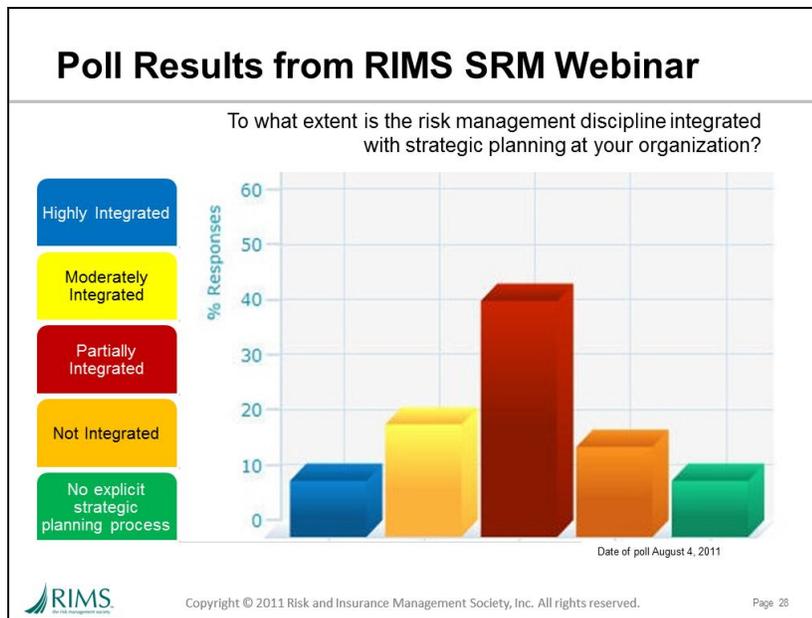
If you also notice on the bottom of the strategy map is the characteristic foundation of strategy maps, which would be innovation and growth, which they call capabilities and growth. And in the middle of that area, they have a specific strategic objective for the organization, which is to develop strategic risk management skills, and culture, which I think is critical in organizations.

And the fourth bar, which is the fourth strategic initiative of the company, called Organizational Alignment, they specifically adapted the Strategic Risk Assessment process as an objective that they wanted to achieve, continuing on an annual basis, as well as develop a specific action plan for an ERM initiative.

I'm going to close with the next slide, which is adapted from the Kaplan and Norton Strategy Execution Process, which is a six-stage process, and in red, we've added where risk management could be embedded within that process. And if you notice in the first step, develop the strategy, a strategic risk assessment process is embedded in that area, as well as other parts of the organization, of that process, similar to what Hans mentioned a few minutes ago, about how new projects go through a strategic risk assessment.



So with that, that presents a few of the things that we're doing and continue to do at the Strategic Risk Management at DePaul University, and now I'd like to ask Carol if she might give us an update on the poll that we had conducted earlier in the webcast.



Carol Fox:

Thanks, Dr. Frigo. Let's see how integrated our webinar guests believe that they are, if we can pull that up. And then I'd like to ask Hans and Dr. Frigo, do these results surprise you? Hans?

Hans Laessoe: No, as a matter of fact, it's pretty normal-- most surprising, it's pretty normally distributed, it appears, against- towards the partial participation, which means that at least we have risk-- most risk practitioners are involved in the terms of they are looking at the strategy, or they are looking at the strategic risks and they're getting input into strategic planning. This level is a lot better than what we saw just a year ago, so a lot of companies have to be getting there and have to get more strategic insights and more strategic risk management and a more strategic perspective to risk management activities, which I think is great.

It, of course, worries me that some companies don't have a strategic process at all, but then again, then that may happen and that could be a more implicit approach. So I maybe shouldn't worry too much about that one.

I would like to see, of course, that the blue bars to the left, those that are fully integrated, would increase more. I believe this is where most of the value, that you spend a few hours talking to some people and they come up with significantly better strategy or just slightly better strategy, will easily be worth the money and resources spent on discussing what are the upsides and downsides of that particular risk, given different images of the world.

In some-- we know it will happen that the world will change in other directions than we planned for, and we need to be prepared for that.

Carol Fox: And Dr. Frigo, most of the responses ended up the middle, as Hans noted with ERM providing information for strategy planning. Based on the work you've done with the C suite and boards, is that typical of what you're seeing as well?

Dr. Mark Frigo: I agree with Hans's assessment. It appears to be consistent with what we see, working with the executive teams and boards. If look at that, if you look at the results, you'll see that you know, partially integrated, that's answer C, for example, risk practitioners identify strategic risks for planning. You know, everything- that included as well as those to the right, there's a great opportunity for organizations to better integrate risk management in strategy and in strategy execution. It's really what we talked about earlier in the discussion, which is the challenge is to do more with less resources. And the integration allows that to happen faster than to build processes per se. So, this integration is critical.

The case-- I think if you look at the case that Hans presented, it's really compelling in terms of elevating the value of risk management through integration. Now, I think that's what I hear over and over again, of organizations that are finding-- they're doing risk management better today than they did a year ago or five years ago. They key

word that keeps coming up is how they've been able to integrate it in their strategy and strategy execution.

Hans Laessoe: I fully concur; it's about being proactive. Damage control is only part of it.

Carol Fox: So let's move now, before we get to the wrap up, to the questions from the audience. The first one -- Hans, you indicated that Lego had defined and reported against its risk appetite? Can you elaborate how you determine and express that, and how you report against it and how often you do that?

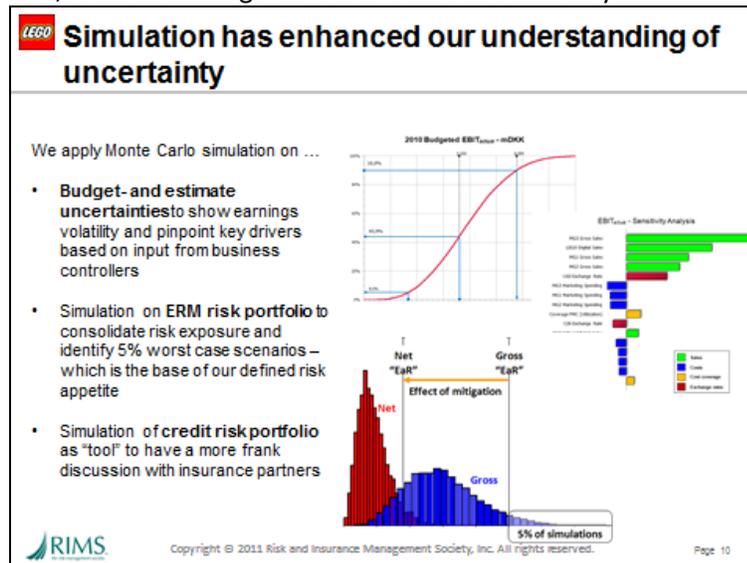
The slide features a dark grey header with the text "Thank You" in white. Below the header, the text "Wrap Up" is displayed. Underneath, there is a bulleted list with two items: "• Questions" and "• Key Takeaways". To the right of the list, the text "Please explore RIMS ERM Center of Excellence" is shown, followed by the URL "www.rims.org" in yellow. At the bottom left is the RIMS logo, and at the bottom center is the copyright notice "Copyright © 2011 Risk and Insurance Management Society, Inc. All rights reserved." At the bottom right, it says "Page 20".

Hans Laessoe: Yeah, sure. We have defined our corporate risk appetite. We have one for different projects and different parts of the business, but one we handed up to the corporate level, we base it on two rather simple measures. One is the risk map. We have a five-by-five risk map, and the very high impact is defined as half, losing half of our planned bottom line. And then it cuts down to half and half and half of that, going down to very low. So that's the design of it. And within that, we've decided that some of them are red or first-priority risks, if you may, and we are not allowed to have first-priority risks after mitigation. Which means that whatever we come up with, if we have a risk that we've mitigated, and it's still a first priority, we have to do more. We cannot-- that's not allowed. So we can't have any one of these humongously important risks and just get away with it.

The other part of it is used, based on the Monte Carlo simulation, of the entire risk portfolio. We have about 100 risks in the portfolio, and there's a lot of them that are groups and are taken out, more or less. But what we do with this portfolio is we say for each and every one of these risks, we say, OK, there's a certain percentage- some

likelihood that they will happen within this timeframe that we are looking at, which is generally two years. So this is a 10% risk that it will happen, and if it happens, it will cost us \$100 million. OK. We don't multiply the two, but we use the Monte Carlo simulation where we say in 10% of the cases, it will come out with a \$100 million loss and in 90% of the cases, it won't. By the way, in 1% of the cases, it will come up with \$200 million, because it happens twice within that period or timeframe.

So, we're using that kind of Monte Carlo simulation, looking at the entire exposure of the portfolio. Having done that, or doing this, we get a chart, pretty much like the one I showed you previously, and I'll just see if I can get back to it, it's that one, I hope -- hope it happens. No, it doesn't. But we will get a chart showing which probability we will have, which loss. Now, we looked at the 1% worst-case, and that was-- now it comes -- and the 1% worst-case is a very large number, which means that it's difficult to use in practical terms, but we could use the 5% worst-case. And we're looking at the 5% loss of earnings compared to our budget. And we've decided that that level is supposed to be below a certain defined share of our earned profits. We will not be closed as a company if we exceed that level. But that is the appetite, that's the risk we're willing to take, so we're willing to lose that amount of money.



Now, our actual exposure is different from that. We're not utilizing the whole thing. So, I'm looking at the actual exposure and saying, “OK, how does that compare with the target we've set, the X percent of our bottom line, as a 5% worst-case?” And right now, we are tracking the in safe area, which means we are utilizing less than half of our risk-- full risk appetite, as provided by the board. Which basically could mean also that we are not aggressive enough. We could allow ourselves to be even more aggressive, but with

the growth we have, we don't think we need to, or actually can carry it for other reasons.

So, it's up against the risk appetite that we are-- that risk appetite that we're monitoring, the full- the impact of the full portfolio as well as the potential first priority of risks that we have on the risk map.

We're doing this reporting every half-year. The board of directors were in the beginning asking for every quarter, and I say forget it, guys. We're in a business where half of our turnover happens in the fourth quarter of the year, and nothing will happen in the third quarter, so it's OK, you get a mid-way report, but you don't get a quarterly report.

Now we had a new chairman of the board at that point in time and he asked the board, "Who is this guy, telling us that we can't get a quarterly report when we ask for it?" And the deputy chairman, who owns the company, and with whom I've been working for more than 20 years, said, "OK, with this guy, I trust him. It doesn't make sense. Forget it." And I got my way, so they get a half-year report.

Carol Fox: So that brings up a good point, and Dr. Frigo, I'd like to ask you, if you believe that SRM is more the purview of the board of directors, listening to Hans, or is it the executive management, or what role do each of those play in SRM, as you see it?

Dr. Mark Frigo: Well, I think Strategic Risk Management, we find that directors, boards, are asking management teams to address Strategic Risk and the risk assessments and risk management. But fundamentally, we are finding that, to be successful, Strategic Risk Management must be business-driven, it must be management-driven, it must be integrated within the organization. So, it's something that is not board-driven, per se, it should be something that's business-driven within an organization.

**Thank You**

Wrap Up

- Questions
- Key Takeaways

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Carol Fox: Thank you, Dr. Frigo. Hans, another question for you -- there's a question about your methodology and whether you're using any particular software in getting to your results. Would you speak to that?

Hans Laessoe: Software-- no, I'm using an Excel spreadsheet. The reason for that is when I started four or five years ago, I was completely ignorant on this, and I had no idea what I was expecting the software to be able to do for me, and if you don't know what the software is supposed to do, it's difficult to buy the right one. And-- well, that's one part. The other part is I've been working with spreadsheets since sometime in '84, or something like that, so I know how to use spreadsheets. And I started out with a spreadsheet and it's grown gradually it's becoming into a database with multiple sheets and a lot of lookups and stuff like that. But it still works and we are, right now, in a period of time where the company is growing and everybody is putting demands on the IT organization, so my request for having a software package installed is being postponed to some perpetuity, because they have other needs in the business that need to be catered to before I get a software package. So I'm making do with my Excel package and it's doing quite well.

Carol Fox: Well, thank you, Dr. Frigo and Hans, not only for your participation in our webinar today, but both for your contribution to RIMS. The work that these two are doing with us on strategic risk management will benefit everyone, not just our members. But I do want to recognize that and acknowledge it.

With that, I'd like to remind everyone that the archive of this webinar will be available at the same link you used today, or through the RIMS website, in the education section.

Should you have any questions or suggestions for future webinars, please direct them to PD@RIMS.org. Reminder, if you didn't see it, you can download a copy of the PowerPoint slides and related documents, using the print documents and view links tab under the speaker photos. I would encourage you to visit the RIMS ERM Center of Excellence to obtain a number of Dr. Frigo's articles, including the one on Strategic Risk Management that he referenced today. We'd also appreciate you completing the survey questions at the end of the presentation. Your opinion is very important for us as we do our planning and thank you all for participating today.

With that, we'll conclude our presentation. Thank you, everyone.