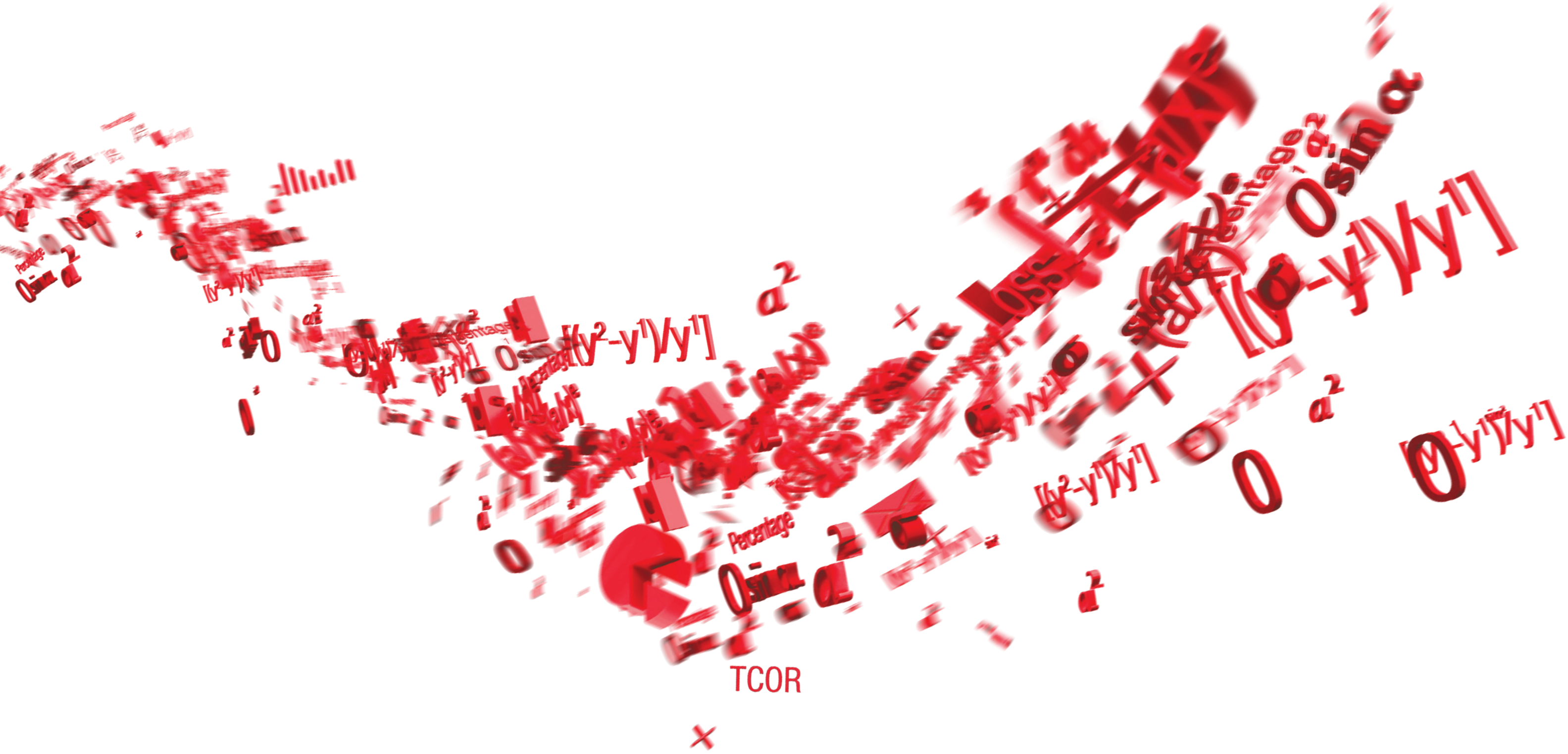
Aon Risk Solutions



Risk Maturity: business effect and driving results

Added value from and important characteristics for a mature risk management process. Based on the outcome of several studies conducted on the Aon Risk Maturity Index.

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Rapport

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Content

Introduction

Increased attention for Enterprise Risk Management (ERM). Signals from inside and outside the organization in order to improve ERM within the company. Should we embed an ERM Process in order to satisfy stakeholders or provides ERM actual added value?

In order to research and answer this question together with The Wharton School of the University of Pennsylvania Aon developed the Risk Maturity Index. The Aon Risk Maturity Index examines specific practices and structures related to ten characteristics of Risk Maturity. These ten characteristics are further broken down into 40 specific components that are scored on a 1 (Basic) to 5 (Advanced) scale similar to the overall Index.

The Aon Risk Maturity Index was designed to enable senior financial and risk leaders to assess, benchmark and track the development of their organizations' risk framework and risk processes. Over time, the aggregated data and findings (close to 700 organizations) have provided researchers from Aon and The Wharton School of the University of Pennsylvania with the ability to provide more complex and sophisticated insights around risk governance and predictive operational risk practices directly linked to the financial performance of an organization.

This article provides by means of analyses of the results of the Aon Risk Maturity Index insight in the positive correlation between the maturity of a company's risk management process and the actual financial performance of this company. Next to that this document confirms the necessity of correct embedded Risk Management ownership within an organization. Concluding with several strategic characteristics to support ma mature risk management process.

1 ERM Maturity correlated with financial performance

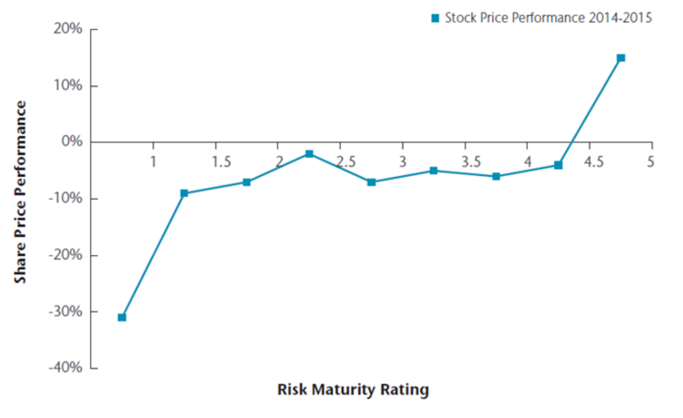
In today's ever-changing environment, the ability to anticipate opportunities and effectively understand and respond to risks is critical to the operational and financial well-being of organizations. This is increasingly important given that internal and external factors influencing organizational risk management practices continue to evolve.

Over the past four years, analysts from the Aon Risk Maturity Index team and the Wharton School have aggregated and analyzed Risk Maturity Index participant data and have developed annual Aon Risk Maturity Insight Reports which present findings on the interplay of organizational risk management and the relative maturity of their enterprise risk management approaches.

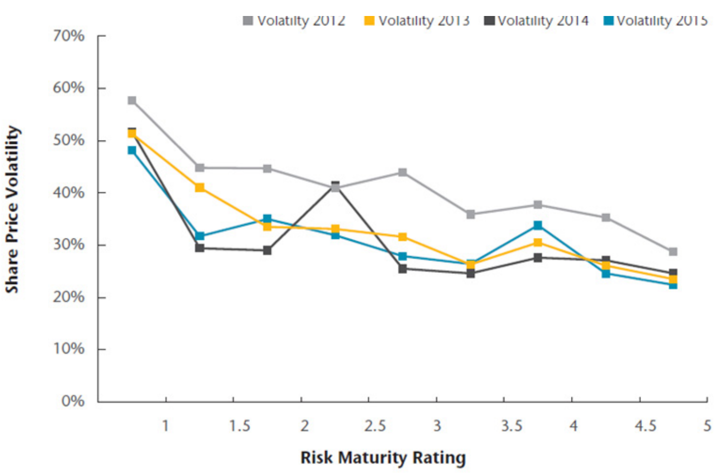
Researchers from Aon and Wharton observed direct correlations between enhanced risk management practices and improved performance in the financial markets. Working with annual financial results from more than 300 publicly traded companies around the world, our research has found continued correlation between higher risk maturity and improved market performance, profitability, and organizational resiliency. These findings continue to emphasize the importance of a robust, integrated, and holistic risk management program.

During the period June 2014 – June 2015, our researchers found significant correlations between risk maturity and stock price performance. This is most likely a result of the general transition away from the bull equity market environment of 2014 and the heightened market volatility, those organizations with advanced risk management practices are better able to demonstrate advanced risk management capabilities and have them reflected in the market's perception of those organizations.

Graph one: Share Price Performance 2015



Graph Two: Share Price Volatility 2015



Consistent with all analysis and findings of previous years, researchers have continued to find a strong statistical correlation between risk maturity and reduced stock price volatility. This further validates the findings that advanced risk management practices are one of the factors that smooth out volatility in an organization's stock price. During the period June 2014 – June 2015, researchers found a stronger correlation between the two factors than during the period June 2013 – June 2014, demonstrating that during periods of plunging equity sentiment, robust risk management practices are essential to an organization's performance.

* The Risk Maturity Index is scored on a scale of 1 – 5, with a rating of 1 defined as Initial and a rating of 5 defined as Advanced.

2 Driving Results

Board Roles and Responsibilities, Financial and Risk Management Practices

Knowing the benefits of a mature ERM process, what level of board involvement, financial analysis methods and risk management practices contribute to advanced risk maturity and more stable financial performance? What makes a robust organizational risk management framework?

Confirming the link between strong risk management practices and superior financial performance, as described above, highlights the need for a better understanding of practical measures that an organization can take to effectively implement and support a sustainable risk management framework. Analyzing responses from the Aon Risk Maturity Index, researchers from Aon and Wharton have identified statistically relevant high-value practices related to governance, decision making and risk management to help organizations focus their resources more strategically as they develop that framework.

A variety of external events, including changes in regulations, more stringent interpretations of directors' fiduciary responsibilities and the issuance of "best practice" governance standards by investors, rating agencies and shareholder advisory groups, have fostered rising expectations for Boards of Directors to exert greater oversight of organizational risk management practices. Utilizing responses from distinct public, private and non-profit organizations from around the world, researchers from Wharton took a close look inside the black box of board risk oversight and assessed the association between ownership structure and legal origin to the sophistication of board oversight practices.

Researchers found that the assignment of board roles and responsibilities are a major determinant of board risk oversight practices. When the assignment of risk responsibilities is delegated to the board as a whole rather than solely to committees and when directors' risk management roles and responsibilities are included in their performance evaluations, the board tends to have more consistent understanding of the organizations top risks, existing risk management activities, quantified risk appetite and emerging risk profile, more extensive and frequent risk reporting, and greater consensus and communication between the board and the management team regarding risk management strategies. Ownership structure (public, private, non-profit) and country-level governance variables (code vs. common law legal origin and creditor and shareholder protections) are significantly associated with the assignment of board roles and responsibilities but have very little effect on specific board risk management practices.

When researchers examined the effects of board practices and risk governance on an organization's overall risk maturity, they found that the overall sophistication of board oversight practices has a significant positive impact on the organization's risk maturity, but solely the assignment of board roles and responsibilities does not. These results suggest that any impact of board responsibility or performance evaluation on organizational risk management practices occurs on the use of more sophisticated board risk practices.

Advisers from Aon have long emphasized the importance of board risk oversight practices given a board's mandate and ability to drive top-down organizational initiatives. From these research findings, it can be gleaned that the board should not only take an interest in risk management but also assign itself specific risk responsibilities and oversee risk management practices in order to drive and ingrain proper risk management practices into an organization's culture.

Risk-Based Forecasting and Planning (RBFP)

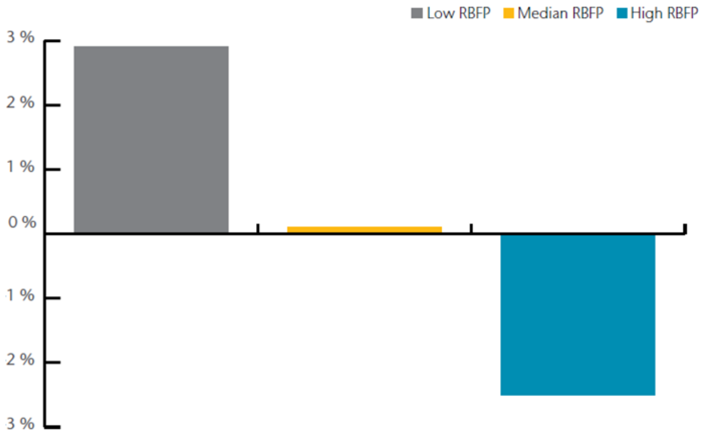
An organization's earnings forecast plays an important role in budgeting and cash management, capital justification, strategic planning as well as providing the foundation for investor communications. However, increasingly volatile environments have made it increasingly difficult for organizations to forecast earnings. Risk-based forecasting and planning (RBFP) provides one potential mechanism for organizations to improve the incorporation of risk considerations into integrated forecasting and planning.

Researchers from Wharton examined the extent to which risk-based forecasting and planning practices were associated with organizational volatility and earnings forecasts from close to 50 publicly-traded companies in the United States that disclose quarterly earnings forecasts. An RBFP score was formed for each organization based on their unique Aon Risk Maturity Index responses regarding the extent to which formal, quantitative risk assessments and evaluations are conducted; the identification of risk drivers and risk interdependencies and the integration of this information into decision-making; and the incorporation of risk considerations in budgeting, project and capital investment decisions and strategy development.

Researchers found a strong correlation between sophisticated risk-based forecasting and planning practices and firm volatility as reflected in cash flows, earnings, sales and stock price. Lower firm volatility, in turn, is associated with greater management forecast accuracy and smaller forecast ranges. Researchers also found that more sophisticated RBFP practices have a direct association with more accurate earnings forecasts and smaller forecast ranges, even after controlling for volatility. These associations suggest that RBFP improves forecasting ability not only by facilitating the reduction of volatility in the organization's operations but also by improving the information used in the process itself. Risk management literature further suggests that the informational role of risk-based forecasting and planning is likely to be most important in firms where volatility is greatest.

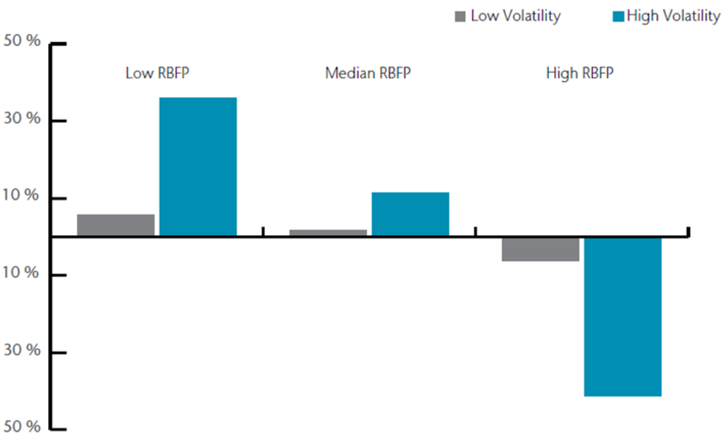
Consistent with these claims, researchers at Wharton found the association between RBFP and forecasting performance to be strongest in settings where the organization faces the greatest firm volatility. Graphs three and four highlight the groundbreaking findings on risk-based forecasting and planning.

Graph three: Estimated Change in Volatility Ranking



Analyzing quarterly earnings forecasts from close to 50 publicly-traded companies in the United States, researchers find that organizations with strong RBFP practices exhibit a 2.5% reduction in firm volatility while organizations with weak RBFP practices exhibit a 2.9% increase in firm volatility.

Graph four: Estimated Percentage Difference from Average Earnings Forecast Error



Analyzing quarterly earnings forecasts from close to 50 publicly-traded companies in the United States, researchers find that for organizations with high firm volatility, weak RBFP practices increase average earnings forecast error by 36.1% while strong RBFP reduce average earnings forecast error by 41.2% in organizations with high firm volatility.

3 Conclusion

The research we execute based on the data out of the Aon Risk Maturity Index confirms that a higher Risk Management Maturity level supports better business performance and lower volatility of business outcome.

In order to implement and execute a pragmatic risk management process Aon has developed ten characteristics of Risk Maturity that should be present within a organization with a higher Risk Maturity Ambition:

1. Board-level understanding of and commitment to risk management as a critical factor for decision making and for driving value
2. A senior-level executive who drives and facilitates key risk management processes and development
3. Transparency of risk communication
4. A risk culture that encourages full engagement and accountability at all levels of the organization
5. Identification of existing and emerging risks using internal and external data and information
6. Participation of key stakeholders in risk management strategy development and policy setting
7. Formal collection and incorporation of operational and financial risk information into decision making and governance processes
8. Integration of risk management insights into human capital processes to drive sustainable business performance
9. Use of sophisticated quantification methods to understand risk and demonstrate added value through risk management
10. A move from focusing on risk avoidance and mitigation to leveraging risk and risk management options that extract value

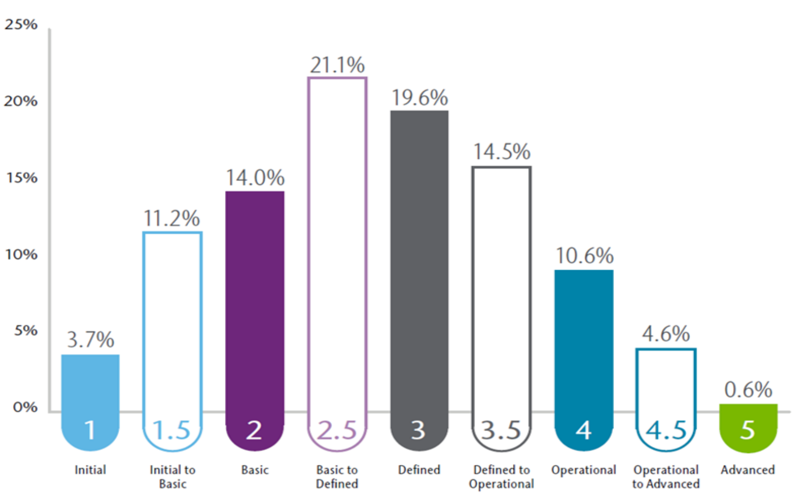
About the Aon Risk Maturity Index

How should your organization align itself around risk? What strategies should your organization implement to integrate risk and strategy? The growth and evolution of the Aon Risk Maturity Index has led it to become an industry-leading tool that helps organizations answer these questions. Analysis of Risk Maturity Index results continue to provide valuable and practical risk management insights in support of sustainable, stable financial results.

Aon will continue its research with The Wharton School to identify key risk management practices and processes that contribute to improved financial performance as well as a deeper understanding of industry-specific best practices in regards to risk management.

The Aon Risk Maturity Index is a free, confidential and online tool. For more information or to participate, please visit **aon.com/rmi** or email **Mark.Braam@aon.nl**.

Graph five: Aon Risk Maturity Index: Distribution of Risk Maturity Ratings (October 2015)



About Aon

Aon plc (NYSE:AON) is a leading global provider of risk management, insurance brokerage and reinsurance brokerage, and human resources solutions and outsourcing services. Through its more than 69,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative risk and people solutions. For further information on our capabilities and to learn how we empower results for clients, please visit: http://aon.mediaroom.com.

About Mark Braam Msc

Mark supports as Senior Consultant Enterprise Risk Management several National and International operating companies with the challenges related to Enterprise Risk Management. A pragmatic approach on strategic, tactical an operational level (based on both experience and theory) is key in Mark's daily practice.

About Aon Global Risk Consulting

In today's challenging global environment, business risks are no longer isolated by industry, geography or country. Economic slowdown, regulatory changes, cyber crime, terrorism, increased competition, damage to reputation, and other critical risks are complex, inter-related and global in consequence. Aon Global Risk Consulting is the world's leading risk consulting organization. With nearly 1,700 risk professionals in 50 countries worldwide, AGRC consultants have the expertise and experience to recognize and address the unique challenges and opportunities that face our clients.

In close partnership with Aon's broking team, AGRC provides comprehensive and tailored solutions through a consistent global approach backed by a panel of industry experts. Our risk control, claims and engineering team consists of 600 professionals who support clients globally in the property and casualty risk control arena.

Our Risk Consulting business unit includes leading disciplines that include actuarial, business continuity management (BCM), enterprise risk management (ERM), risk management outsource and risk feasibility. Our Actuarial & Analytics (A&A) practice consists of more than 100 consultants including 47 actuaries having Property & Casualty (P&C) credentials.

Aon's Captive & Insurance Management practice is widely recognized as the leading captive manager, managing nearly 1,200 captives globally with local capabilities in over 30 countries.

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