Enterprise Risk Management Seminar

Capturing the Upside

19 November 2014 • Hilton Sydney

Actuaries Institute

Risk Appetite

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Today's Outline

1. Working Party Papers
2. Risk Appetite Framework
3. Risk Tolerances and Risk Limits
4. The Risk Appetite Statement
5. Challenges

Working Party Papers

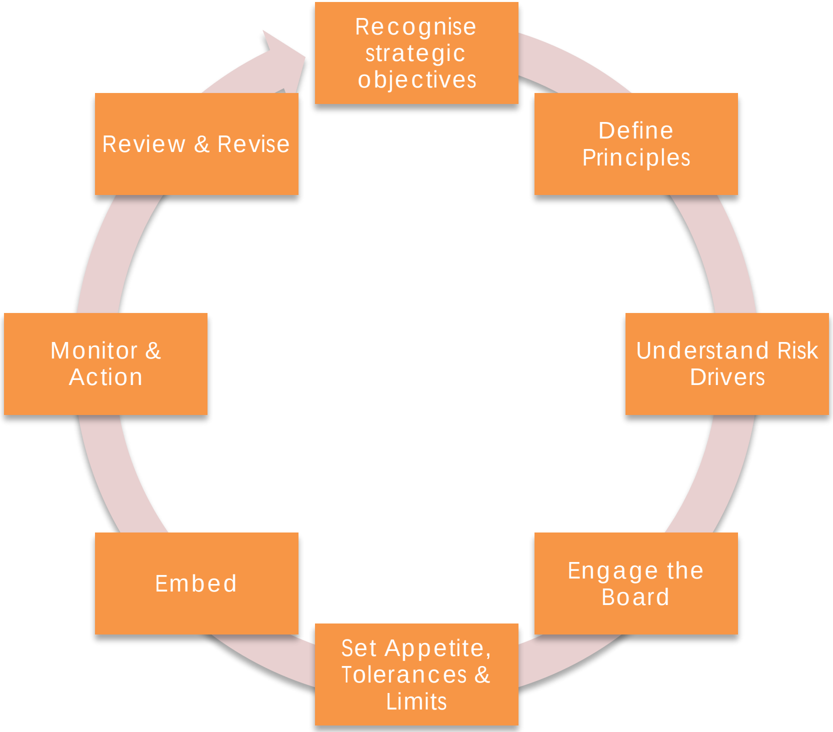
1. Risk Appetite Framework (including definitions)
2. Risks facing Life and General Insurers
3. Risk Appetite Statement
4. Risk Tolerances and Risk Limits
5. Process for setting the Framework
6. Calculation Methodologies
7. Risk Management

Risk Appetite Framework – what is it?

The framework describes the overall approach through which risk appetite is established, communicated and monitored.

RAS	Roles & Responsibilities	Tolerances & Limits
Monitoring	Embedding	Governance Framework

Setting the Framework



Linking Risk Appetite Concepts

Risk Capacity ↓	The maximum level of and type of risk an organisation is able to support before breaching constraints determined by regulatory capital and liquidity needs and its obligations to customers, shareholders and other stakeholders.
Risk Appetite ↓	The aggregate level and types of risk that an organisation is willing to accept, or to avoid, in order to achieve its business objectives.
Risk Tolerances ↓	The quantitative measures and the qualitative assertions for the maximum risk allowed by the risk appetite. Risk tolerances are generally set at the enterprise level.
Risk Limits	The restrictions prescribed by an institution on the business activities designed to constrain overall risk taking within the Risk Tolerances.
Risk Profile	A point in time assessment of risk exposures, expressed in relation to Risk Limits, Risk Tolerances and Risk Capacity.

Risk Tolerances and Risk Limits – what’s the difference?

- Risk Tolerances can be viewed as constraints on business *outputs.*
- Risk Limits can be viewed as constraints on business *inputs.*
- Effectively applied, Risk Limits are the manner in which Management gives effect to the Board’s Risk Appetite and associated Risk Tolerances.

Attributes and examples of Risk Tolerances

Component of Tolerance	*Examples*
Identification and definition of the set of strategic outcome or exposure variables upon which risk will be expressed	Profit, solvency, value, liquidity, reputation, individual risk silos
What the planned outcome is	EBITDA growth of 8%, Solvency ratio of 150%
What the tolerated outcome is	EBITDA growth of 0%, Solvency ratio of 120%
An expression of the frequency of the tolerated outcome	5%, or 1 in 10 years

Attributes of Risk Limits

Attribute of Risk Limit	
Must be measurable	If a risk owner can't tell if they are within a limit they can't take remedial action.
Quantitative Limits are preferable	We recognise that some Limits may not be amenable to quantification.
Should be sufficiently binding as to potentially restrict the business	A speed limit that cannot be reached doesn't help a risk owner in conducting business but may impose a reporting burden. They also lead to a blasé attitude to the risk function.
Should be unambiguous	Discussion should be about what the limits should be, not whether they were breached or not.
Expressed in the language of the business	The limits will be discussed and agreed with the risk owners. It is important that they be expressed in terms risk owners and the business can understand, measure and report on.

The Risk Appetite Statement (RAS)

1. **The RAS should, at the very least, articulate in writing the Board's willingness to accept risk in the pursuit of its corporate objectives.**
2. **A Board-approved RAS should exist at least at each of the following levels:**
   1. at the enterprise level; and
   2. for each material risk type.
3. **Enterprise-level risks that may be considered are:**
   1. Achievement of target performance;
   2. Preservation of capital;
   3. Maintenance of liquidity; and
   4. Protection of franchise value.
4. **Material risks may include:**
   1. Insurance risk (Life);
   2. Asset risk;
   3. Reserving Risk(GI);
   4. Operational Risk.

Challenges

1. Linking the risk appetite conversation to the strategic / objectives conversation

2. Cascading broad appetite into operational limits

3. Confusing tolerances and limits