

Applying Your Risk Appetite

IRM NW/AIRMIC

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Agenda

- What do we mean by 'risk appetite'?
- Setting the context for risk appetite
- Expressing risk appetite: it's easier than you think!
- Using risk appetite
- Single or multiple risk appetites?
- The importance of effective escalation

What do we mean by risk appetite?

'The extent and categories of risk which [the board] regards as acceptable for the company to bear'

Paragraph 16: *Internal Control: Revised Guidance for Directors on the Combined Code* (October 2005)

Understanding risk appetite

'An area of increasing importance for boards and which is closely related to corporate strategy is risk policy. Such policy will involve specifying the **types and degree of risk** that a company is willing to accept in pursuit of its goals. It is thus a crucial guideline for management that must manage risks to meet the company's desired risk profile.'

Revised OECD Principles of Corporate Governance
2004, p 60

Defining risk appetite

- 'The level of risk that is acceptable to the board or management. This may be set in relation to the organisation as a whole, for different groups of risks or at an individual level.'

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- 'The amount of risk that an organisation is prepared to accept, tolerate or be exposed to at any point in time.'

HM Treasury

Setting the context for risk appetite

The Board /top team plays a crucial role in establishing and communicating the backcloth against which risk management decisions are to be taken throughout the business:

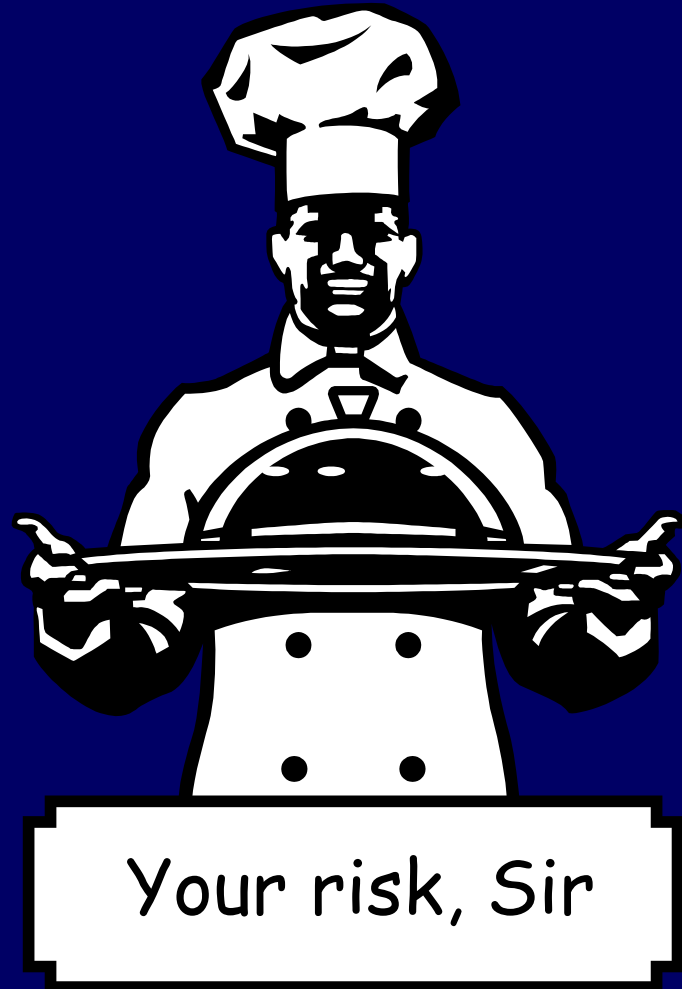
- Strategic direction and goals
- Risk management framework
- Agreeing and communicating risk tolerance thresholds (risk appetite)
- Defining roles and responsibilities

Management's role on risk

- Management is responsible for implementing board policies on risk and control
- They should identify and evaluate risks faced by the business for consideration by the board
- They should design, operate and monitor a suitable system of internal control to manage risks within the risk appetite set by the board

What is *your* organisation's appetite for risk?

Is your business risk averse or risk-taking?



Appetite for risk may vary



- Dependent on level of regulation
- From department to department (sales vs. safety)
- According to current level of success
- Executives vs. rest!!!

So it's vital to define and articulate it

Risk appetite vs. competence in controlling risk

Risk taker	Gambler	Winner
Risk averse	Loser	Also-ran
	Low competence	High competence

Expressing risk appetite - It's easier than you think!

How do you express and communicate it in practice?



Which are the 'no go' areas?

- Currency speculation?
- Gender discrimination?
- Safety compliance?
- Anti-competitive activity?
- Insider trading?



Often covered
by policies

Are some risks acceptable provided due process is followed?



- Capital expenditure
- New product launches
- Staff recruitment
- Political contributions
- Acceptance of gifts
- Sales to sensitive countries
- Write-offs

Usually covered by policies and procedures

Expressing generic risk appetite

		VL / VH	L / VH	M / VH	H / VH	VH / VH
VH						
H		VL / H	L / H	M / H	H / H	VH / H
M		VL / M	L / M	M / M	H / M	VH / M
L		VL / L	L / L	M / L	H / L	VH / L
VL		VL / VL	L / VL	M / VL	H / VL	VH / VL
Impact						

Classes of risk severity

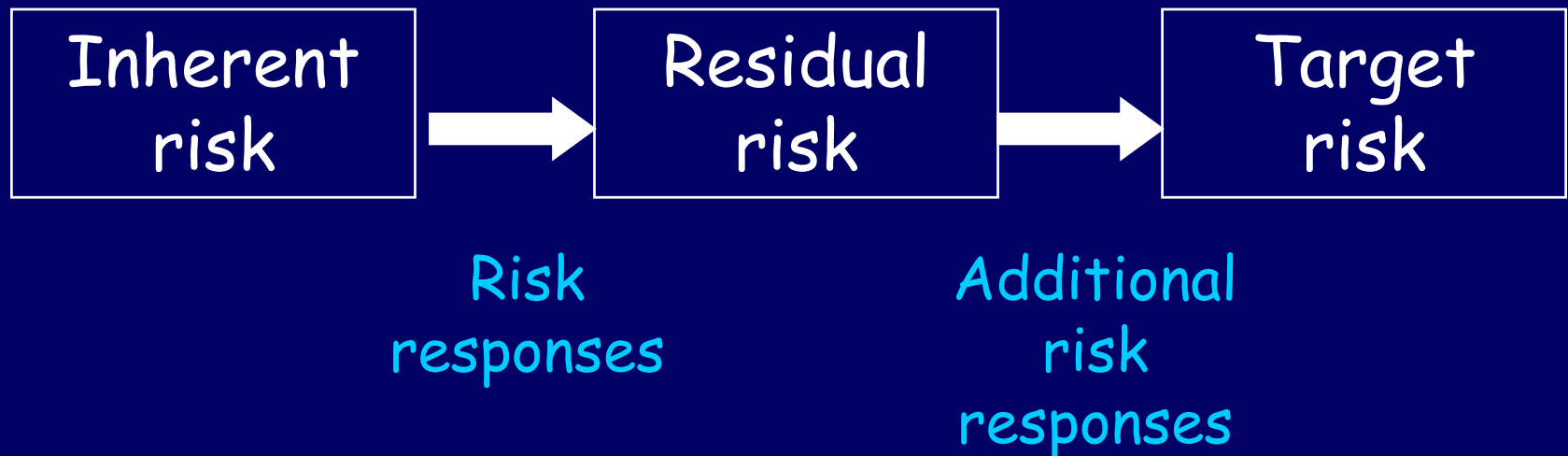
- **Black:** Risks that significantly exceed the risk acceptance threshold and need urgent and immediate attention
- **Red:** Risks that exceed the risk acceptance threshold and require proactive management
- **Amber:** Risks that lie on the risk acceptance threshold and require active monitoring
- **Green:** Risks that are below the acceptance threshold and do not require active management

Using risk appetite

- Assess risks for likelihood and impact
- Plot this on the risk appetite grid
- Compare with the agreed risk tolerance threshold
- Decide on the appropriate risk response (4Ts: transfer, terminate, tolerate, treat)
- Develop risk response action plan

Expressing risk appetite for individual risks

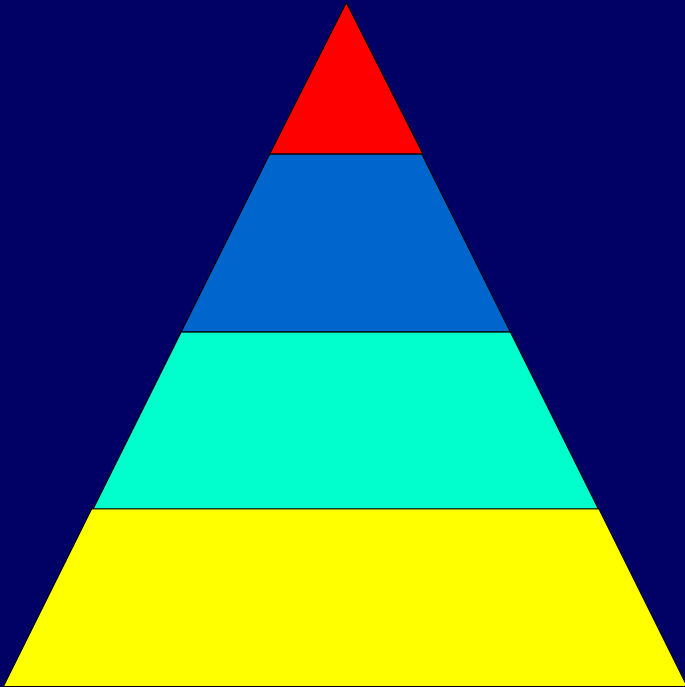
The concept of 'target risk'



Single or multiple risk appetites - some considerations:

- Complexity of organisation (levels)
- Diversity of activity (strategic, operations, projects etc)
- Diversity of sensitivity to risk (sales versus safety)
- Will people be demotivated if they only ever hit 'green'?

Your aim is to create a 'freedom to act' hierarchy



- Clarity on what constitutes 'significant risk' at each level
- Staff at all levels know their 'freedom to act'
- Staff are prepared and know how to escalate critical risks to the next level up if necessary

Effective escalation is the key

- It's fine to allow flexibility and the exercising of judgement
- Provided the basic ground rules are clear
- And adherence to them is monitored!

Any questions?



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