



The Rating Agency Working Group

On the Voluntary Business Preparedness Accreditation and Certification Program

Hosted by:
International Center for Enterprise Preparedness (InterCEP)
New York University

Initial Meeting
March 27, 2008

DRAFT SUMMARY PROCEEDINGS

(6/13/08 Version)

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EXECUTIVE SUMMARY

On March 27, 2008 a diverse group of private sector representatives and other stakeholders convened in an initial online forum of the Rating Agency Working Group to discuss rating agency issues pertaining to the voluntary business preparedness accreditation and certification program currently under development pursuant to US federal legislation.

The discussion focused on the following key issues:

- **In recent years, the major ratings agencies have become increasingly focused on business risks in general.**
- **Recently, Standard & Poor's (S&P) has begun to explore the possibility of incorporating enterprise risk management (ERM) into its ratings processes for all companies.**
- **ERM is a broad framework for managing risk, and the voluntary certification program focuses on core elements of operational risk - business continuity and emergency preparedness,**
- **The voluntary business preparedness certification program could provide valuable input to support rating agency analysis of key qualitative aspects of managing operational risk.**
- **From a rating agency perspective, it will be important for any assessment process to use consensus-based standards/metrics and a common assessment methodology that can be audited by others.**
- **There is precedent for using a third-party certification as input to ratings analysis.**
- **Many firms are already motivated by operational, regulatory and competitive pressures to undertake business preparedness programs, and for them certification of their efforts could allow for acknowledgement / crediting of these efforts in the ratings process..**
- **It will also be important for the certification program to incorporate and acknowledge existing sector-specific best practices as well as reporting requirements.**

ABOUT THE INTERNATIONAL CENTER FOR ENTERPRISE PREPAREDNESS (InterCEP)

- InterCEP is the world's first academic research center dedicated to private sector preparedness & resilience.
- The Alfred P. Sloan Foundation funds InterCEP's research on incentives for business preparedness in the following areas:
 - Insurance, rating agency, mitigating legal liability, supply chain, corporate governance.
- InterCEP's research focuses on linking the "what" and the "why" of preparedness and resilience:
 - "What" should be done in terms of preparedness is often most effectively reflected in preparedness standards and best practices.
 - "Why" preparedness efforts should be undertaken by business generally includes both internal economic impacts of preparedness as well as external incentives.
 - Linkage of the "what" and "why" of preparedness often requires measurement or assessment to determine if the "what" to do of preparedness has been accomplished so that the "why" to do it can be achieved or rewarded.

MEETING AGENDA

- 11:00 – 11:10: Overview of New Law: "The Implementing Recommendations of the 9/11 Commission Act of 2007" (Public Law 110-53 – Title IX, Section 524)
- 11:10 – 11:20: Focusing on the rating agency perspective: Key questions
- 11:20 – 12:00: Open, facilitated discussion
- 12:00 – 12:30: Defining the Working Group agenda, including: possible next steps, activities, recommendations, etc.

GROUND RULES

- Participants may contribute directly to the conversation but should be recognized by the moderator first.
- Conference call will be recorded.
- All comments are not-for-attribution.
- Those not participating verbally, please forward your questions and comments throughout the discussion via Question & Answer Function.
- For post-forum comments, please email to intercep@nyu.edu.

OVERVIEW OF NEW LAW

"The Implementing Recommendations of the 9/11 Commission Act of 2007" (Public Law 110-534) was signed into law on August 3, 2007. Title IX Section 524 of the law calls for the creation of a voluntary business preparedness accreditation and certification program. The legislation stipulates that the program should:

- Provide a method to independently certify the emergency preparedness of private sector organizations, including disaster/emergency management and business continuity programs;
- Be administered outside of government by third party organizations with experience / expertise in managing and implementing voluntary accreditation and certification programs;
- Be voluntary;

- Designate one or more preparedness standards. NFPA 1600 is referenced as an example;
- Integrate/recognize where appropriate existing industry efforts, standards, practices and reporting in this area;
- Give special consideration to small businesses; and
- Protect proprietary and confidential information of companies.

U.S. DEPARTMENT OF HOMELAND SECURITY'S RESPONSIBILITIES

The legislation also assigns the following specific responsibilities to the U.S. Department of Homeland Security (DHS):

- Designate one or more organizations to act as the accrediting body to develop and oversee the certification process, and to accredit qualified third parties to carry out the certification program;
- Separately designate one or more standards for assessing private sector preparedness;
- Provide information and promote the business case for voluntary compliance with preparedness standards; and
- Monitor the effectiveness of program on an ongoing basis.

CURRENT STATUS

As of March 27, 2008, the current status of the certification program development process (to the best of InterCEP's knowledge) reflects the following:

- A 'Framework for Voluntary Preparedness' encompassing multiple preparedness standards and other guidance has been developed by key organizations (RIMS, DRII, ASIS, NFPA) with the support of the Alfred P. Sloan Foundation.¹ This document argues for flexibility within a framework in terms of certification activity potentially including the recognition of multiple preparedness standards/guidance by the program.
- DHS is preparing to report soon to Congress on a plan for program development.
- A potential accreditation body has been identified and notification published. That body is ANAB which has substantial experience in administering the private sector driven and voluntary certification efforts in quality management and environmental management.
- One or more preparedness standards are still to be designated by DHS.
- Outreach to the private sector for input is in process by DHS and includes a National Stakeholder Forum sponsored by the Sloan Foundation and hosted by InterCEP in December 2007.

THE WORKING GROUPS INITIATIVE

The objectives of InterCEP's initiative to organize Working Groups focused on the voluntary business preparedness accreditation and certification program are as follows:

- To identify existing practices and principles in specific topical areas relevant to private sector preparedness;
- In view of these practices and principles, to identify issues, opportunities and potential strategies relevant to the design and implementation of the voluntary business preparedness certification program that would promote effectiveness and business value of the program; and,

¹ Cf. "Framework for Voluntary Preparedness – Briefing Regarding Private Sector Approaches to H.R. 1 and public Law 110-53 'Implementing Recommendations of the 9/11 Commission Act of 2007' Title IX" prepared by representatives of ASIS International, DRII, NFPA, and RIMS. Available at www.sloan.org

- To gather these outputs generated by Working Group participants and communicate them to program stakeholders including where appropriate DHS, accrediting and certifying bodies.
- To place emphasis on five areas of incentives that, according to InterCEP's ongoing research, could provide economic value to businesses that undertake certification, including: supply chain management, legal liability mitigation, rating agency acknowledgement, insurance and existing business reporting.

THE RATING AGENCY PERSPECTIVE

InterCEP's ongoing research on incentives for business preparedness has indicated that businesses operate in an increasingly uncertain global environment with growing operational risks from a diversity of sources ranging from technology failures and supply chain interruptions to natural disasters and pandemics. A business' capacity to manage these risks has become an increasingly important component of its financial condition. InterCEP has for several years advanced the notion that in the interest of enabling more informed financial decisions by both investors and creditors, rating agencies should acknowledge corporate preparedness in the rating process.²

With regard to the potential significance for rating agencies of the voluntary business certification program, discussion among participants in the initial meeting of the Rating Agency Working Group is framed by the following key questions:

- How do rating agencies currently acknowledge preparedness activities by corporations that they rate?
- How does the recent decision by Standard & Poor's (S&P) to consider including enterprise risk management (ERM) in the ratings process for nonfinancial firms potentially change the landscape?
- How should the preparedness certification program be designed and implemented in order to provide ratings analysts with relevant information on business preparedness?

DISCUSSION

InterCEP has identified general themes touched on during the Working Group discussion. In this summary, these themes are briefly articulated, and then specific issues relevant to each theme are presented. Comments by participants have not been independently confirmed by InterCEP.

- **In recent years, the major ratings agencies have become increasingly focused on business risks in general.**
 - For example, Moody's has developed a specialized risk management practice which cuts across industry sectors. Moody's analyzes risk in terms of four distinct pillars: market risk, credit risk, liquidity risk, and operational risk. Business continuity and contingency planning are part of that operational risk pillar. They also differentiate specific risk types in terms of frequency and severity, so for example they would look at high frequency low severity events, as well as low frequency high severity events. Moody's analysts also focus on geographic concentration or business line concentration to determine the extent to which those risk types can impact business.
- **Recently, Standard & Poor's (S&P) has begun to explore the possibility of incorporating enterprise risk management (ERM) into its ratings processes for all companies.**
 - Historically, S&P has included analysis of ERM in their rating of financial firms, and to a limited extent with utilities and agribusiness companies. Recently they issued a Request

² Cf. www.nyu.edu/intercep/research/pubs/Crediting%20Preparedness%208.2.06.pdf

- for Comment regarding the potential of including consideration of enterprise risk management (ERM) in the rating of nonfinancial companies.
- S&P's explicitly stated assumption is that a firm's future ability to meet financial obligations is enhanced by strong ERM. In other words, a company is less likely to default on debt if it has a strong ERM practice.
 - S&P's stated interest in evaluating ERM in the ratings process is to implement steps that will limit the frequency and severity of losses associated with operational risk management.
 - The time period for offering comment in response to the Request for Comment has now passed, and presumably the analysts at S&P are evaluating the feedback currently in preparation for a decision about whether, and if so how to change the ratings process to focus on ERM.³
- **ERM is a broad framework for managing risk, and the voluntary certification program focuses on core elements of operational risk - business continuity and emergency preparedness,**
 - While ERM provides an all-inclusive, enterprise-wide perspective on risk, the focus of the voluntary certification program is on emergency management and business continuity. These disciplines are a subset of ERM, but a subset that figures importantly into any operational risk management process.
 - **The voluntary business preparedness certification program could provide valuable input to support rating agency analysis of qualitative aspects of managing operational risk.**
 - Effective preparedness programs include a range of qualitative factors, including planning, management, communication, exercises, etc. Because ratings analysts have focused historically on quantitative information (e.g., from financial reporting), as they turn to focus on ERM, they may need to develop and expand existing methodologies to assess the various qualitative aspects of business management. In this regard, the certification program may provide analysts with a way to approach certain qualitative aspects of effective preparedness management.
 - A related issue is the fact that assessing a preparedness program can involve extensive, on-site evaluation and analysis, and the rating agencies are not typically staffed to send team of auditors out to companies to conduct on-site assessments of physical facilities and management processes. However, since the preparedness certification program would include the opportunity for an independent third party audit, the certification could provide ratings analysts with a way to acknowledge business preparedness programs.
 - **From a rating agency perspective, it will be important for any assessment process to use consensus-based standards/metrics and a common assessment methodology that can be audited by others.**
 - As noted above, ANAB appears likely to be the accrediting body for this program. This organization works with international standards that govern how audits should be conducted by certification bodies. These standards cover issues including documentation, tracking, measurement, etc. Thus the certification program will likely employ process standards that assure that assessments be audited.
 - One participant also suggested that the rating agencies may be waiting to see what preparedness standards are identified for the certification program so that they can then take guidance for what might be addressed by the rating analysts.
 - **There is precedent for using a third-party certification as input to ratings analysis.**
 - The Insurance Marketplace Standards Association (IMSA) is a market conduct and compliance organization serving the life insurance marketplace. IMSA qualification is

³ (Note: S&P announced on May 7, 2008 that it will be proceeding with inclusion of ERM in all corporate ratings analysis.)

conferred upon life insurance companies that meet IMSA standards, and one participant noted that this qualification is taken into consideration by analysts as one component of the ratings process.

- If a company has obtained that certification, it serves them well in the ratings process. By contrast, if that certification is lost, it may not be an automatic trigger for the rating to go down, but it triggers additional follow-up questions for the analyst in the ratings process.
- **Many firms are already motivated by regulatory and competitive pressures to undertake preparedness, and for them certification of their efforts could facilitate receiving credit for their efforts as well as other benefits..**
 - For example, financial services firms regulated by the Federal Financial Institution Examination Council (FFIEC) are required already to attempt to evaluate the emergency preparedness capability of vendors that provide critical support services. This is necessary since these financial services firms are required by regulation to resume their operations after a crisis within certain time periods and in order to do so they require the provision of supplies and services from these critical suppliers.
 - Other firms in supply chains outside of financial services also find themselves responding to client demands for proof of certain levels of business continuity when the supplier is critical to the operations of the customer.
 - One participant suggested that once the certification program moves forward and companies start to become certified, there will be an enormous pressure for companies to be certified. Companies that can say they are certified will be at a competitive advantage, whereas those who cannot claim certification will be at competitive disadvantage.
 - Another participant acknowledged that getting nonfinancial institutions to embrace preparedness is very difficult, but suggested that rating agencies may be a very important motivator. For example, if S&P's begins asking companies, "Are you certified?" then a great number of companies will begin to consider the value of preparedness in a new light.
- **It will also be important for the certification program to incorporate and acknowledge existing sector-specific best practices as well as reporting requirements.**
 - For example, in the area of health care, The Joint Commission on the Accreditation of Healthcare Organizations (JCAHO) sets standards for healthcare organizations and issues accreditation to organizations that meet those standards. JCAHO conducts periodic on-site surveys to verify that accredited organizations comply with Joint Commission standards. JCAHO recently added six points to its certification standard that specifically addresses business continuity and disaster recovery programming as part of the certification process.
 - Other examples cited by participants include the FFIEC reporting requirement for the financial services industry and the various standards and guidelines that apply to organizations that handle hazardous materials.
 - Participants affirmed the notion that wherever these existing, sector-specific reporting requirements include elements of emergency preparedness and business continuity, those elements should be accounted for within the new certification program.
- **Additional players who should be involved in the Rating Agency Working Group include:**
 - Representatives from major rating agencies (S&P's, Moody's, A.M. Best, etc.).
 - Corporate leaders (e.g., CFO's) who interface directly with the rating agency analysts.
 - People who have been involved with the JCAHO effort (e.g., James Paturas, Yale New Haven).

INTERCEP'S ACTIVITIES

InterCEP is committed to supporting the Rating Agency Working Group by undertaking the following activities:

- Produce high-level summary proceedings of Working Group meetings, to be drafted by InterCEP, then vetted with participants, and finally distributed for stakeholder consideration;
- Develop greater awareness within the general business community of the voluntary business preparedness certification program;
- Produce research output that presents knowledge generated by the working group relevant to the design and implementation of the voluntary business preparedness accreditation and certification program;
- Develop an online clearinghouse of documentation relevant to the voluntary business preparedness accreditation and certification program.

SETTING THE WORKING GROUP AGENDA MOVING FORWARD

Next steps possibly to be undertaken by InterCEP with the support and involvement of members of the Rating Agency Working Group include:

- In the context of S&P's increased emphasis on ERM, work with business continuity professionals in conjunction with their CFO's to clarify how business continuity and emergency preparedness efforts can be presented in the ratings analysis process as evidence of proactive management posture toward ERM.
- Identify specific issues for consideration in the development and ongoing operation of the Voluntary Private Sector Preparedness Certification Program including how it might best be structured and operated to be of value to rating analysts.
- Revise and update InterCEP's white paper "Crediting Preparedness"⁴ to reflect recent changes in rating agency practice as well as more recent data supporting the business case for preparedness.
- Continue to advance discussions with other rating agencies (e.g., Moody's, Fitch's, A.M. Best, etc.) regarding the inclusion of business continuity, emergency preparedness and operational risk management in the rating analysis process.

With respect to each of these possible next steps, InterCEP seeks feedback and indications of interest from Working Group participants and readers of this document in response to the following questions:

- Do you think these next steps would have value?
- Do you have any information relevant to these next steps?
- Would you like to get involved and help craft these next steps?

In general, InterCEP is committed to shaping an agenda for the Working Group, including additional next steps and other action items, based on the feedback gathered from participants in response to these additional questions:

- Who else should be at this table?
- In what forums should this discussion be taking place?
- Who/what are the most relevant individuals, job titles, organizations, associations, etc.?

⁴ Cf.. www.nyu.edu/intercep/research/pubs/Crediting%20Preparedness%208.2.06.pdf

- What concrete next steps can be taken to acknowledge, integrate, and credit existing efforts?
- Additional next steps – what are we missing?
- What meeting formats are most appropriate to maximize participation and productivity?
- How regularly should Working Group meetings be scheduled?

InterCEP encourages readers of this document and other stakeholders to contact us on an ongoing basis with questions, comments and suggestions regarding the Working Group agenda, as well as in reference to the broader process of developing and implementing the certification program. InterCEP's efforts to support this process are undertaken independent of any government agency or accrediting body with the financial support of the Alfred P. Sloan Foundation.

International Center for Enterprise Preparedness, New York University (NYU)
113 University Place, 9th Floor, New York, NY 10003
+ 1-212-998-2000 (t) + 1-212-995-4614 (f)