

# Risk Appetite

How to use the concept in practice in Solvency II  
world

IRM Solvency II SIG 30<sup>th</sup> June 2010

## Introduction

- Peter Johnson, Risk Manager
- The Medical and Dental Defence Union of Scotland (MDDUS), mutual indemnity association
- The MDDUS is not an insurance company, benefits of membership are discretionary
- Formed 1902, 50% membership in England
- Not regulated but we seek the highest standards of corporate governance
- Risk appetite experience in the Public Sector

## Objective

- To provide a practical approach to the classification and application of risk appetite within the public sector
- To review where this approach may have gone wrong in the Student Loans Company (SLC)
- To consider the lessons to be learned

## Definition of Risk Appetite

- Risk appetite defines the amount of risk an insurer is willing to accept to achieve its business objectives
- Classifications of risk appetite – averse, minimalist, cautious, open and hungry

## Solvency II – Risk Appetite framework

- Adopt an integrated approach to risk and capital management
- The Board sets the risk appetite and cascade it down
- Management is responsible for ensuring the firm operates within the agreed appetite
- Embed risk appetite within the organisation to meet regulatory requirements

## Benefits of articulating risk appetite

- Prioritise risk management action by focusing response planning, monitoring and control activities on risk activities that cause the most harm
- Improve resource allocation to take advantages of beneficial changes in the insurance market
- Improve decision making

## 5 step process

- Step 1: Articulate risk appetite classification
- Step 2: Agree risk categories
- Step 3: Map risk categories to risk appetite classification
- Step 4: Map risks to risk categories
- Step 5: Reassess the risk

# Step 1 – Risk appetite classification

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High	M	H	H
	Med/High	M	H	H
	Med	L	M	M
	Med/Low	L	L	M
	Low	L	L	M

# Risk Appetite - Averse

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High	H	H	H
	Med/High	M	H	H
	Med	M	H	H
	Med/Low	M	M	M
	Low	L	M	M

# Risk Appetite - Minimalist

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High	M	H	H
	Med/High	M	H	H
	Med	M	H	H
	Med/Low	L	M	M
	Low	L	L	M

# Risk Appetite - Cautious

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High	M	H	H
	Med/High	M	H	H
	Med	L	M	H
	Med/Low	L	L	M
	Low	L	L	M

# Risk Appetite - Open

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High	M	H	H
	Med/High	L	H	H
	Med	L	L	M
	Med/Low	L	L	M
	Low	L	L	L

# Risk Appetite - Hungry

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High	L	H	H
	Med/High	L	L	H
	Med	L	L	M
	Med/Low	L	L	L
	Low	L	L	L

## Step 2 – Agree risk categories

- Operational (Business to Business)
- Operational (Business to Customer)
- Technological
- Political
- Governance (Fraud)
- Governance (Other)
- Financial
- People
- Programme / Project
- Reputation

## Step 3 – Map Categories to Classification

<b>Risk Category</b>	<b>Risk Classification</b>
Technological	Open
Financial	Open
People	Open
Programme / Project	Open
Governance (Other)	Open
Reputation	Cautious
Operational (Business to Business)	Minimalist
Operational (Business to Customer)	Minimalist
Governance (Fraud)	Minimalist
Political	Averse

## Step 4 – Map Risks to Category

<b>Risk Category</b>	<b>Risk Classification</b>	<b>Strategic Risk</b>
Technological	Open	S10
Financial	Open	S9, S11
People	Open	S2
Programme / Project	Open	S4, S8
Governance (Other)	Open	S12
Reputation	Cautious	S6
Operational (Business to Business)	Minimalist	S7
Operational (Business to Customer)	Minimalist	S3, S5
Governance (Fraud)	Minimalist	S12
Political	Averse	S1

# Step 5 – Reassess the risk e.g. Open

		LIKELIHOOD		
		Low	Medium	High
IMPACT	High		<b>S10</b>	
	Med/High		<b>S2, S9, S11</b>	
	Med		<b>S4, S8, S12</b>	
	Med/Low			
	Low			

# Redefine Risk Statement on Strategic Risk

Risk Description	Risk Category	Risk Appetite	Existing Risk Score	New Risk Score	Risk Status
As a result of an uncertain political climate there is a risk that Government Administrations' long term objectives/ priorities are not clear which may result in Company X being unable to plan effectively and meet objectives.	Political	Averse / Minimalist			Open Action Status: <b>AMBER</b>

## The Student Loans Company review

- Centralised and unified service failed to offer value for money
- Processed claims a third more slowly than local authorities the previous year
- New document scanning system untested and failed
- Led to an increase in phone calls, £4m in September 09 alone, 87% unanswered

# The Student Loans Company review

## Technology / Business to Customer

- November 09 Hopkin report laid blame on technical (ICT), management and service failure at the Company
- December 09 IT and Customer Services Directors resign

## Reputation

- May 2010 – Chairman sacked, CEO stepped down

## Consider the lessons to be learned?

- Was the SLC too “hungry” with technology / project risk appetite?
- Were the risk categories managed in silos?



Questions?

# Summary

- Defined risk appetite
- Considered the benefits in line with Solvency II
- Outlined a 5 step process to practical application
- Considered the lessons to be learned from the SLC experience