

## The Current State of Enterprise Risk Management

by Kenneth R. Rado and James Noble, CPCU, ARM



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Long thought of as the next big thing in corporate risk management, enterprise risk management (ERM) has yet to take off as anticipated. While the goal of embedding sound risk management practices into the operational areas of the full organization remains the same, ERM has failed to meet the expectation of becoming a holistic approach beyond the insurance-buying function.

There are several reasons why ERM has yet to catch on in the general business landscape. Many organizations think of risks in independent silos and treat them accordingly, while management is typically more focused on results than risk profile. Many believe the chief executive officer (CEO) is the sole leader responsible for managing enterprise risk, and board committees tend to address only those risks that the organization deems significant. Moreover, adopting an ERM strategy can mark a difficult adjustment for leadership. An effective ERM strategy will require a significant and ongoing time commitment and will affect all ownership lines, which, in turn, can lead to priority issues.

Yet while ERM may be developing as a discipline at a much slower pace than originally expected, it still has a number

of key advantages over traditional risk management that enhances its value for an organization. For instance, classic risk management traditionally focuses on distinct catastrophic risks that result in financial loss, while ERM takes a more subjective view of loss and its cross-functional effect on the organization as a whole. It also aims to identify and manage top risk drivers to exploit potential value creation or preservation, as opposed to insuring only individual events on a loss or no-loss basis.

ERM can also measure the impact of a single event across multiple areas of the enterprise—such as employee relations, capital markets, succession planning, or product safety. This is achieved by applying risk-weighting prioritization in an effort to determine the financial and human capital costs. This can be particularly useful considering that the impact of risk—such as the illness, injury, or death of an employee—can be difficult to measure in terms of lost training, experience, and knowledge.

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# The Current State of Enterprise Risk Management

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## Adopting an ERM Strategy

Before adopting an ERM strategy, it is vital to define ERM in a way that specifically fits the organization and its business objectives. Though this process is subjective by nature, the definition should address several general issues, including key material risks and resource allocation, analytics and scenario planning, and value creation and preservation metrics. Taking these issues into consideration, ERM could be defined as an entitywide process to identify, assess, and prioritize key internal and external risk drivers to ensure strategic response with focus on value creation and preservation.

Developing an ERM program does not necessarily mean building one from scratch. Organizations can adopt a recognized ERM framework, such as that proposed by the Committee of Sponsoring Organizations of the Treadway Commission, and tailor it to gain a better understanding of and support for ERM at the operational level.

Regardless of whether the organization builds its ERM program from the ground up or adapts it from an existing model, it is critical that the program be built into all major organizational initiatives. The overall goal of ERM is to align the organization's risk appetite with its strategic alternatives while recognizing the discrepancies in risk appetites between departments, using risk efficiently and effectively with interrelated impacts, and capturing opportunities to improve the use of capital.

## Elements and Objectives of Effective ERM

An effective ERM strategy is designed to promote better risk-adjusted decision making and should include strategic, operations, reporting, and compliance components. Following is an overview of these key components:

- **Strategic**—view of an organization's collective risks and how they relate to



the mission and business objectives of the entity from an overall and business unit perspective.

- **Operations**—identification and assessment of internal and external risks that may affect business objectives and strategies.
- **Reporting**—control and monitoring activities, policies, and procedures throughout the organization as well as monitoring the role of internal auditors.
- **Compliance**—focus on results through established roles and responsibilities throughout the organization; external compliance with applicable laws and regulations, including the Sarbanes-Oxley Act and the Dodd-Frank Act.

Additional elements of an ERM program—such as risk identification, assessment, response, control, and monitoring—are critical to establishing risk appetite, tolerance, and response strategies within the organization.

### Risk Identification

Before setting out to identify an organization's material sources of risk, risk managers should use risk mapping and department manager risk awareness

sessions to create a preliminary list of risk categories that can later be prioritized based on a weighting of probability, severity, cost, or ability to control. Such a hierarchy can help ensure resources are allocated in the most effective and efficient manner.

An organization's supply chain can serve as an important guide during the risk identification process. It can pinpoint key drivers and the appropriate risk management strategy—for example, the need for a low-cost supplier versus a higher-quality supplier or the need for supply chain efficiency versus risk management redundancy.

To properly monitor and mitigate the identified material risks, organizations should employ a wide variety of techniques to evaluate and employ risk avoidance, reduction, sharing, and retention while implementing mitigation plans. Oversight and review processes need to include on-site engineering risk analysis and use scenarios wherever possible. Additionally, insurance should be used to spread financial risk and minimize the severity of an occurrence.

Regardless of the method used in the risk identification process, it is important

that it be based on industry best practices, compliance requirements, and organizational culture.

Most important, the method must be applied uniformly across the enterprise at every level. Department managers must be aware of an organization's risks and should be regularly polled. Many risk managers may be surprised to learn that insurable risks like natural disasters do not usually rank as a top five risk. In fact, risks such as loss of reputation, succession planning, competitive actions, regulatory actions, and resource allocation generally rank higher.

Advanced technologies and analytics are also available to help organizations better identify key drivers of risk. Tools such as risk-based analytics, on-site risk assessments, and customized risk surveys can be used to help firms quantify risk probability, impact, and cost to control. These tools also establish whether the risk can be held, eliminated, reduced, or transferred through insurance in a cost-effective way. The tools, along with large databases and subject matter expertise, can help risk managers achieve cost-effective delivery of services, provide value to customers, and align technical findings with business-driven solutions.

## ERM Leadership Is Essential

Any successful ERM strategy needs a leader to champion the organization's commitment to the program. The leader should have responsibility over various lines of business and be able to ensure that organizational culture does not adversely affect risk focus. The chief financial officer (CFO) is an example of a senior corporate figure who may be considered. The CFO has the necessary responsibility, authority, executive-level knowledge of the organization, analytical skills, and understanding of the evolution of the overall risk portfolio.

While a high-level officer is ideally

positioned to lead an organization's ERM effort, the risk management group continues to play a critical role as a channel and resource for other individuals and groups involved, including the chief risk officer, risk committees, oversight groups, and business units. The skills and training that risk managers bring to the table—*influencing, risk prioritization, risk assessment, response, control, and monitoring practices*—are invaluable to a successful ERM strategy.

As some of the most qualified people to determine the effect of risk on the organization, risk managers should be the catalyst for ERM and experts on the key capabilities that facilitate a successful program, including the use of risk-based decision making, advanced analytics, business continuity planning, and effective data management.

## Communicating Awareness and Progress

Communication is a vital part of an ERM program, and members of the organization should be updated on its progress. The risk management team needs to make regular presentations to operating units, and periodic newsletters should be circulated to all employees to facilitate embedding risk awareness into organizational culture. Additionally, key initiatives should be addressed at all management meetings, and risk committee minutes should be distributed widely throughout management to ensure all organizational leaders are involved in the process.

ERM progress should also be reviewed and monitored by the board of directors on a recurring basis to help maintain a focus on risks and rewards and to make the appropriate response decisions. The designated ERM leader should ensure risks are grouped, reviewed, and monitored by the organization's "primary risk owners" and work with them through the oversight review process while also providing the board of directors with regular reports.

While the adoption of ERM as a discipline has been slower than expected in the global business landscape, the fact remains that risk often can be viewed as more abstract than concrete. As such, ERM necessarily stretches a risk manager beyond how or her role as a buyer of insurance. It is likely only a matter of time before ERM's holistic approach to risk becomes the widely accepted norm.

Establishing an effective ERM program is critical in these uncertain economic times. Dynamic external and internal organizational changes present a unique set of risks to businesses of all types and sizes. The sooner an organization expands its approach to risk, the better able it will be to strengthen its position in the marketplace. ■

# The New Paradigm of Risk

by Michael W. Elliott, CPCU, AIAF



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The term “risk” has several meanings in an insurance context. It is used to refer to the subject matter of an insurance policy, such as a building or an airplane. It is also used when describing an insurable event, such as a lawsuit. For analysis purposes, it is synonymous with the probability of a loss occurrence. When viewed from these various insurance-related perspectives, risk is characterized as something that can result only in negative consequences, referred to as “losses” among insurance professionals.

Insurable risk, however, usually constitutes only a small portion of the overall risk faced by an organization. Strategic and financial risks, which can result in positive or negative consequences, tend to be much more significant in terms of their impact on the organization. Furthermore, the level of these risks is positively correlated with potential return—the greater the strategic or financial risk accepted by the organization, the greater its expected return.

## A New Approach to Managing Risk

Organizations that manage all their risks, both insurable and noninsurable, on a holistic, or enterprise-wide, basis enjoy efficiencies over those that manage them separately by unit. An integrated approach to risk management allows an organization to consider risk interdependencies and offsets when examining its corporate-level risk profile and when choosing risk treatments. Consider an insurance company that manages its underwriting and investment risks together as a portfolio. These sources of risk are independent, so there are likely to be offsets—when one results in negative consequences, the other may result in positive consequences to offset it.

Key tools for implementing this integrated approach are a framework to embed risk management within the organization, a risk management process to guide risk-related decisions, and a common vocabulary that facilitates risk communication across the organization.

In 2009, the International Organization for Standardization (ISO) published an international standard for risk management that includes a framework and a process,<sup>1</sup> as well as a vocabulary<sup>2</sup> that defines risk and risk-related terms and relates them to organizational objectives. This was preceded by an enterprise risk management framework published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2004.<sup>3</sup> It is similar to the ISO standard in that it defines risk and risk-related terms and provides a framework for achieving an entity’s objectives. Many organizations adapt one or both of these frameworks to suit their specific needs.

## A Paradigm Shift

This enterprise-wide approach to managing an organization’s risks has taken hold in many organizations. It presents a paradigm shift for risk

managers who have traditionally focused on insurable risks. They must adapt by participating in the development of an organization-wide risk management framework and process and by using these tools to manage both insurable and noninsurable risks. Where possible, they should substitute common risk-related terms for insurance terms. For example, a risk manager could refer to an insurable loss as “the negative consequence of an event,” implying that there are many types of events, both insurable and noninsurable, and that events can have positive consequences, negative consequences, or both. This new way of viewing and managing risks taps risk managers’ skills of assessing and treating risk and is a natural evolution of the management of risk across the organization. ■

## Endnotes

- (1) International Organization for Standardization, *ISO 31000; Risk Management—Principles and Guidelines* (Geneva, Switzerland: International Organization for Standardization), 2009.
- (2) International Organization for Standardization, *Guide 73; Risk Management—Vocabulary* (Geneva, Switzerland: International Organization for Standardization), 2009.
- (3) Committee of Sponsoring Organizations of the Treadway Commission, *Enterprise Risk Management—Integrated Framework*, (Durham, N.C.: Committee of Sponsoring Organizations of the Treadway Commission), 2004.

# Popeye and Longshore & Harborworkers Workers Compensation

By Jerome "Jerry" Trupin, CPCU, CLU, ChFC



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**T**he United States Longshore & Harborworkers workers compensation law (USL&H) mandates coverage to protect maritime workers who are not seamen. It aims to close the gap between state workers compensation (WC) coverage and the Jones Act, the federal law that protects seamen. USL&H provides employee benefits to employees who are not seamen but who are engaged in maritime employment if injury or death occurs on U.S. navigable waters, including on any adjoining pier, dock or other area used to load, unload or repair ships. It was needed because of many rulings denying state workers compensation coverage to employees injured on navigable waters.

Benefits are similar to, but often better than, those provided by state workers compensation plans. The current maximum weekly wage replacement payment for USL&H is \$1,225. State workers benefits are usually less, and sometimes dramatically so. For example: New York's workers compensation maximum is \$740 a week, and Mississippi's maximum is \$427.20. In addition, USL&H benefits are not "scheduled injuries" and so can provide benefits for life. That can result in a much larger recovery for an injured worker. Concurrent benefits are permitted,<sup>1</sup> that is, in certain situations, employees can collect state WC benefits plus additional USL&H benefits to equal the maximum USL&H benefit level.

If USL&H benefits are not covered by the employer's insurance, the employer is subject to both a civil action for damages—to which it may not plead the defense of contributory negligence or assumption of the risk—and a criminal misdemeanor charge—for which its corporate officers, in addition to the firm,<sup>2</sup> are personally liable.

Disputes over just who is covered by USL&H requirements started almost immediately after the law was passed in 1927. In 1984 the act was amended to exempt several groups from coverage: (1) employees exclusively performing clerical, data processing, and other office work; (2) employees of a club, camp, recreational operation, restaurant, museum or retail outlet; (3) employees of a marina not engaged in construction work on the marina other than routine maintenance; (4) employees of suppliers, transporters or vendors who are temporarily on the premises of a covered employer but not doing the usual work of that employer; (5) aquaculture workers; and (6) individuals employed to build, repair or dismantle recreational vessels under 65 feet long.<sup>3</sup>

In a 2006 case, a judge remarked that "The Longshore and Harbor Workers' Compensation Act does not cover 'all those who breathe salt air,' but neither is it limited to Popeye." In that case, the U.S. Court of Appeals upheld the Hawaii Benefits Board, which ruled that an employee killed while excavating a utility trench on land in connection with the renovation of submarine berths at Pearl Harbor was a harbor worker, even though his or her specific job was not uniquely maritime in nature.<sup>4</sup> (The judge was in error about Popeye, though. Popeye was a seaman—"I'm Popeye the sailor man"—so he would be covered by the Jones Act, not USL&H.)

The learning point for most of us is to watch out for operations with an incidental maritime aspect: USL&H may be needed in situations where it is not immediately obvious that employees are engaged in maritime employment. ■

## Endnotes

- (1) The U.S. Supreme Court case setting out the concurrency principle is *Sun Ship v. Pennsylvania*, 447 U.S. 715 (1980).
- (2) Robin Federici, CPCU, "Is This Law Making You Crazy?" This is an excellent presentation covering the topic. It was presented at the Massachusetts Agents Association Big Event, November 2011. See <http://www.massagent.com/events/11manuals/longshore.pdf>.
- (3) Daniel N. Price "The 1984 Amendments to the Longshore and Harbor Workers' Compensation Act," Office of Research, Statistics, and International Policy, Office of Policy, Social Security Administration. See <http://www.ssa.gov/policy/docs/ssb/v48n4/v48n4p39.pdf>.
- (4) *Healy Tibbitts Builders, Inc.; John M. Manner vs. Director, Office of Workers' Compensation Programs, Darlette Maumau, et al.* No. 04-70575 U.S. Court of Appeals 9th Circuit (2006).

# 2011 Annual Meeting Student Program— ‘Ongoing Success’!

by Lamont D. Boyd, CPCU, AIM



**Lamont D. Boyd, CPCU, AIM,** director, insurance scoring solutions with FICO® (Fair Isaac Corporation), is responsible for client and partnership opportunities that use FICO's credit-based insurance scoring and property risk scoring products and services. Speaking regularly to various groups on behalf of FICO for the past 18 years, he is recognized as a leading expert in predictive scoring technology. In addition to managing the CPCU Society Student Program, he is a member of the Underwriting Interest Group Committee and the 2012 Annual Meeting Task Force.

**D**ozens of notes from chapter and Society leaders, risk management/insurance students and professors, mentors and others involved in our 2011 CPCU Society Student Program inspired me to express my own sincere appreciation for all who contributed time, effort, and money to make this program another in a series of ongoing successes!

Here are just a few of the comments we've received about the 2011 Student Program:

**Tyler Cockrum**, Missouri State University, expressed appreciation similar to so many others:

“I would like to begin by saying how grateful I am that I had the opportunity to participate in the CPCU Student Program. The Annual Meeting was a

very successful trip for me. I had the opportunity to learn about several different career paths (the majority of which I had not even considered). I also was given countless opportunities to meet new people and network with both students and professionals in the industry. This experience has had a positive impact on me and will greatly help to advance me in my future career.”

**Brigid Tarpey**, University of Southern Maine, shared her thoughts and plans for the future:

“I just wanted to thank you for all you did to make the conference successful and meaningful to me. I can't imagine all the hard work and organization that goes into setting up something like this, and I want to thank you for making it possible for my fellow classmates and me to have attended such a fantastic conference. We all benefited greatly from attending and enjoyed all the networking we did. I look forward to graduating in the spring and furthering my education and career in the insurance field.”

**Erika Villavicencio**, University of North Texas, offered insight into her CPCU study plans:

“I just wanted to tell you how much I appreciated your time throughout this whole process and for getting the Student Program to be so successful. It was a great experience for me, and I fully enjoyed my time with the rest of the CPCU members. The whole week there made me excited to start my journey with CPCU and start studying for the exams. I'm hoping to get everything done by 2016!”

**Le'Yante Williams**, Florida State University, also expressed her appreciation:

“I would really like to thank you for extending the opportunity to attend the CPCU Society Annual Meeting. I had a fantastic time learning about the industry; listening to the fascinating stories of

the speakers; and being able to not only network with professionals, but also make some friends along the way. I will definitely relay the awesome experience I had at the meeting to help increase awareness of the outstanding possibilities the meeting has to offer.”

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**Steve McElhiney, CPCU, MBA, Are, AIAF**, 2011–2012 CPCU Society president and chairman, shared his thoughts about the future:

“The pipeline issue is the core strategic challenge faced by the insurance industry and the Society in the next ten to fifteen years, as a generation of knowledge workers retire and new talent needs to be identified, trained, and developed to fill these technical roles. This program, going now into its third year, serves as a prototype for success for the industry, as bright and eager insurance students from programs based around the country gain an opportunity to be immersed into a vibrant CPCU Society Annual Meeting and Seminars, network with professionals at all levels, and discover various career options. At this point, I cannot imagine an Annual Meeting and Seminars where students are not present as an integral part of the meeting experience for all of us; this program has had a profound impact in such a short period.”

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**Warren L. Farrar, CPCU, CLU, ChFC**, 2011–2012 CPCU Society immediate past president and chairman, offered the following observations:

“I continue to be impressed with the level of excitement and commitment demonstrated by the students attending our annual event. They, too, benefit by gaining insight into our industry, having the opportunity to meet with leaders of the industry, and developing new relationships that can enhance their careers. This is a small but important effort at attracting young professionals into our industry—a critical issue for the industry and the CPCU Society.”

“A Look into the Future,” our unique student-focused seminar in Las Vegas, was a rousing success as well. The seminar highlighted the property-casualty insurance industry’s need for the “best and brightest” now and in the future and provided the perspective of students working toward risk management/insurance careers. The seminar was specifically designed to help risk management and insurance students understand more fully the variety of paths available to them in the property-casualty insurance industry. Students also gained a clear understanding of the value of the CPCU designation in helping them on their chosen path.

Many thanks to our seminar speakers: **Noelle Codispoti, ARM**, executive director of Gamma Iota Sigma, the international risk management, insurance, and actuarial sciences collegiate fraternity; **Dale M. Halon, CPCU, CIC**, vice president of sales, ISO Innovative Analytics; **Connor M. Harrison, CPCU, ARe, AU**, director of custom products, The Institutes; and **James R. Jones, CPCU, ARM, AIC**, executive director of the Katie School of Insurance and Financial Services at Illinois State University.

Our hope is that all students, new designees, and industry veterans walked away from this seminar with great ideas and a clear understanding of what is needed to grow our industry through the development of talented individuals. The CPCU Society is uniquely positioned--in large part because of the direction and support provided by chapter and interest-group leaders--to offer a bridge between those who are seeking a rewarding future in the industry and those who are seeking people to contribute to a successful future.

## 2012 Student Program

As a direct result of the efforts of so many of you and your colleagues over the past two years, the Society has given the Student Program an enthusiastic “green light.” Our next stop will be in Washington, D.C., for the 2012 Annual Meeting and Seminars.



*Forty students from some of the country's leading universities and colleges attended the 2011 CPCU Society Annual Meeting and Seminars in Las Vegas. Participating students, in alphabetical order: Alexander Abbott, St. John's University; Scott Adams, Illinois State University; Masmoudath Anjorin, Morgan State University; Matt Baber, University of Southern Maine; Ashleigh Buchanan, University of North Texas; Cheng Cheng, University of Illinois; Tyler Cockrum, Missouri State University; Erin Connell, University of Colorado-Denver; Danielle Corde, Boston College; Walter Filmore, University of North Texas; Brendan Francis, Howard University; Dan Fuld, Illinois State University; Kaitlin Graf, St. John's University; Weijing "Lilia" He, University of Illinois at Urbana-Champaign; Jocelyn Horton, University of Colorado-Denver; James Howe, UNC Charlotte; Jonathon Jaeger, University of Iowa; Christopher Juntura, University of Southern Maine; Jennifer Medeiros, St. John's University; DeAndrai Mullen, Morgan State University; Jin Na, University of North Texas; Jacqueline Negrete, Southern Methodist University; Mason Novess, Olivet College; Christina Oda, University of Illinois; Kwesi Ofori-Atta, Georgia State University; Rachel Patterson, Appalachian State University; Linda Pollock, University of Southern Maine; Mary Rhodes, University of Louisiana at Lafayette; Ashley Rieger, Illinois State University; Benjamin Robbins, Appalachian State University; Sanae Russell, St. John's University; Catherine Sebolt, University of Iowa; Olena Shchukina, Georgia State University; Marcus Somerville, Georgia State University; Brigid Tarpey, University of Southern Maine; Ottonian "Toni" Tate, University of North Texas; Edward Van Strate, Olivet College; Erika Villavicencio, University of North Texas; Le'Yante Williams, Florida State University; and Dahao Zheng, University of Illinois at Urbana-Champaign.*

Being ever mindful of chapter interests, overall expense considerations, and complicated coordination efforts, we have amended the 2012 Student Program slightly:

- The Society will waive Annual Meeting and Seminars registration fees for twenty-four students. This will allow for greater, focused attention on each student. As in previous years, registrations will be taken in the order of contact with the Society’s Membership Resource Center. The first twenty-four qualifying students will receive the waiver. A waiting list will be available in the event of student

cancellations.

- Students must be juniors, seniors, or graduate students in risk management, insurance, or actuarial sciences programs to qualify for the Student Program. This helps focus our attention on students who have clearly chosen the insurance industry as their career path.
- All students must be individually recommended by their professor/adviser.
- Each participating university/college will be able to recommend up to two students.

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## 2011 Annual Meeting Student Program — 'Ongoing Success'!

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- Qualifying students who do not receive direct chapter sponsorship will receive "out-of-pocket" expense reimbursement based on chapter contributions to the 2012 Student Program.
- A chapter that is directly sponsoring a qualifying student for 2012 can reserve one spot among the twenty-four students within the program. This student must be named before Aug. 1, 2012, or the spot will be opened to the next student on the waiting list.

At the request of some chapter leaders, an option is available for students who would not otherwise qualify under the 2012 Student Program guidelines. A chapter can choose to fully sponsor (including any payment of full registration fees) a "nonqualifying" student (for example,

a business major). This student will be included in all Student Program activities and, if possible, will be paired with another student to help mitigate hotel expenses.

Once again, my sincere appreciation to all who contributed in so many ways to the success of our 2011 Student Program. Because ongoing success is fully expected again in 2012, please don't hesitate to contact me (lamontboyd@fico.com) with any thoughts you may have or assistance you're willing to offer to help us attract bright, young minds to the insurance industry and the CPCU Society! ■

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