



Capturing Risk Appetite Through ERM - Implementation Challenges

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Risk Appetite Concepts

Defining Risk Tolerance, Risk Appetite, Framework, Statement

- ❑ **Risk Tolerance** is the maximum level and type of risks at which a firm can operate and remain within constraints of capital as well as obligations to stakeholders.

Source: Senior Supervisors Group, December 23, 2010

- ❑ **Risk Appetite** is the level and type of risk a firm is able to assume in its exposures and business activities, given its business objectives and obligations to stakeholders.

Source: Senior Supervisors Group, December 23, 2010

- ❑ **Risk Appetite Framework** is the outline for constructing a Risk Appetite Statement .

- ❑ **Risk Appetite Statement** expresses an organization's Risk Appetite.

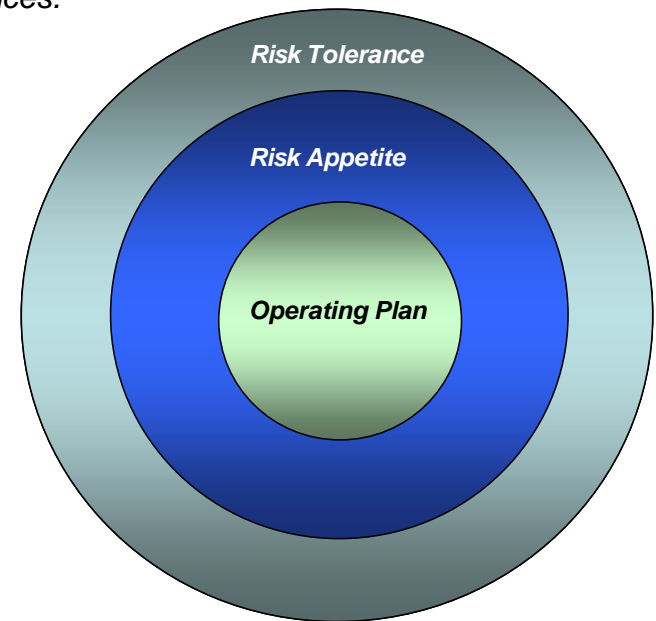
Operating within Risk Appetite

- ❑ The Statement of Risk Tolerance sets the limits or “risk capacity” that an corporation is willing to accept via its businesses and asset profile.
 - *Targeted Senior Debt Rating*
 - *“Well Capitalized” from a regulatory perspective in all circumstances.*

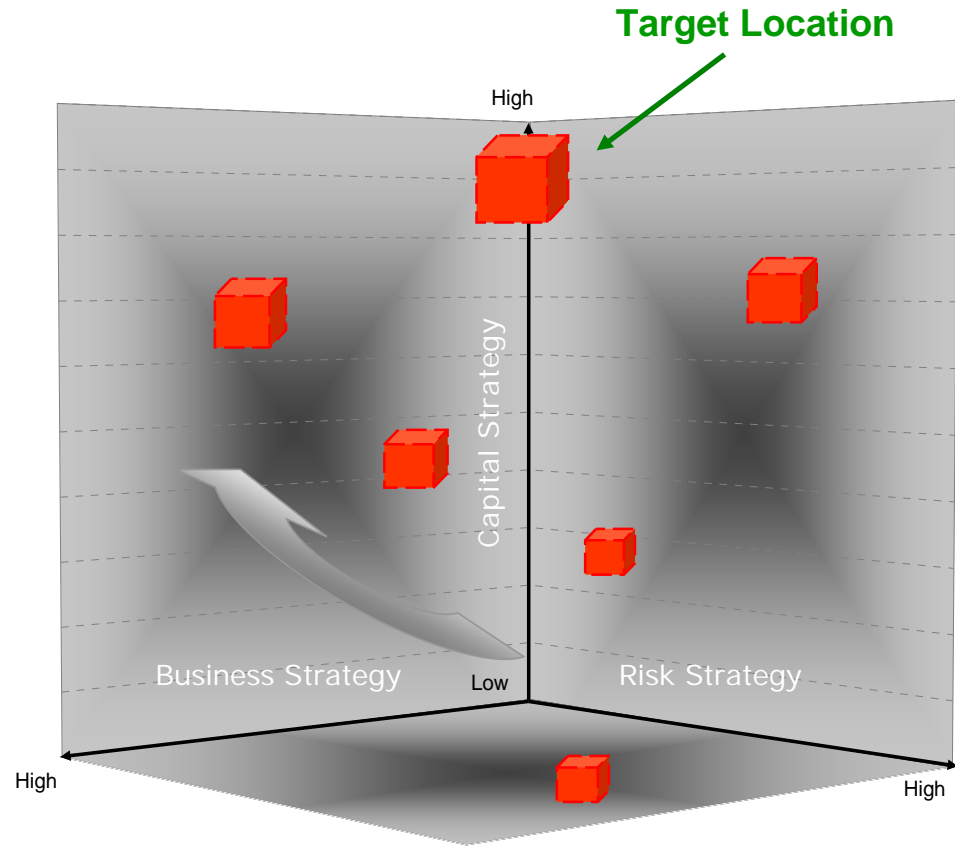
- ❑ Risk Appetite profile falls within the bounds of Risk Tolerance.

- ❑ The organization is asked to build its operating plan in the context of Risk Appetite.

- ❑ Risk Appetite is expressed via a set of qualitative and quantitative measures and is documented in a Risk Appetite Statement. The Statement guides the organization in developing its plan within the established Risk Appetite.

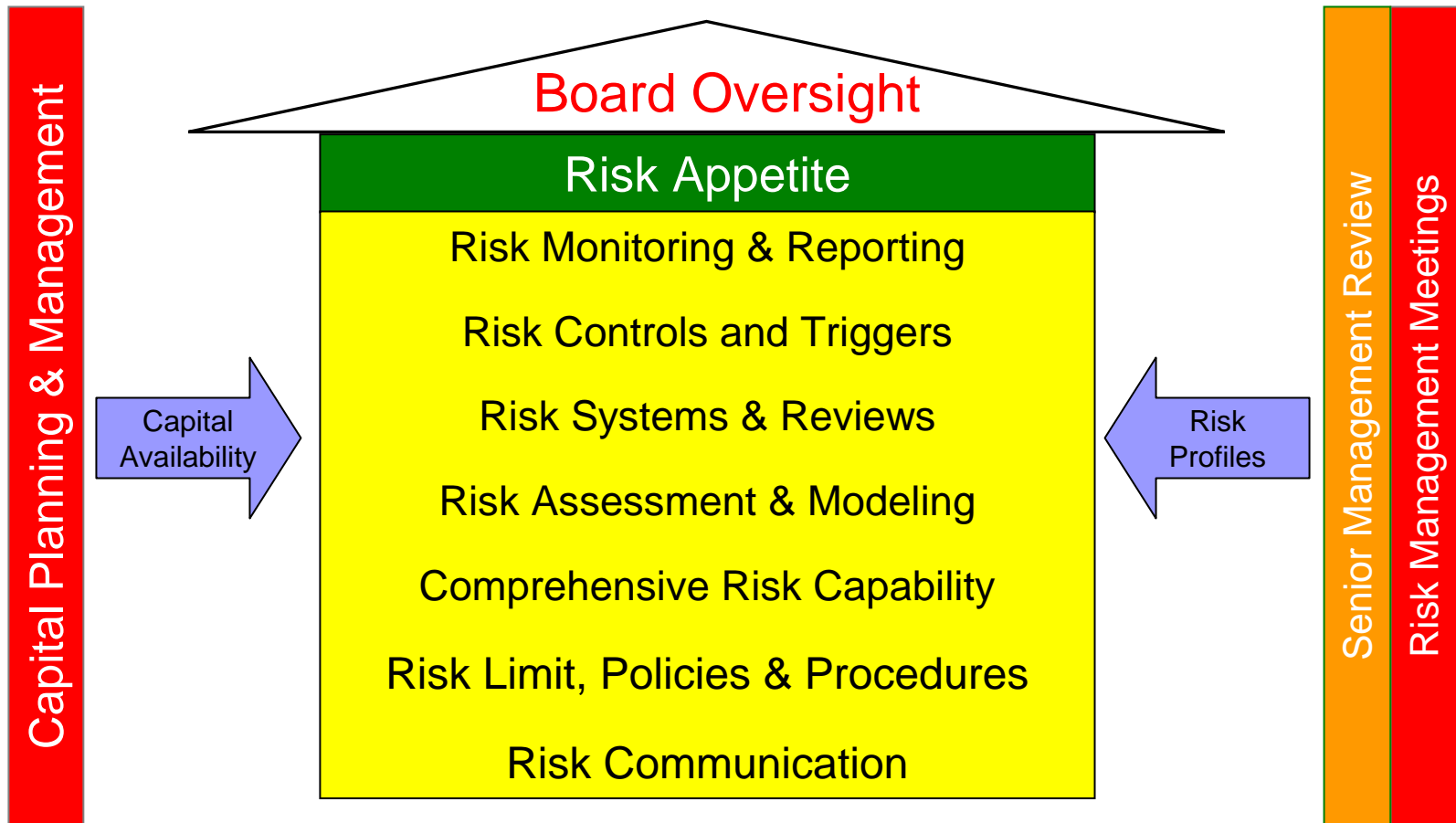


Aligning Business Strategy, Capital Strategy, Risk Strategy under ERM



Business Strategy, Finance and Risk Management Functions should be working in sync for ERM to succeed

Risk Appetite within ERM





Risk Appetite In Practice

Developing Risk Appetite Framework – Risk Return Objectives

□ **Determining Risk Objective:**

- Specify risk measures (such as target debt ratings and earnings volatility) and state objective relative to the risk measures
- Synthesize the Willingness and Ability to take risk
 - Willingness > Ability, then risk taking is constrained by ability
 - Willingness < Ability, then risk taking is constrained by Willingness and value creation will be diminished

□ **Determining Return Objectives**

- Specify a return measures (such as ROE or RAROC) and state objective relative to the return measures.
- Determine the required rate of return
- Evaluate business mix to achieve the required rate of return

□ **Board determines the target Risk-Return Trade-off**

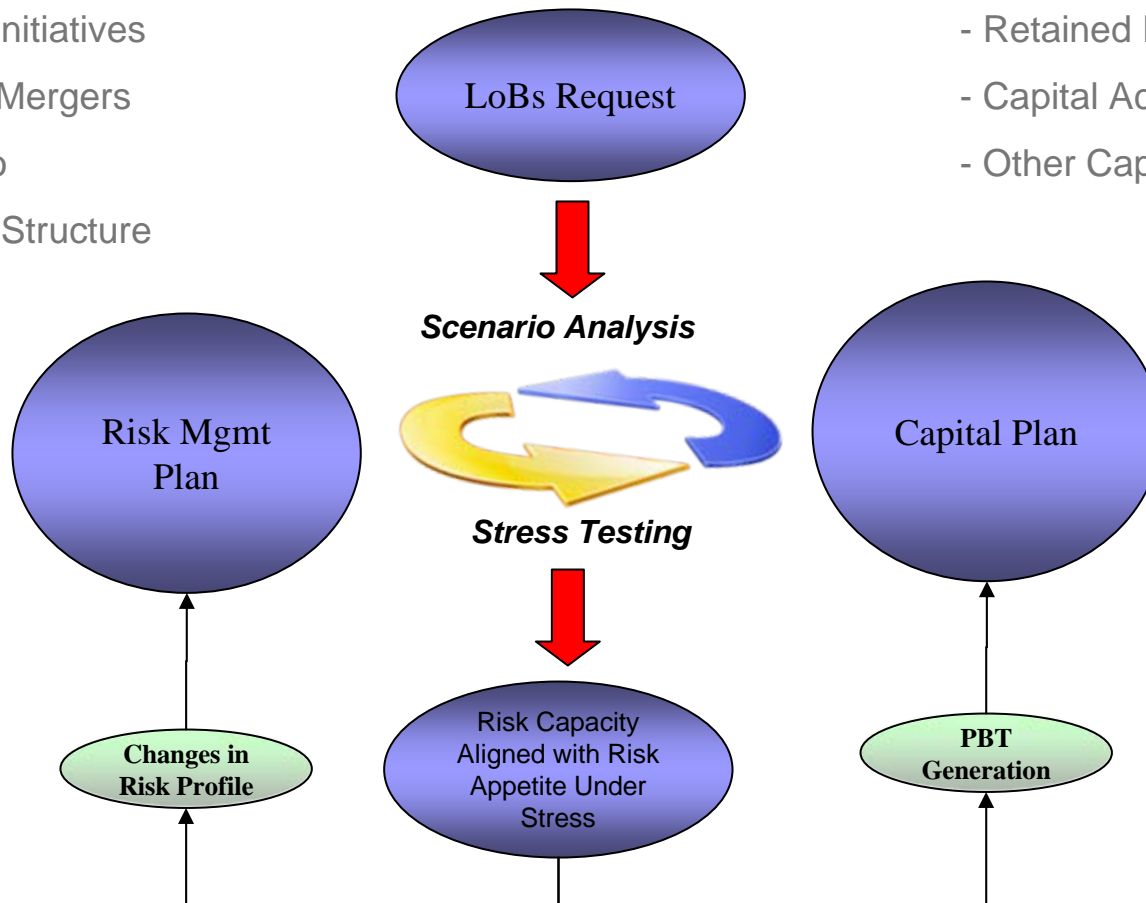
Risk Appetite and Capital Management Process

Change in Risk Profile

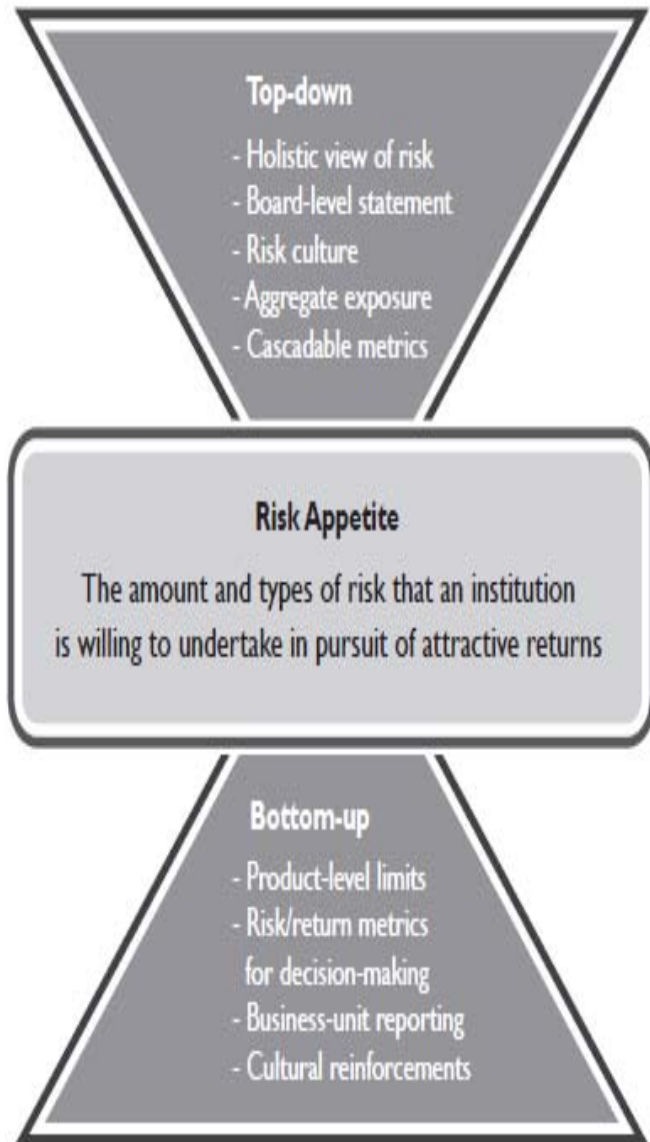
- New business initiatives
- Acquisitions & Mergers
- Runoff Portfolio
- Compensation Structure

Change in Capital Supply

- Retained Earnings
- Capital Accretive Transactions
- Other Capital Sources



Risk Appetite: Bottom Up and Top Down Approach



- ❑ Setting a strong Risk Appetite Framework starts with the Board's endorsement. High level statement of Business Strategy and expectations of risk appetite is articulated from top down.
- ❑ Senior Management and business line managers work towards operationalizing board's risk appetite expectations.
- ❑ Business Strategy, Capital Strategy, and Risk Strategy work within the RAF to determine Risk Capacity and Risk Appetite

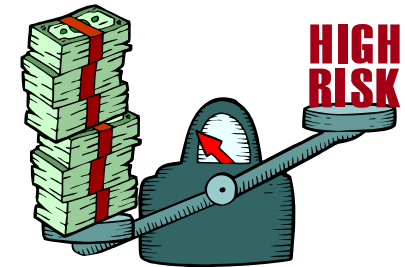
Reconciling Request vs Capacity Hand to Hand Combat

- ❑ Refine based on discussion and recommendations from Risk Management Meetings.
- ❑ LoBs prepare plans and request capacity using the high level risk appetite guidance.

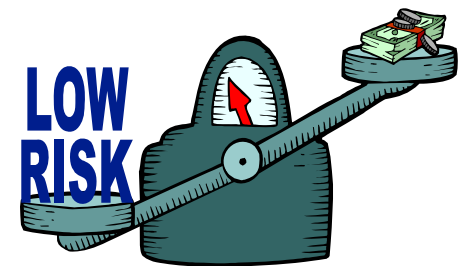
Expressing Risk Appetite

Risk Appetite embodies everything an ERM functions wants to achieve. It spans the entire organization from impacting days to day risk management functions to molding the overall risk profile.

Earnings & Share Price	Economic Profit
	Return on Equity
	Earnings Volatility
	Share Price Volatility
	Profit Growth
Capital & Liquidity	Capital & Leverage Ratios
	Liquidity & Funding
	Securitization
	Risk Benchmarks for Capitalization
	Regulatory Capital > Economic Capital
Impairments and EL	Maximum LIC %
	Expected Loss
Segmentation	PBT, EC & EP, Targets by Region and Customer Group
Strategic Investments	Maximum market value of investments
Stress Testing	Capital Ratios Under Different Scenarios
Risk Categories	Credit Risk
	Market Risk
	Interest Rate Risk in the Banking Book
	Pension Risk
	Operational Risk
	Business Risk
	Reputational Risk
	Sustainability Risk
Diversification	



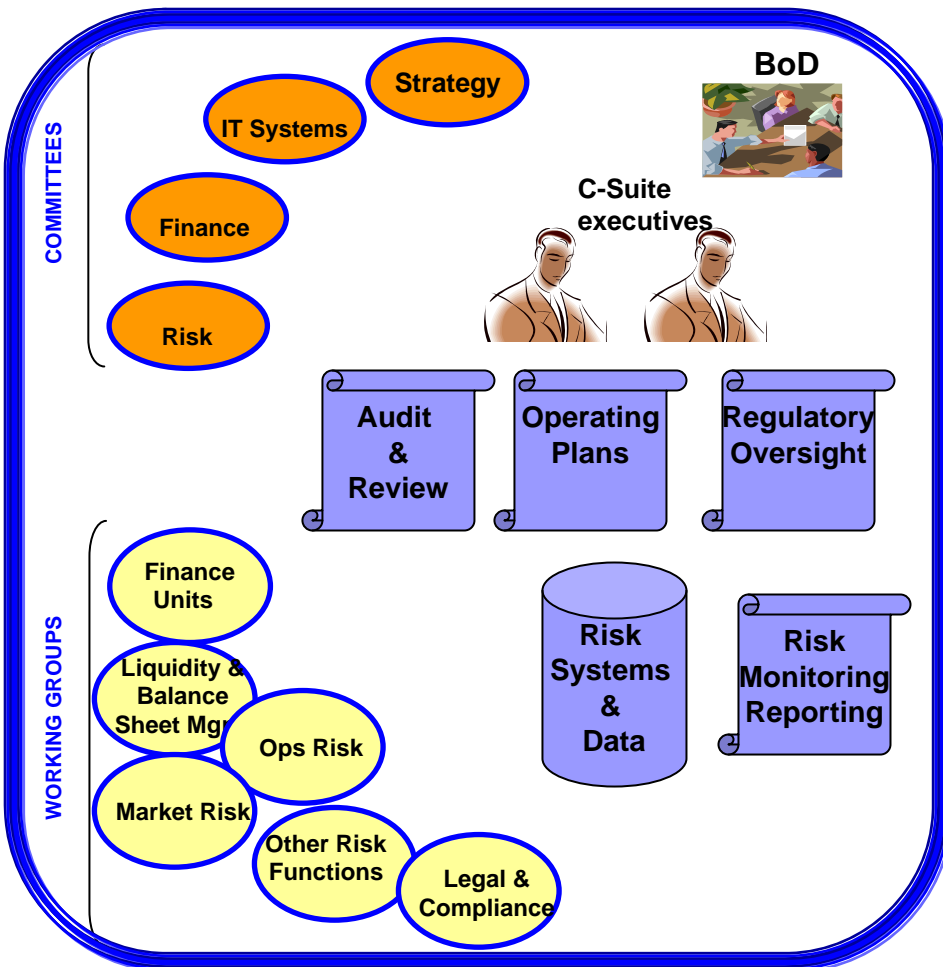
Risk Appetite a
Balancing Act





Risk Appetite Implementation Challenges

Challenge: Communication and Coordination



- Wide and deep level of engagement with diverse group of Stakeholders.
- Getting everyone to agree is a frustrating process.
- Strong communication and coordination with clear articulation of risk appetite

Challenge: Advanced Risk Infrastructure

Key to managing risk, within the stated risk appetite, is risk information

Heavy investment in technology and risk talent is needed to identify, measure, and manage all risk types. Sponsorship from the Board and C-Suite executives is a must for establishing sound risk MIS.

- ❑ Risk Appetite Framework is most successful when performance measures and metrics are readily available and actionable. The need for a comprehensive risk data infrastructure cannot be understated.
- ❑ Increasingly complex regulatory environment with emphasis on qualitative and quantitative risk appetite measures and metrics puts a premium on collection, aggregation, and reporting of accurate and timely risk data.
- ❑ Lack of information flow among internal stakeholders constraints management actions in shaping risk appetite. Advanced risk MIS allows Board and management to be proactive in addressing risk appetite.
- ❑ Speed, accuracy, reliability, and flexibility of the Risk Appetite Framework would be critical in sizing anticipated and unanticipated opportunities. Hence, risk data/report automation would be paramount.

Challenge: Is it Embedded in Your Risk Culture?

RAF is well understood



RAF is not a common currency

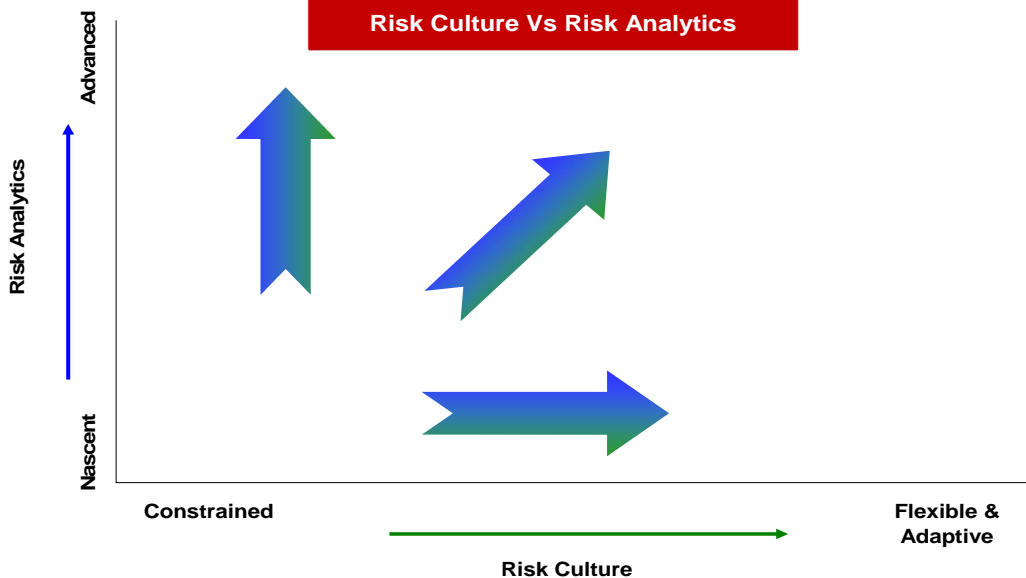


Vs

"is neither wholly bestowed, nor wholly acquired, but cultivated."



Risk Culture Vs Risk Analytics



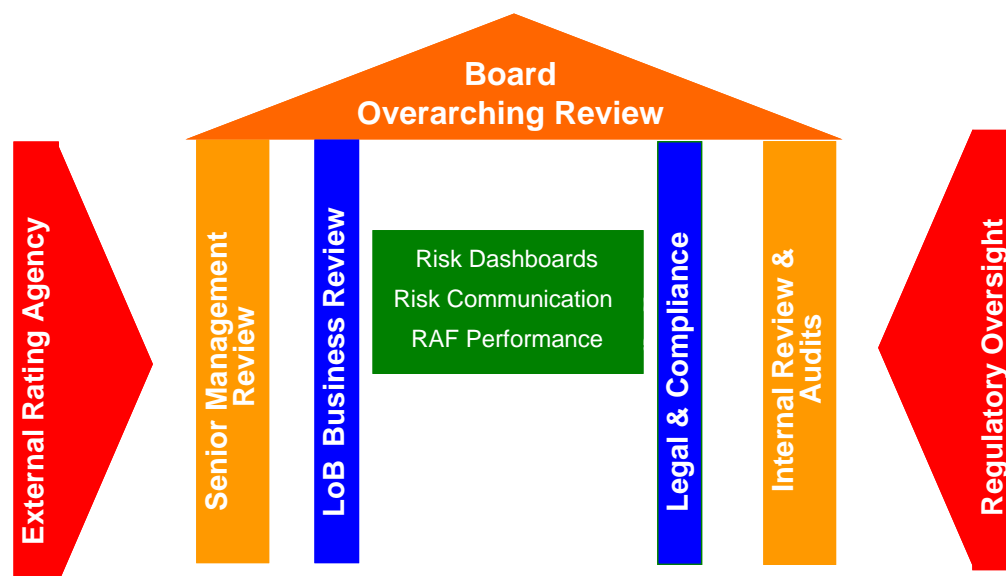
Action Plan

- ❑ *Clear and concise risk appetite expectation from top down*
- ❑ *Training and compensation incentives that promote RAF*

Challenge: Proactive Risk Appetite Governance

The Board has overarching governance and review capacity and should lead in embedding risk appetite within the organization. As RAF gets stronger and broader, every business manager will have a stake in ensuring that the framework performs along expected lines.

- ❑ Establish clearly defined roles and responsibilities of key stakeholders which is critical to the success of implementing the RAF while ensuring transparency and accountability around actions.
- ❑ Mandate regular reviews and audits on the adherence of risk appetite framework as articulated by the board and senior management.
- ❑ Develop internal governance structure on risk appetite MIS on its accuracy and consistency.
- ❑ Conduct independent review of managerial decisions taken based on the risk appetite measures to complete the feedback loop.



Thank You

If you have any further questions, please reach us at

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