Steve Dreyer Interview Segment 1
Enterprise Risk Management and the Banking Crisis: Lessons Being Learned
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Interviewer: **Bonnie Hancock, Executive Director of the ERM Initiative**
Interviewee: **Steve Dreyer, Managing Director, Standard & Poor's**

Hancock: Hello. I am Bonnie Hancock, Executive Director of NC State's ERM Initiative in the Poole College of Management. I am speaking with Steve Dreyer who is Managing Director at Standard & Poor's. Steve has been leading the ERM review efforts at Standard & Poor's. If you were trying to convince a CEO or a board of directors about the value of embracing an ERM process, how would you articulate the reasons why they should strongly consider implementing ERM?

Dreyer: I think senior executives that have embraced ERM or are seriously considering moving in that direction are seeing that it's a language to communicate with the key stakeholders of an organization, the board, the stock—key stockholders, bond holders, regulators, even consumers and customers. As a demonstration of kind of maturity, I guess, of their management of the organization, moving from perhaps a more opportunistic kind of approach to a more thoughtful—thoughtful approach.

So while there are various flavors of ERM in various organizations, I think the commonality is a desire to have kind of a more formal process for thinking—you know, thinking about risk, having a more formal process of management that is maybe the next generation of how companies ought to be managed.

Hancock: A lot of critics of ERM point to the bank failures of 2008 and 2009 and say, "Weren't the banks supposed to be so far ahead of the curve and so advanced in ERM?" And they say the fact that the banks failed is evidence that ERM is not an effective tool or isn't working. In their view, the banks were practicing ERM, but they still failed in spite of it, so what is the value of ERM? How would you respond to those critics?

Dreyer: The experience with the banks is sort of a black eye for ERM, to some extent. When you peel it back, though, I think what really happened there was that the banks were doing ERM. They were setting their risk tolerance at a level that, in retrospect, was too high, and/or they didn't have good metrics. I mean, one of those two, or probably both of those things were going on. In other words, didn't really—weren't able to capture the true risk in the various products and, more importantly, the correlations of risk across their various—various areas. So although they were doing risk management, they weren't really doing enterprise-wide risk management, as I think we would all define it today.

As to whether that besmirches the whole discipline of ERM, I think you have to ask, "What are the alternatives to that? Are we—are we not going to manage risk? Are we going to say that it's too difficult to look across those businesses and be able to better prepare for a meltdown kind of situation, as occurred in the end of 2008?" If that's the case, then there are much more serious questions to be ask here, like should a bank even exist in the form that it is or should an organization be allowed to engage in those various activities which can, you know, erupt at the same time?

And of course, that thinking is behind a lot of the regulation that's—that's followed. There's not any consensus that that regulation will eliminate the problem. I think—I think the banks were headed in the right direction and either willfully or unknowingly didn't calibrate their risk management in a way to protect themselves against the calamity that occurred.

Hancock: As a follow-on, you talked about risk management versus enterprise risk management. How would you explain the difference between those two things?

Dreyer: When we started looking at enterprise risk management, we had a debate internally about whether we should use the word "enterprise," because it had become and has become a kind of a brand name for a lot of different things. We decided that we ought to use the word "enterprise" because it would underscore the kind of strategic, broad nature of what we're talking about, and I think in retrospect we failed to help encourage the sort of broadness of thinking. In fact, in most companies that we see, enterprise risk management is really risk management. It's siloed risk management. It's focused in particular areas, typically the core business of the company. If it's a company with a lot of, you know, the manufacturing, there's going to be a lot of focus on engineering risk, but not much beyond that.

So I think there's still some way to go before we can say that a lot of companies and a lot of different industries are really doing enterprise—enterprise-wide risk management. And I think that's partly a lack of will. Companies, I think—executives, I don't think, are really seeing the value to take that—that next—that next step. And the other reason is, even if they are taking that—taking that longer-term view and wanting to go to an enterprise-wide risk management function, it takes a long time.

It has to be molded to the culture of the organization, or in some cases, they're trying to change the culture of the organization. Those aren't things that you do in a year or two, and it gets away from the granular, detailed level of risk, into the strategic area, which is a very difficult thing for companies to kind of get their arms around. And in some cases, it's difficult for senior executives, CEOs, to share that risk. A lot of—in very many cases that we see, CEOs kind of hold that—and senior executives sort of hold that close to the vest, so to speak. It's not kind of a shared vision.

I mean, the company—generally, employees know where the company's going, but as far as engaging in managing those strategic risks, it's tended to be kind of an aloof activity and not connected to people on the ground. So those are monumental kinds of changes if you don't have that—you know, that right culture to sort of support that. And, you know, I'm still optimistic that enterprise risk management is on the rise, but I'm probably changing my forecast in terms of how many decades it's going to take to have it be really prominent.

Hancock: Thank you, Steve, for being here. For our audience, I'd like them to be aware of the fact that on our ERM Initiative website, we have several resources under our article section that discuss how Standard & Poor's is looking at ERM in the context of their ratings process. There's a searchable link to help you locate relevant resources, so I would encourage our audience to take advantage of that ERM Initiative website.