



Leading the risk profession

# Risk Appetite

## A consultation document

**Richard Anderson**

Deputy Chairman, Institute of Risk Management &  
Managing Director - UK, Crowe Horwath Global Risk Consulting  
London, 6 July 2011

# Risk appetite – a meaningless phrase?

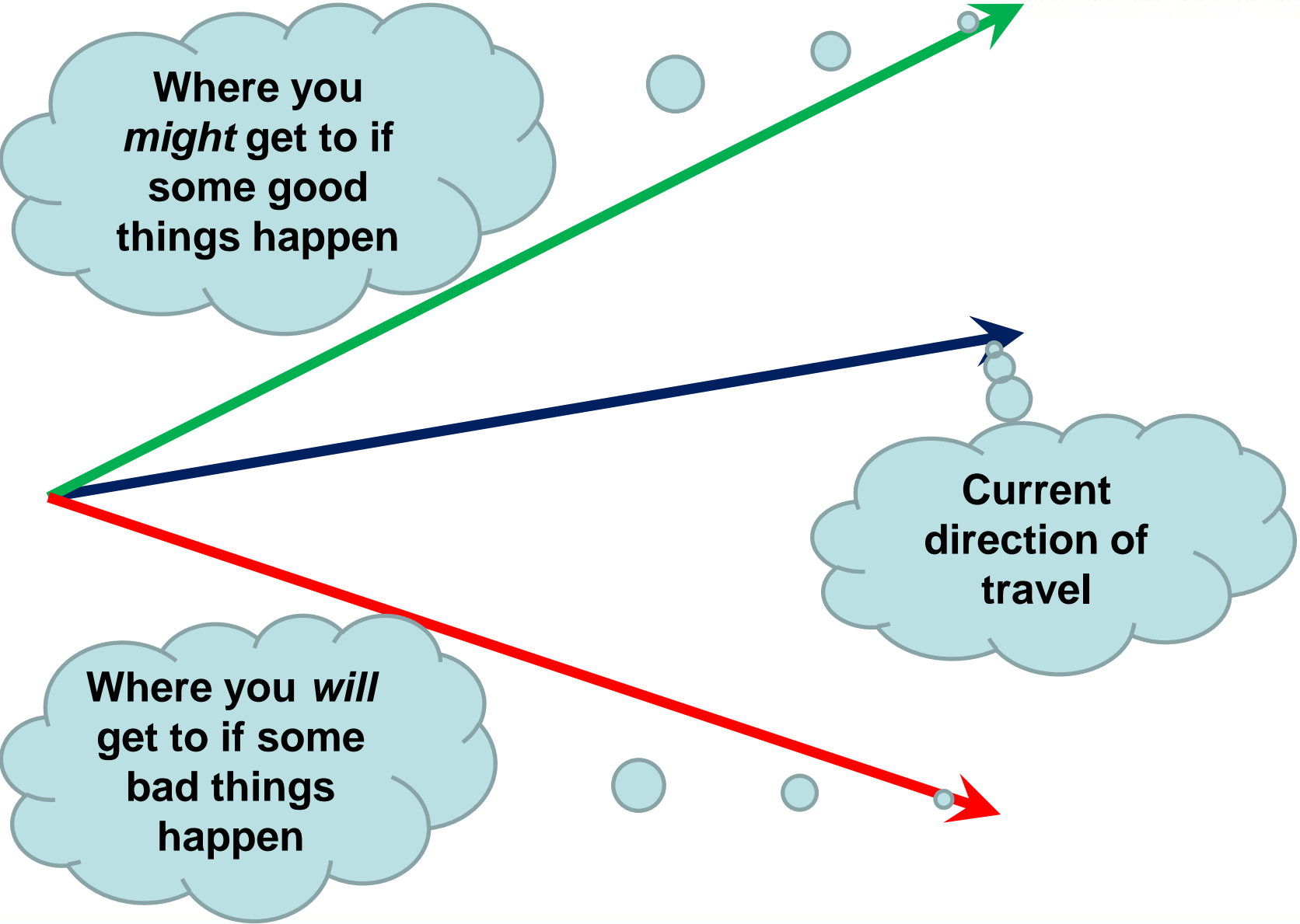
## Risk appetite:

- What we want to eat?
- What we can eat?
- What we need to do in order to eat?
- What we must not do in order to survive?

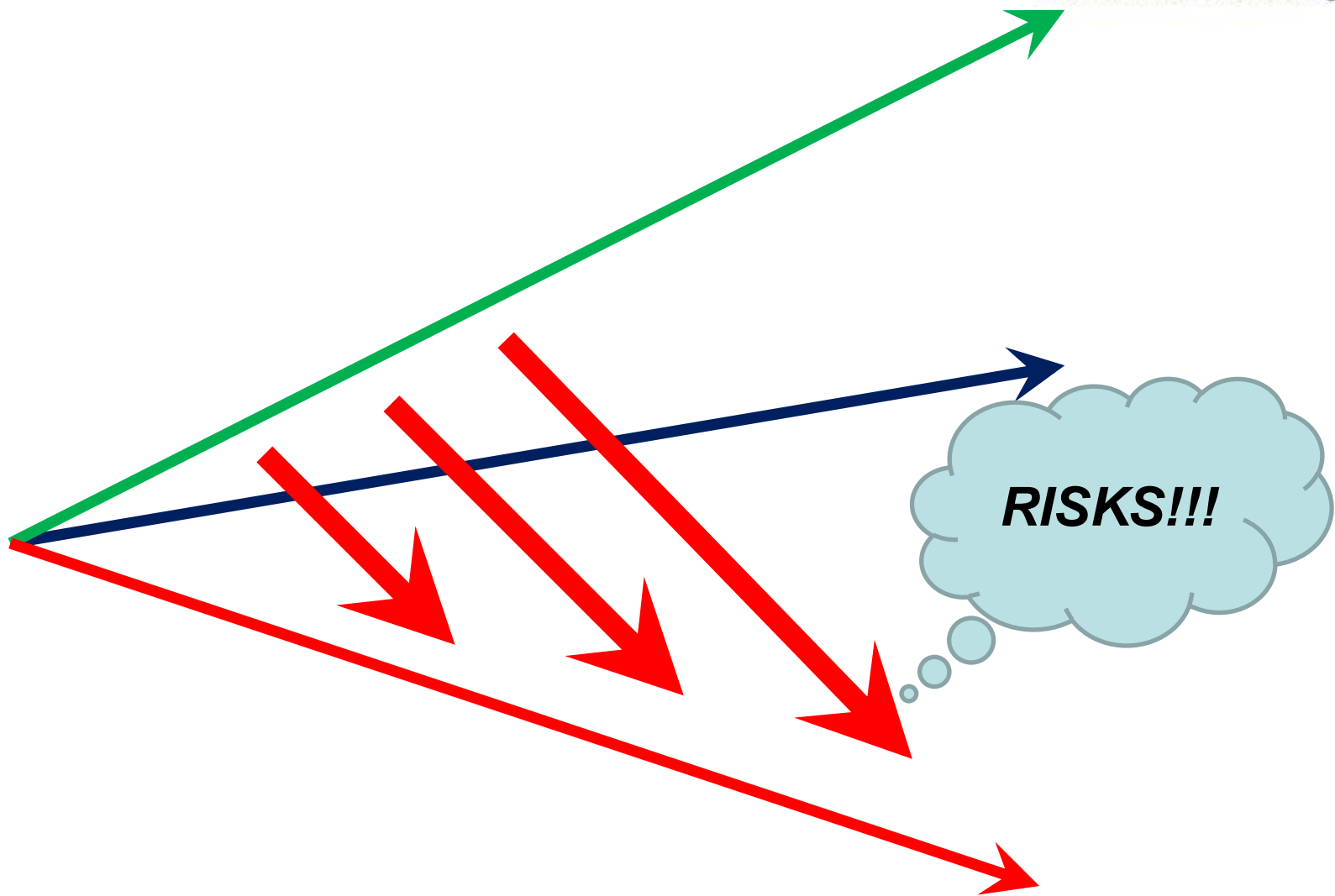
## My personal view:

- Move away from eating...
- Think more of fight or flight...
- And then, when there is time, supplement with front of brain thinking (cognitive) approaches.

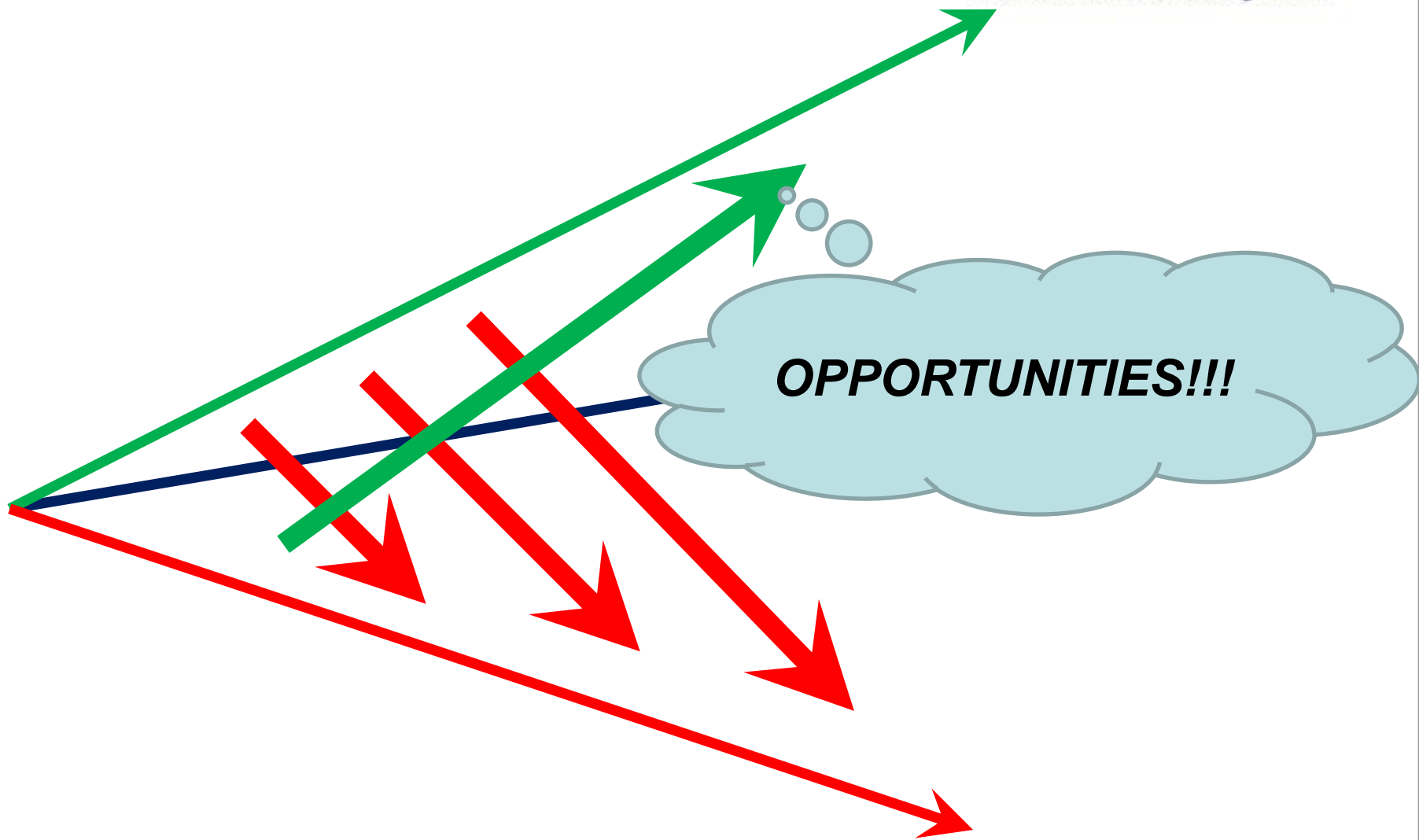
# A pictorial guide



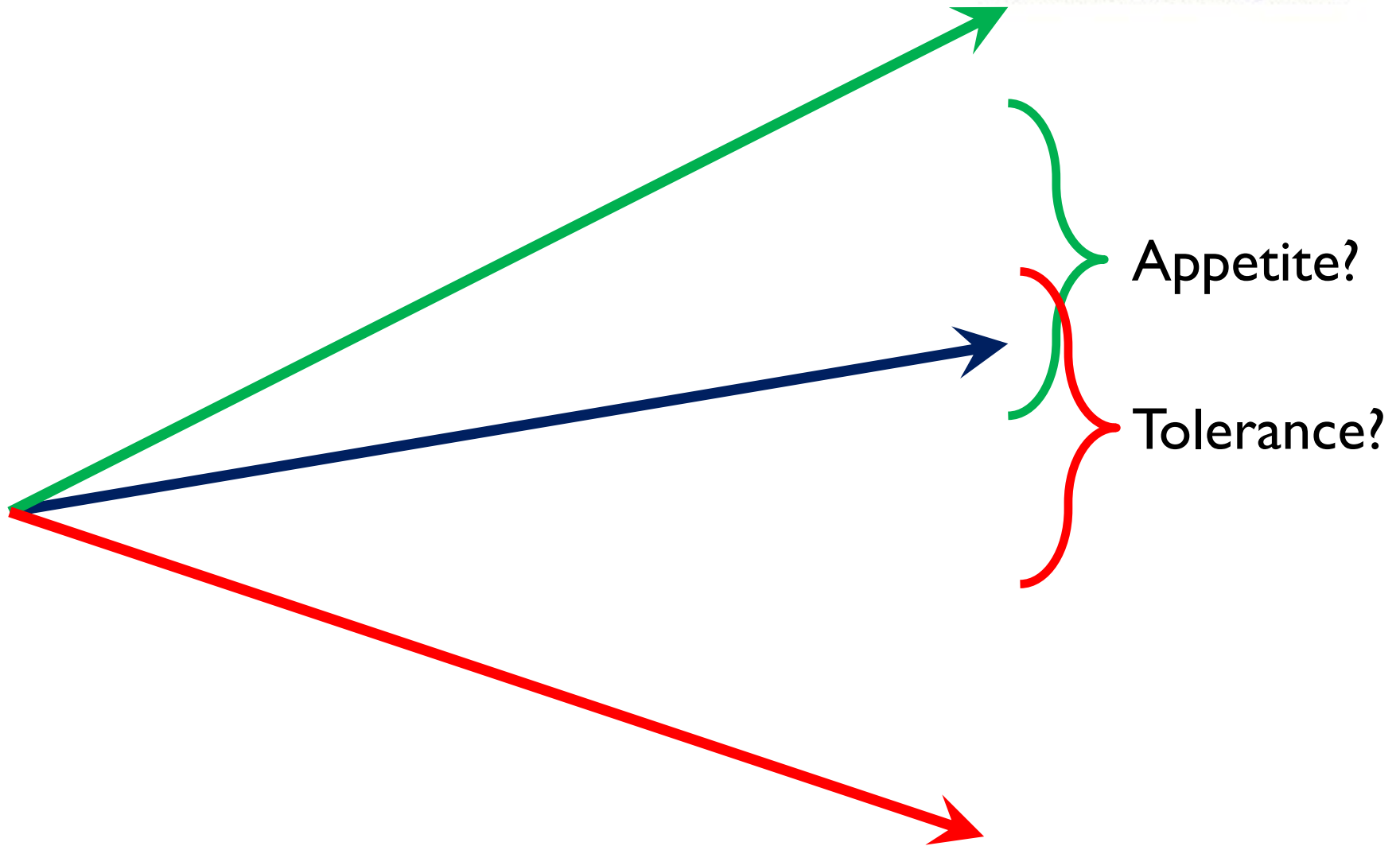
# A pictorial guide



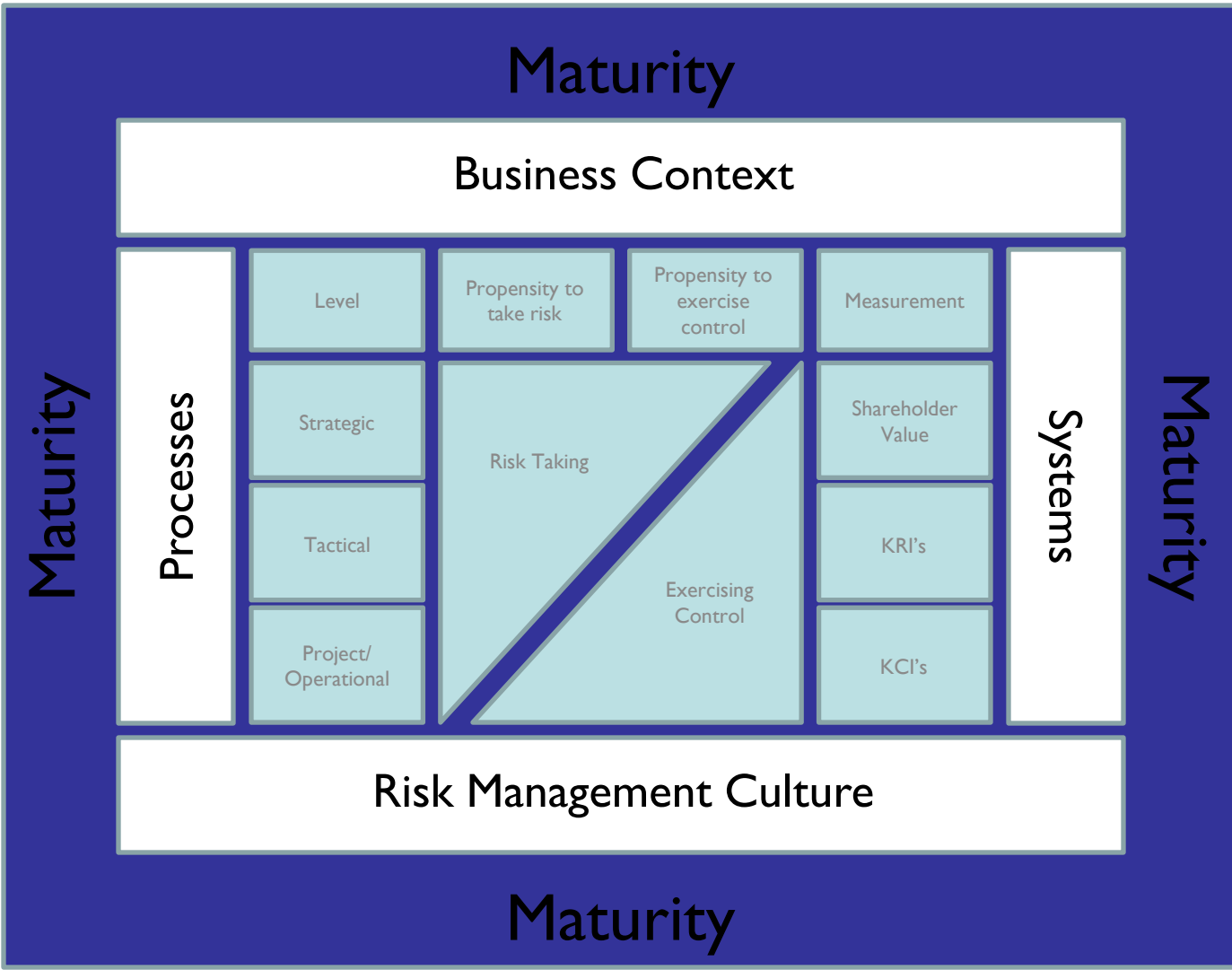
# A pictorial guide



# A pictorial guide



# Risk appetite in context of maturity



# Or maybe capability

What risks can I deal with because:

## *CAPACITY*

My balance sheet is strong enough to deal with the risk? Think in terms of:

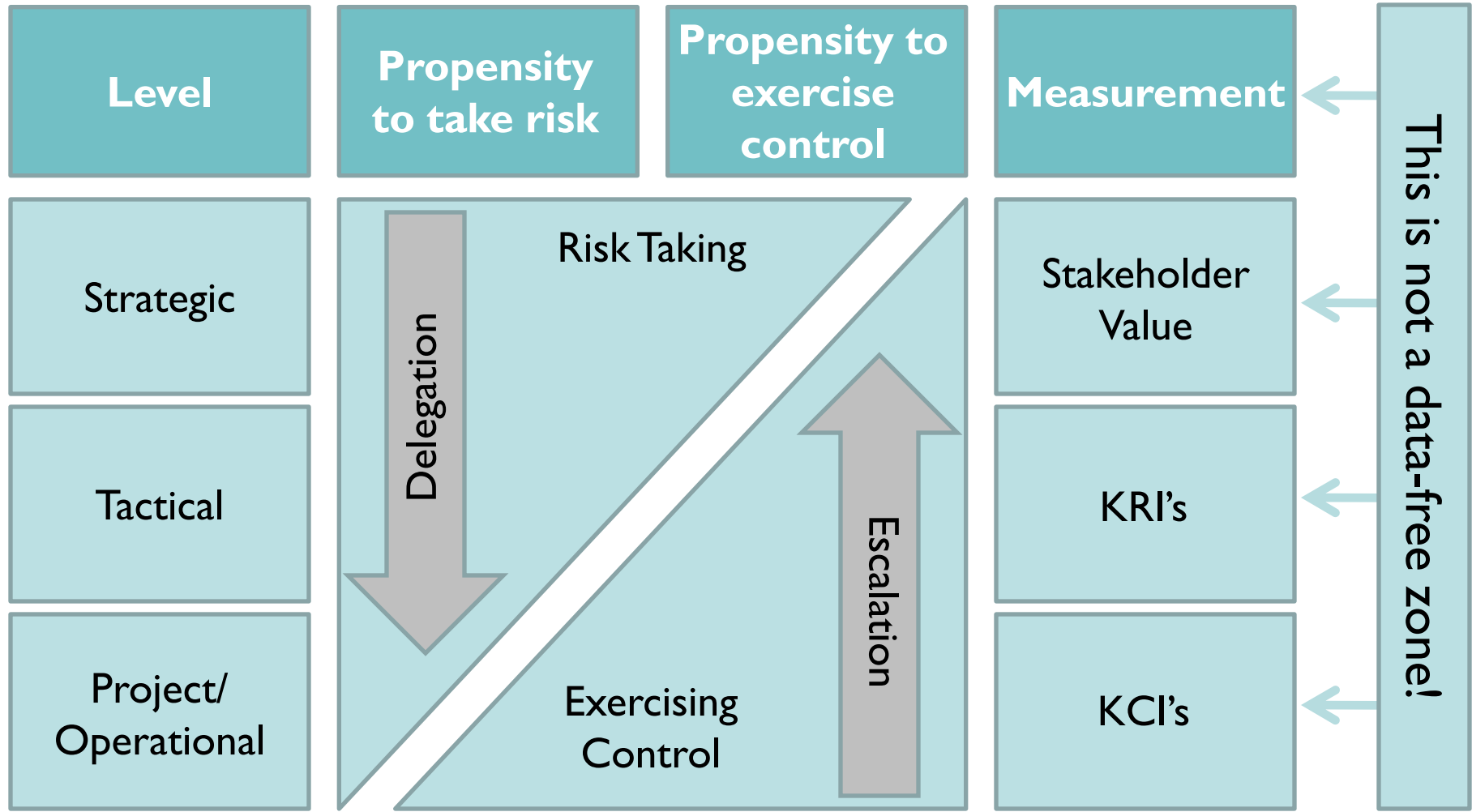
1. Assets and liabilities
2. Reputation
3. Liquidity
4. Political capital

## *ABILITY*

I have the abilities to manage the risk? Think in terms of:

1. Risk systems
2. Risk culture
3. Risk processes
4. How prone to disasters

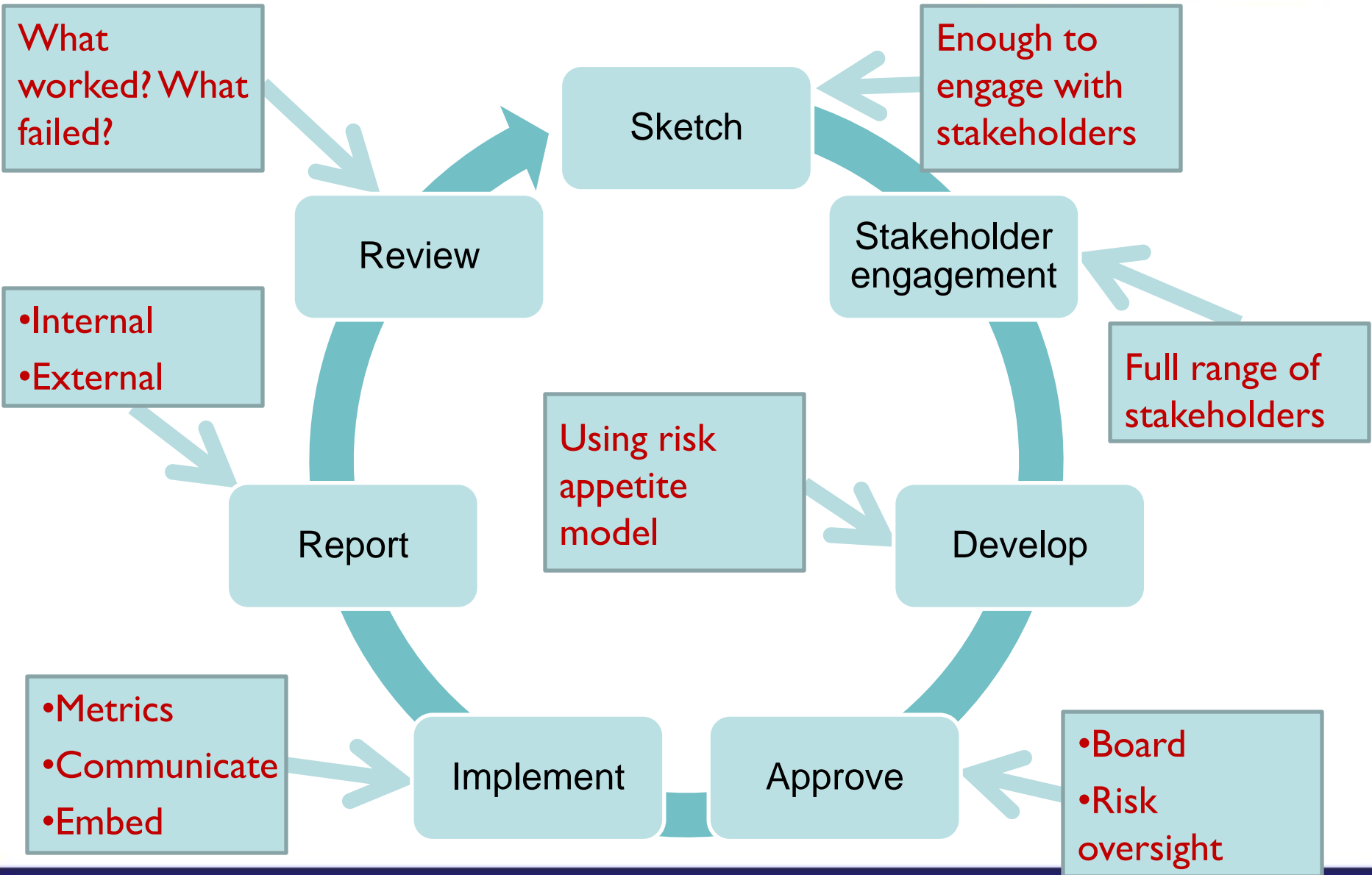
# Contents of framework



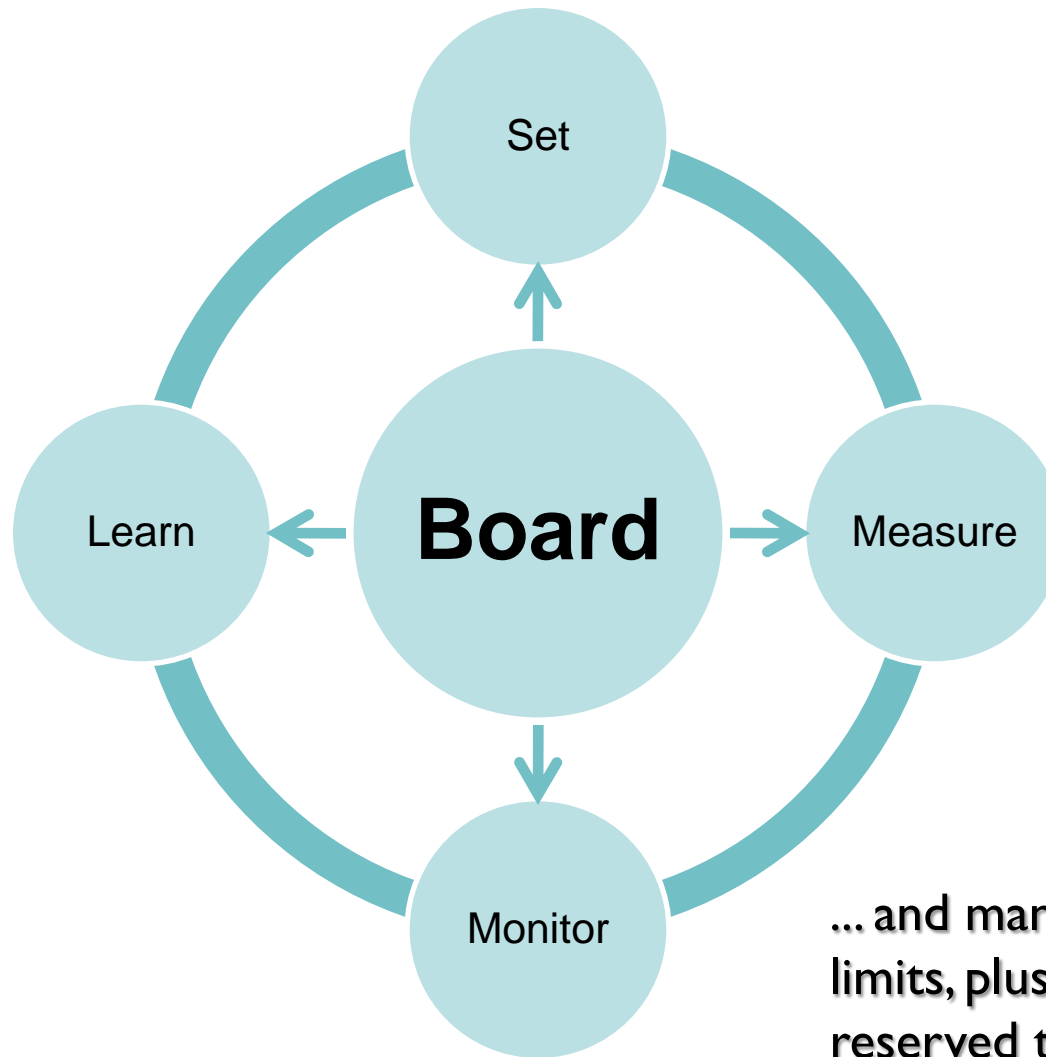
# Establishing risk appetite



# Establishing risk appetite

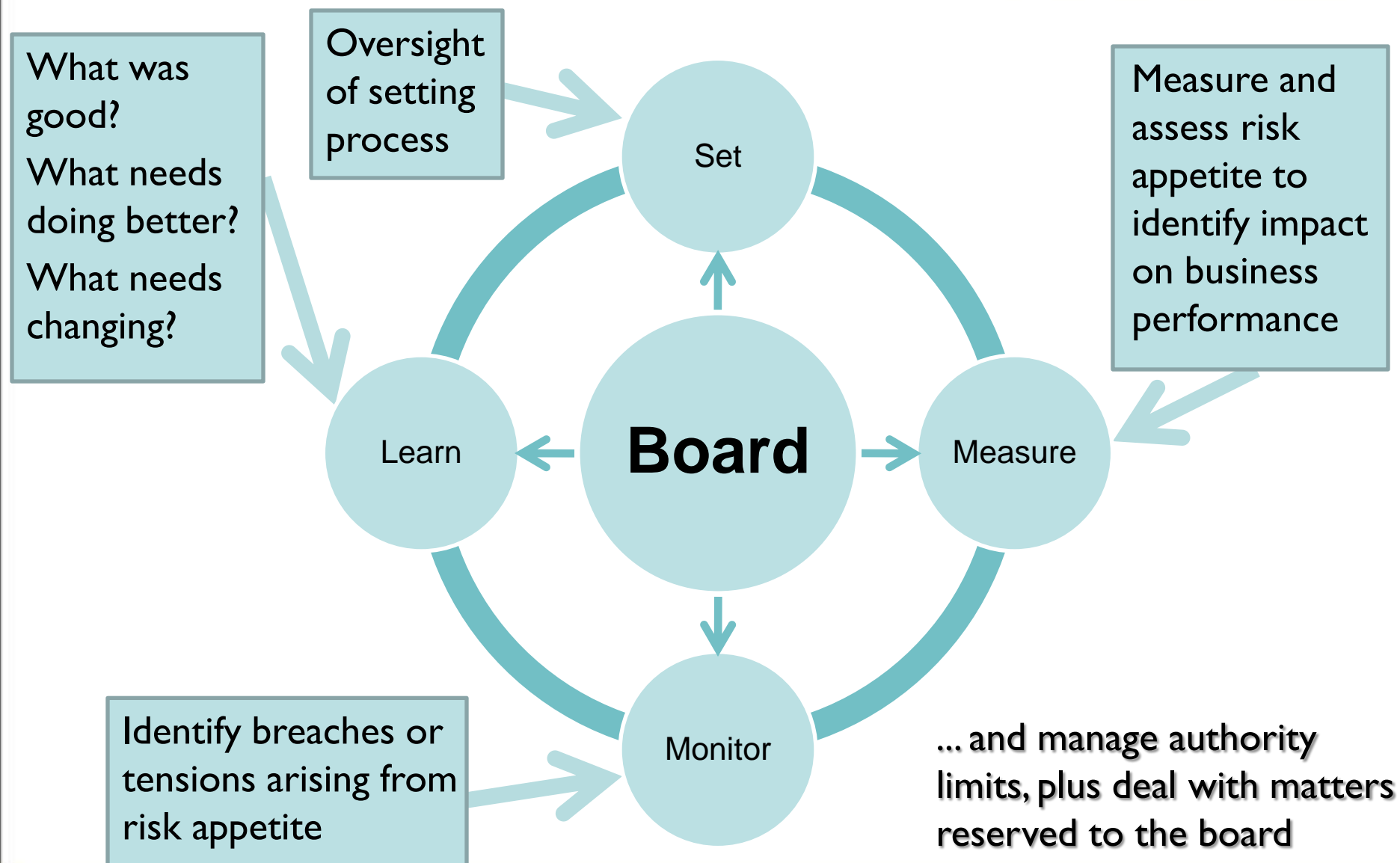


# The board's (risk committee's) role



... and manage authority limits, plus deal with matters reserved to the board

# The board's (risk committee's) role



## Step

Development

## When

- With periodic strategy and annual budgetary process

Measure

- With periodic management reporting

Monitor

- At every board meeting

Learn

- Before sketching the next year's process

# Timing

## Step

Development

Measure

Monitor

Learn

## When

- With periodic strategy and annual budgetary process
- With periodic management reporting
- At every board meeting
- Before sketching the next year's process

Link to strategy development and your regular budgetary processes

Embed into regular reporting processes

Demonstrate its importance to board, staff and external stakeholders

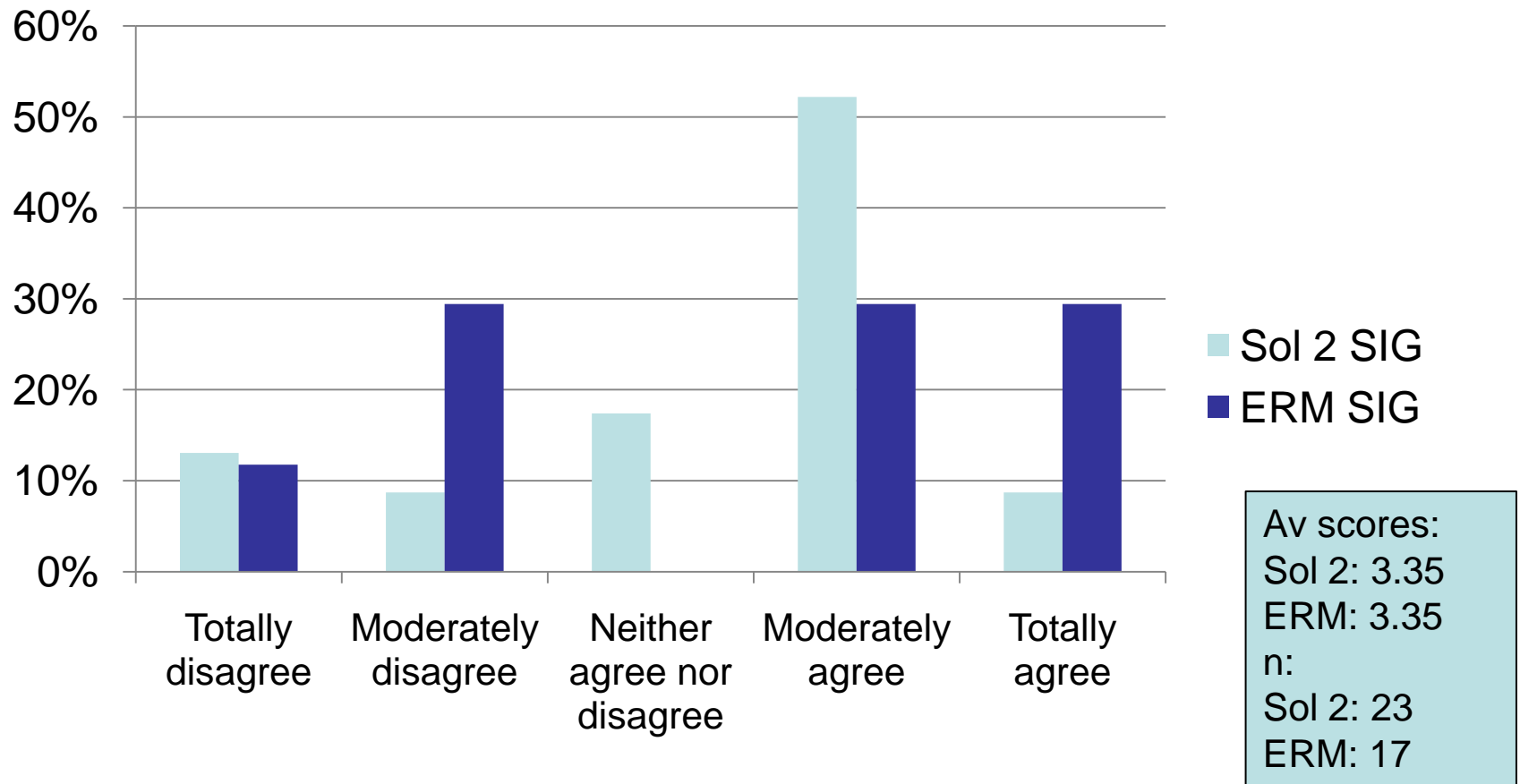
Learn and apply lessons



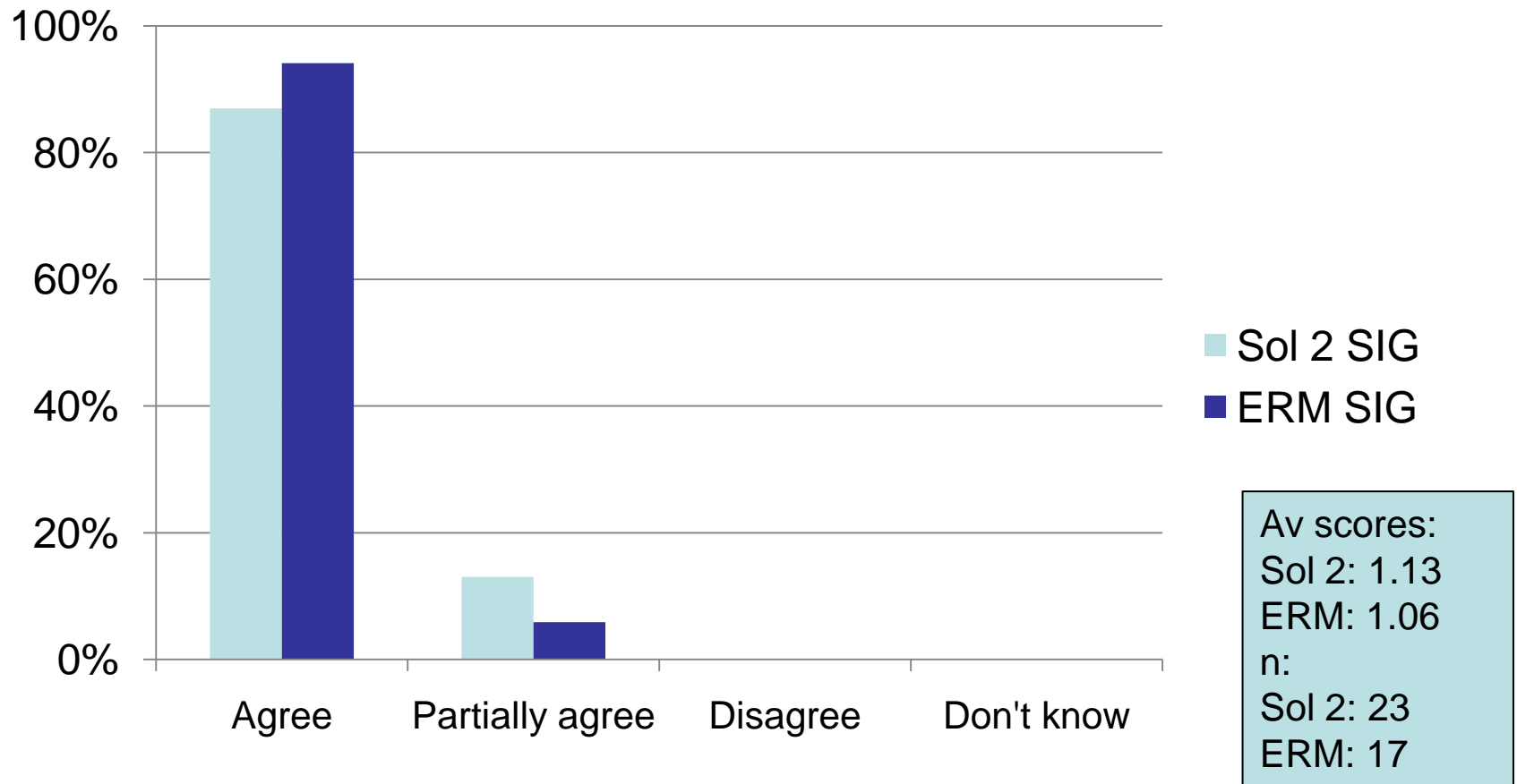
“The best paper I have ever read on risk management”

# THE SURVEY

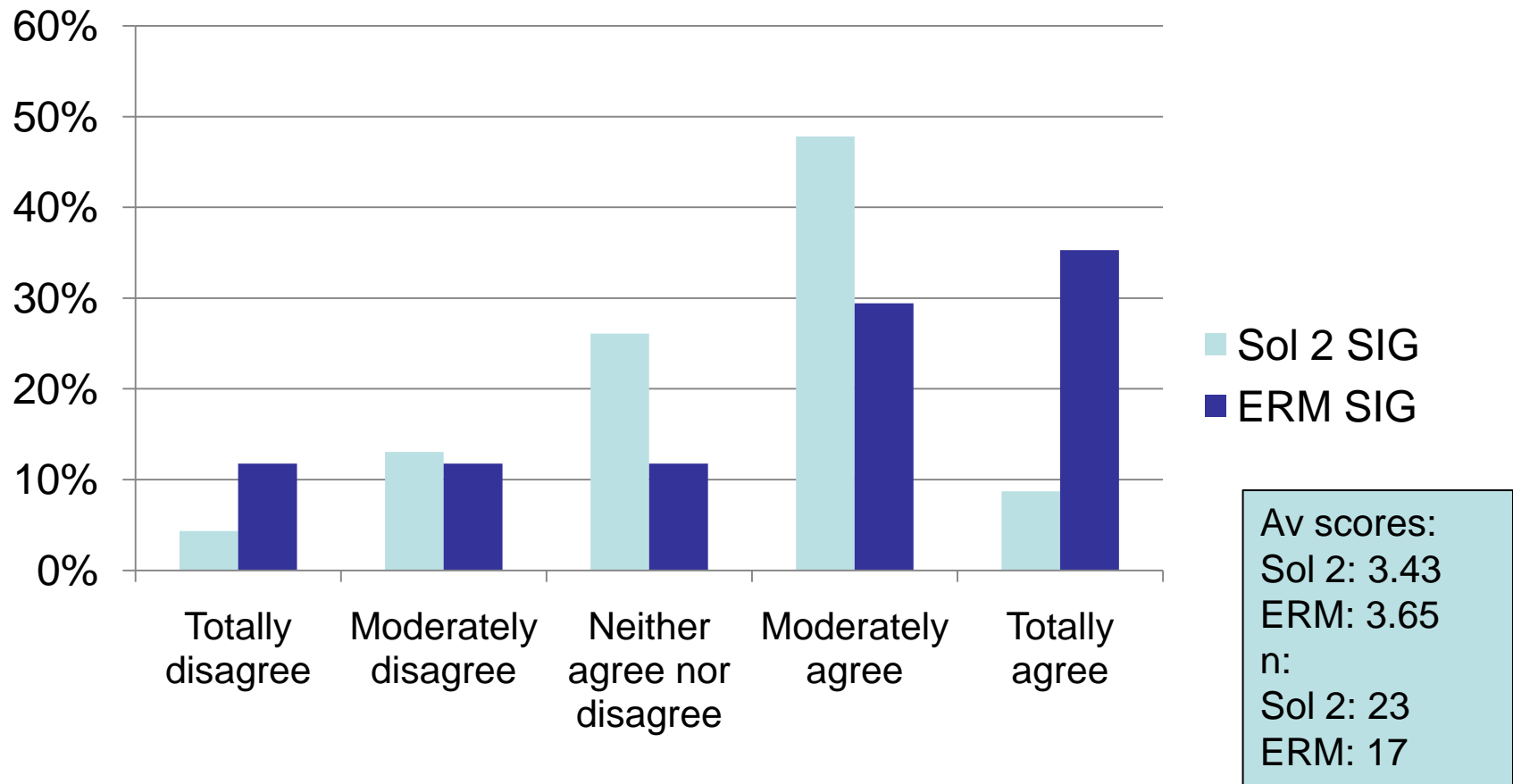
Q1: Do you agree that the approach set out in the IRM Risk Appetite consultation paper provides a workable basis for developing an organisation's approach to risk appetite and risk tolerance?



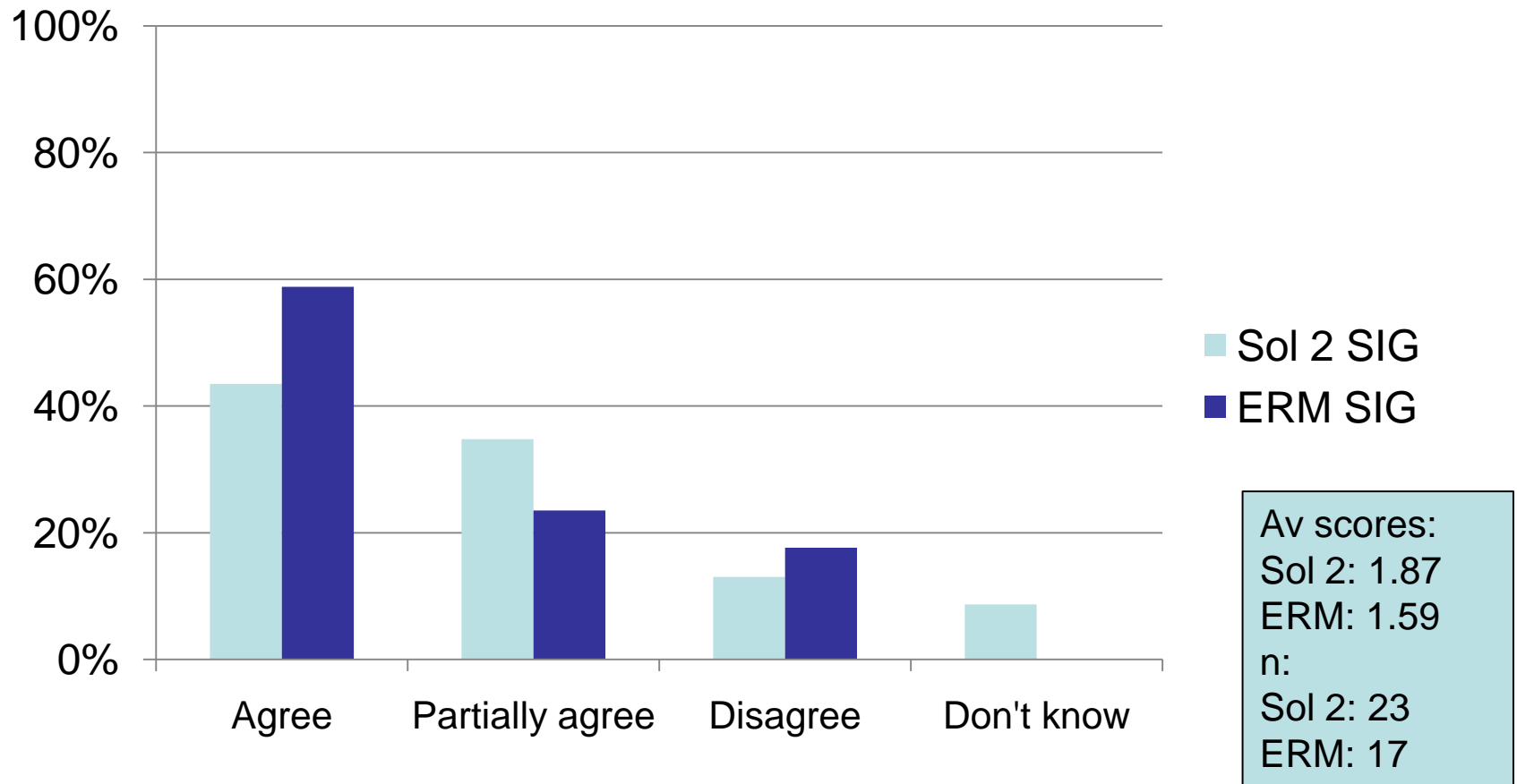
Q2: Do you agree that an organisation has multiple risk appetites?



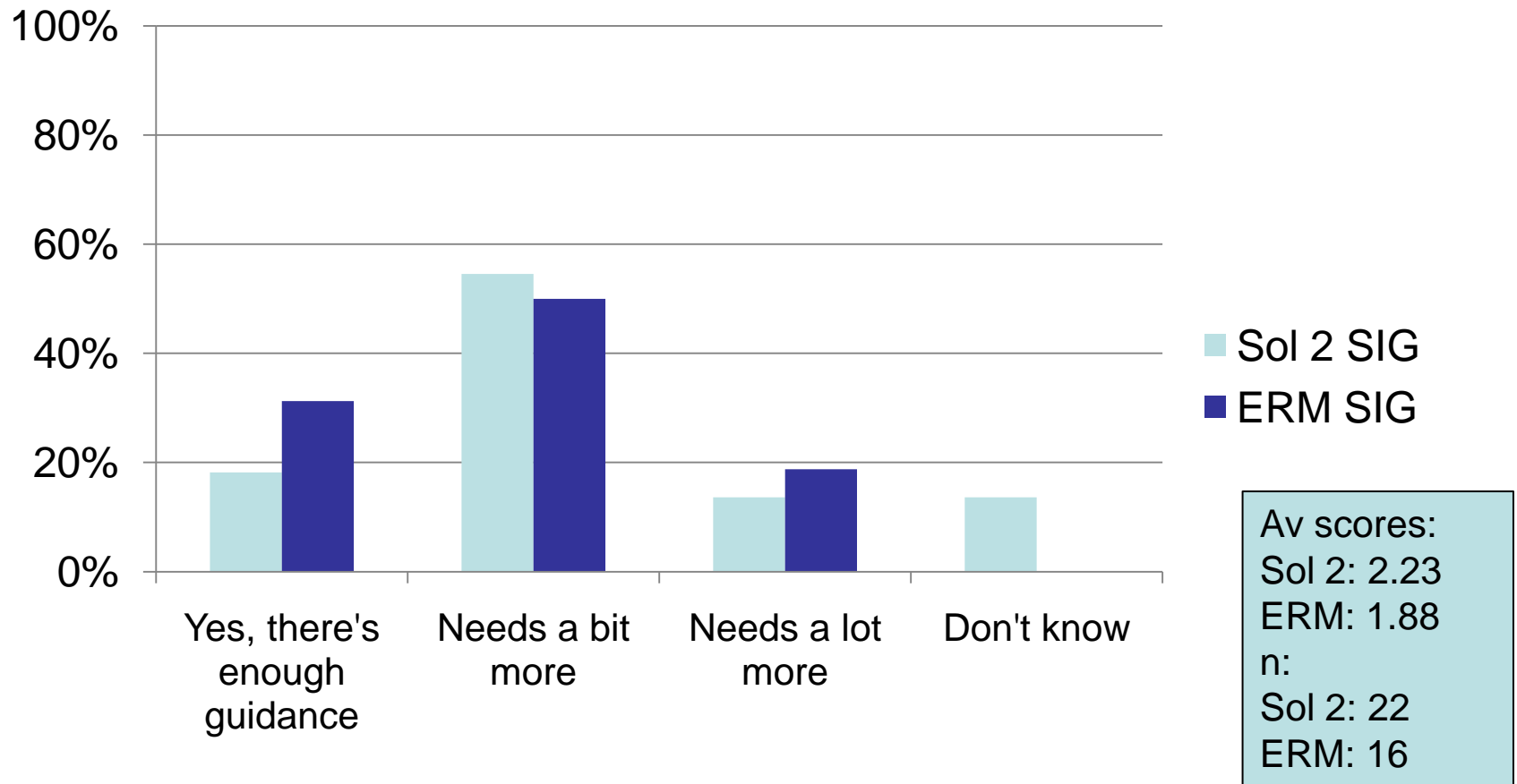
Q3: Is the concept of multiple risk appetites appropriately reflected in the draft guidance?



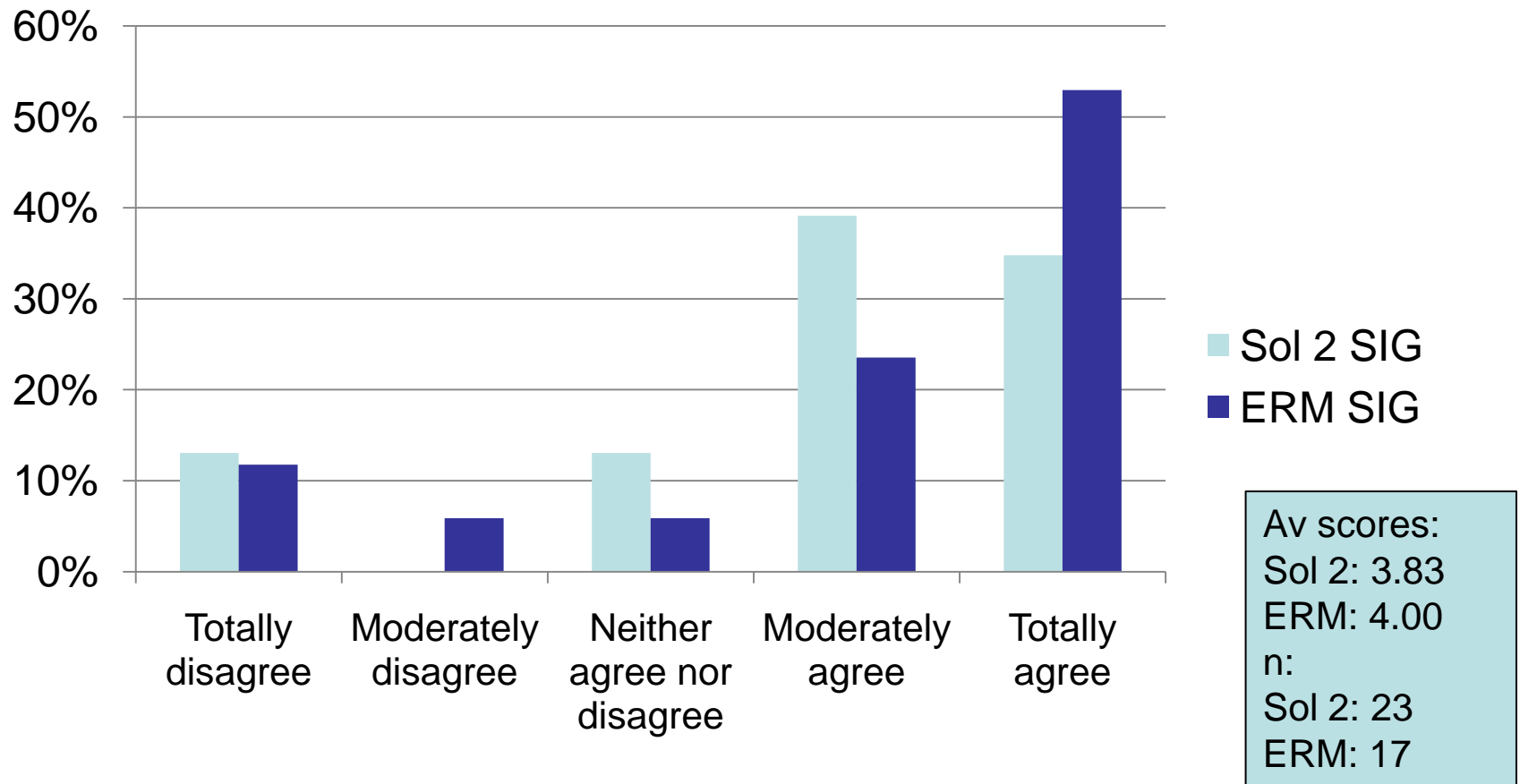
Q4: Do you agree that risk management maturity is an appropriate concept as a starting point for risk appetite and risk tolerance?



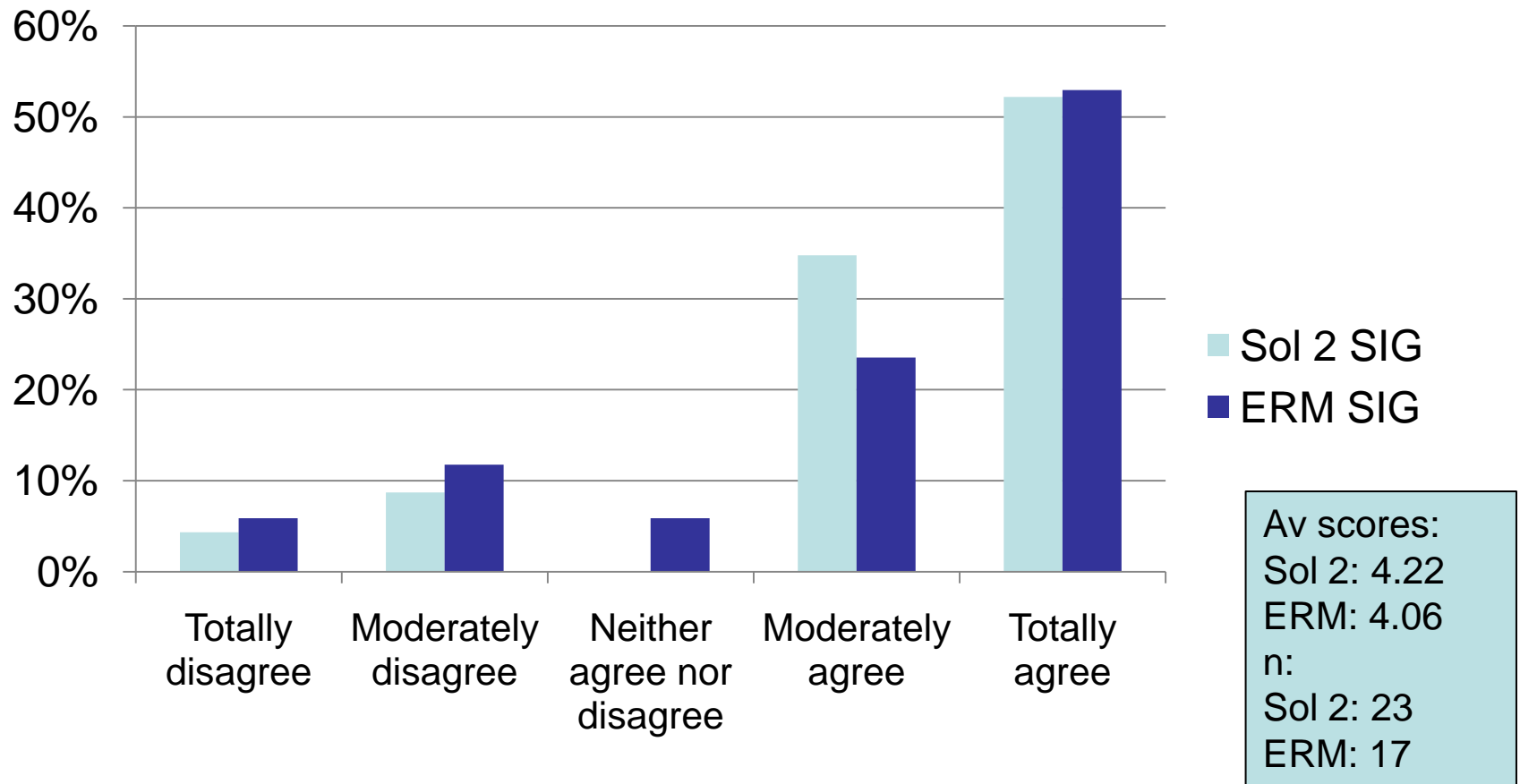
Q5: Is there sufficient guidance on risk management maturity in the document?



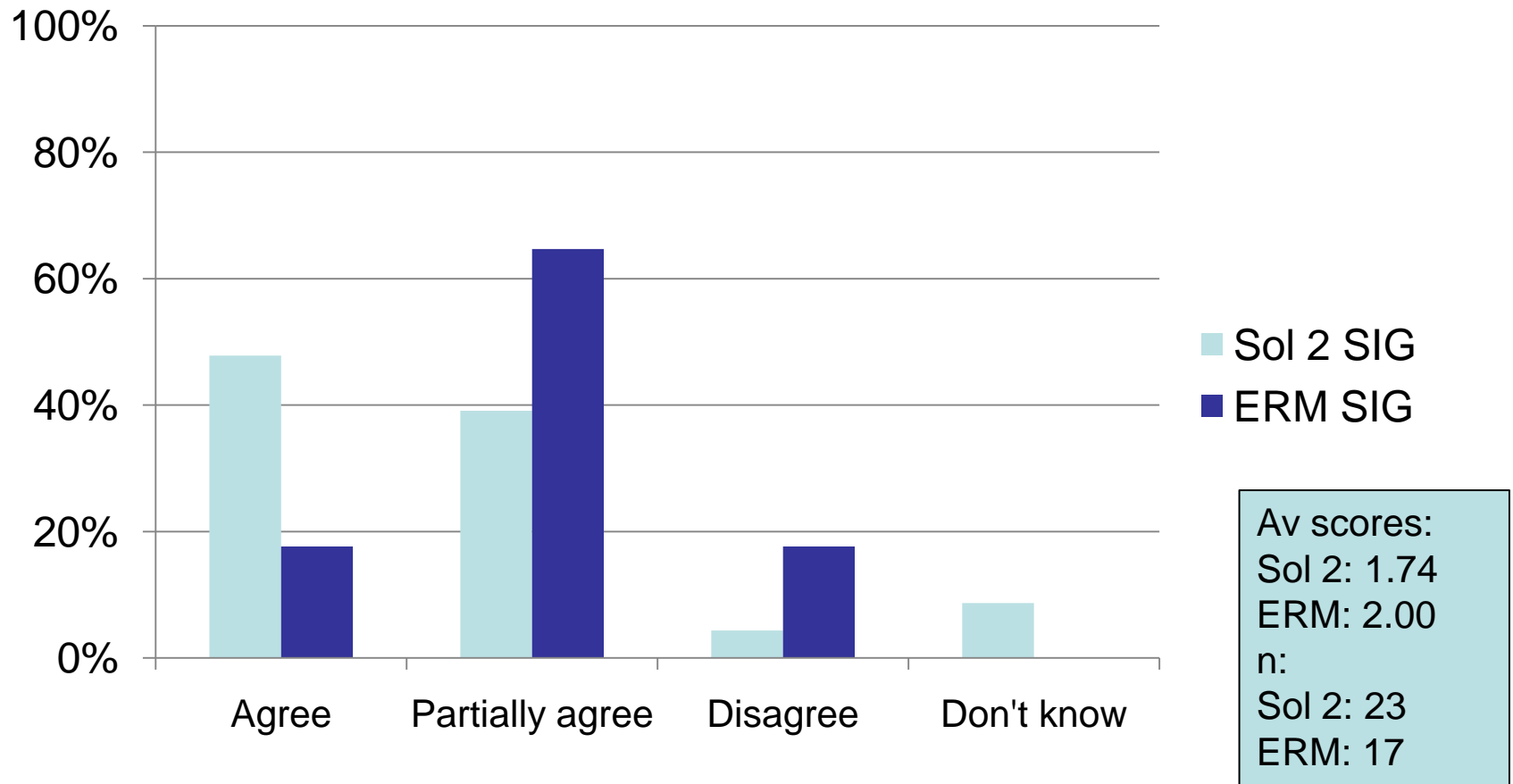
Q6: Do you agree with the approach of looking at the propensity to take risk and the propensity to exercise control?



Q7: Do you agree with the need to apply some form of measurement to risk appetite?



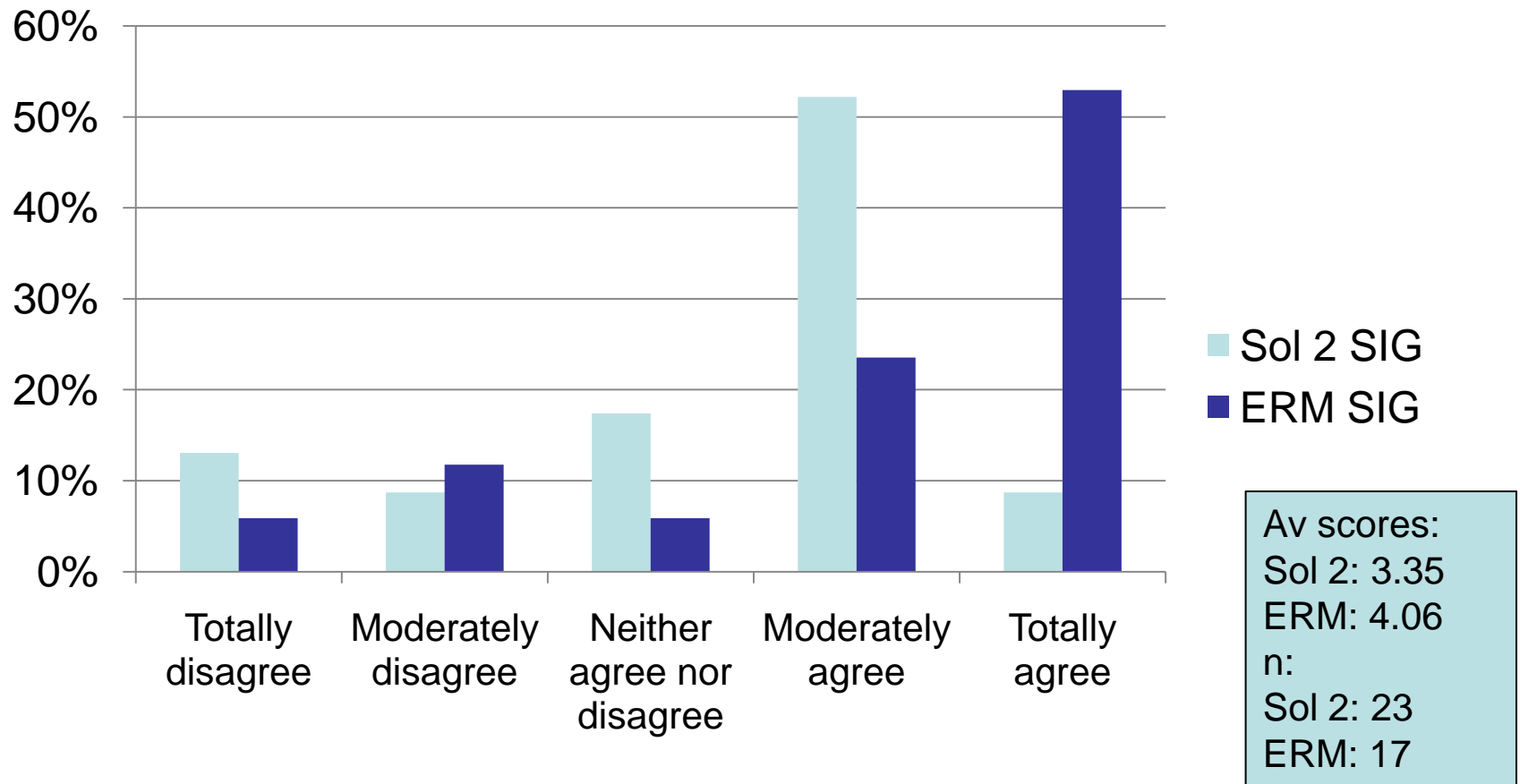
Q8: Is shareholder value an appropriate consideration for risk appetite for quoted companies?



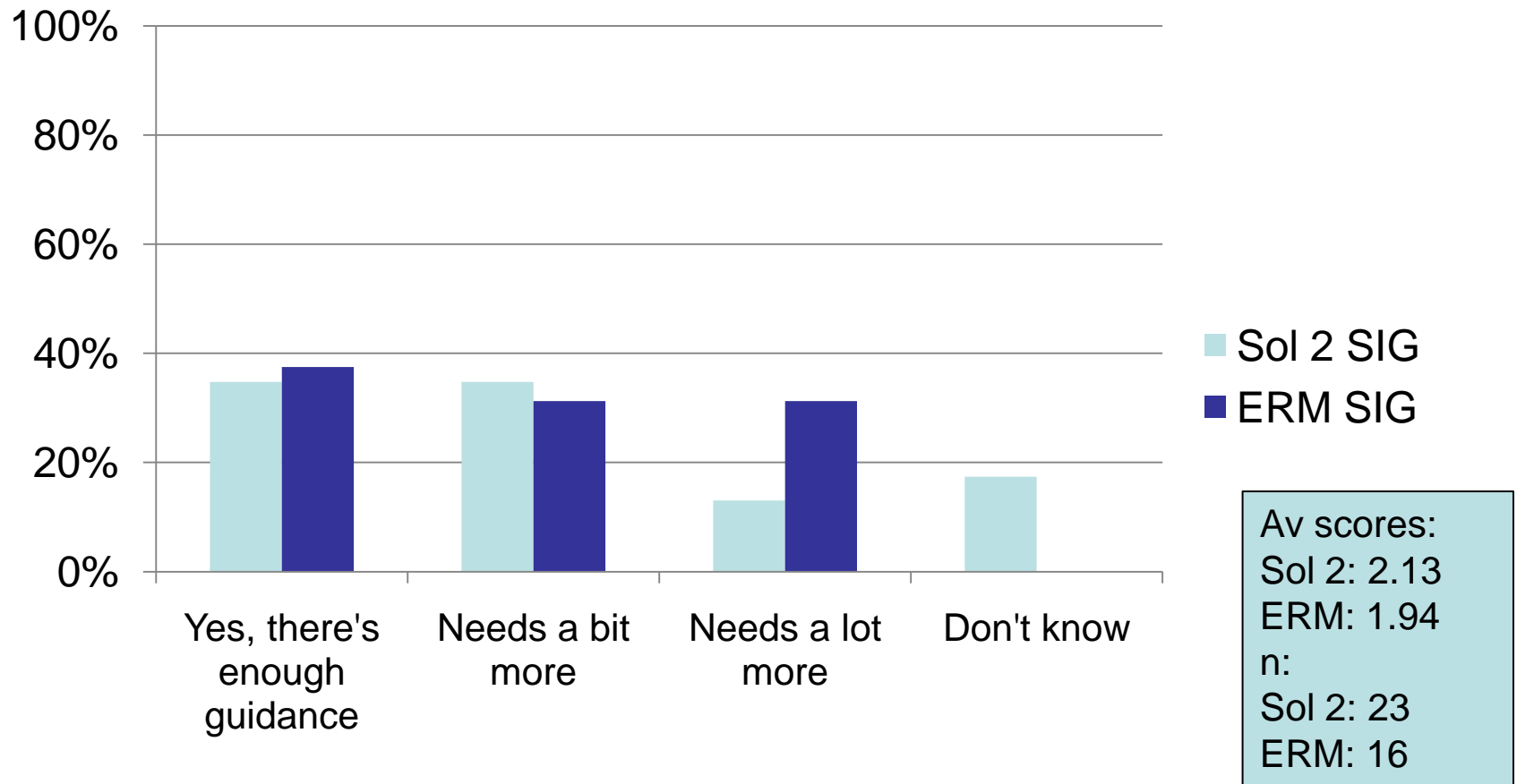
Q9: If you disagree and you think there are better alternatives, please explain here:

- But you need to ensure that the basis of measuring this is consistent and agreed as it is difficult to monitor due to multiple variables.
- Shareholder value should perhaps be one measure but is a short term measure and results in short term decisions and actions. Longer term measures need to be considered to ensure long term company viability and success.
- Appetite is to be set by the total company risk exposure i.e. total risk exposure to financial risks + non financial risks. There should be more explanation that the financial risks only are about 15% of the total risk exposure. There is a lot of disservice that have been done since the financial crisis on the strategic and operational risks. We have forgotten how important these are. Strategic risks can represent 61% of the total risk profile but this can vary a little according to the industry you are in.
- How do you measure Shareholders value?

Q10: Do you agree that the approach set out in the IRM Risk Appetite consultation paper provides a workable basis for developing an organisation's approach to risk appetite and risk tolerance?



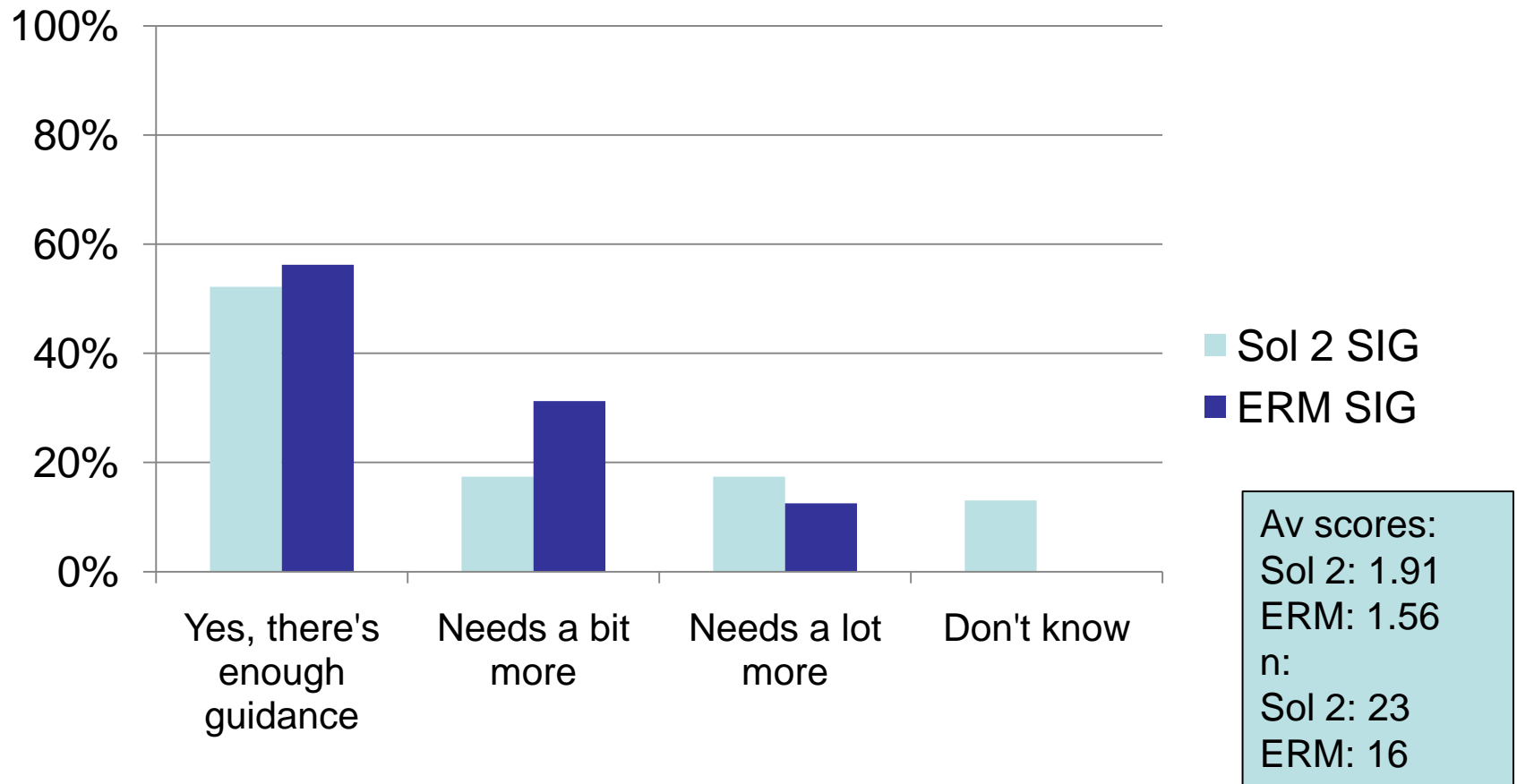
Q11: Is there sufficient guidance on the development of risk appetite in the document?



Q12: If you think more is needed, what additional guidance would you like to see?

- How to actually go about doing it - not what to do but how it is applied in practice as each organisation is different and tools applied may not always work in differing settings.
- I would add the discounted cash flow model to calculate company value and hence overall net risk value.
- Practical steps for consideration of key elements that should be considered and then measured as part of the organisation's risk appetite e.g. key organisational objectives such as HSE targets, profit margins and revenue, delegations of authority etc.
- More on the process for engagement and getting agreement to the process.

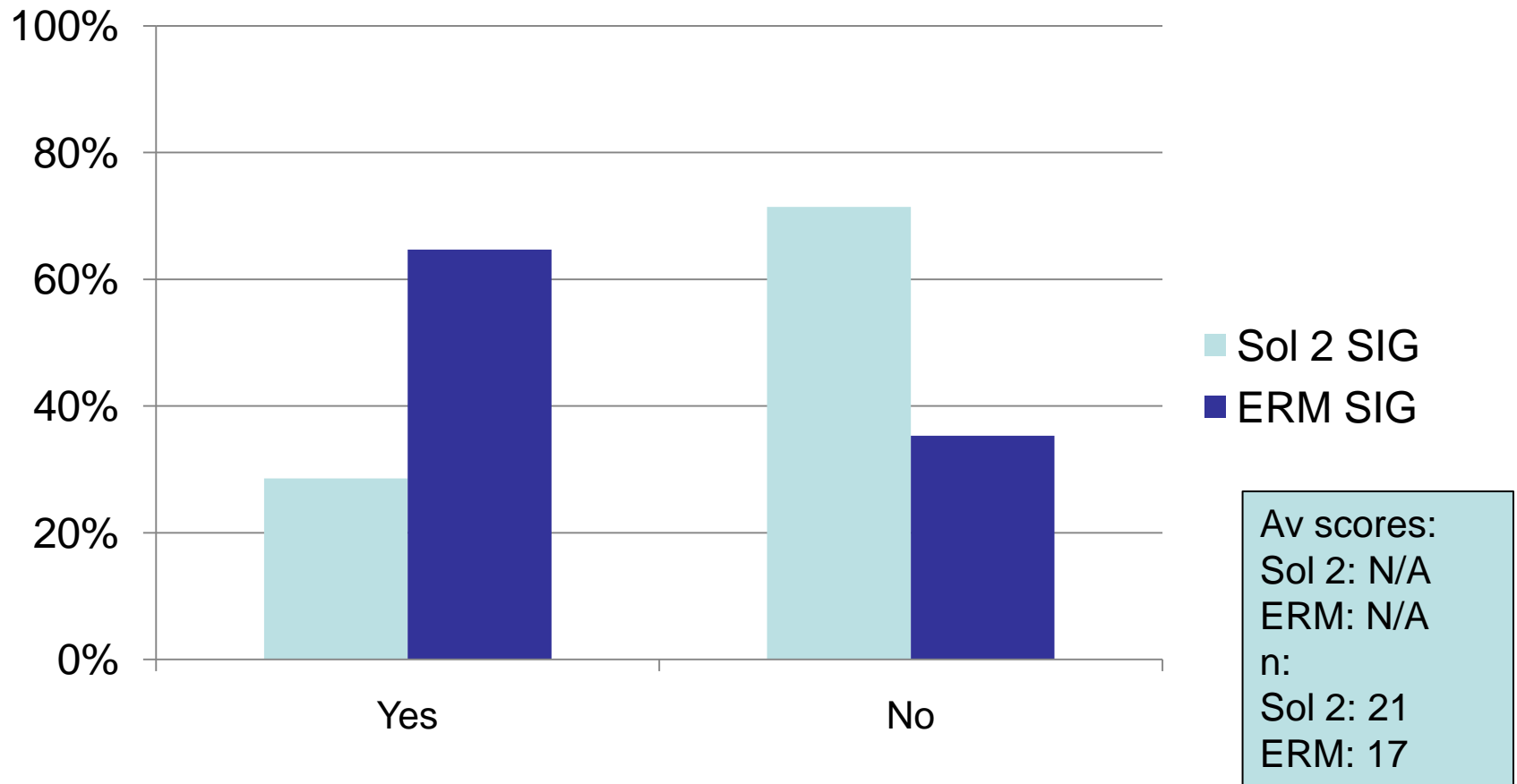
Q13: Is there sufficient guidance on the oversight by the board (or risk committee) of the development and implementation of risk appetite?



Q14: If you think more is needed, what additional guidance would you like to see?

- How do they participate not just passive involvement.
- "Let is be exhaustive here. This is an FSA key point at the moment and are putting pressure on the Exec to know how risk appetite is set.
- If they need to know, the Exec will turn to the risk managers for training and members need to know."
- Again, some practical guidance around how frequently the Boards should approve and review, indicators of what they should be looking for in their review etc.
- Risk Appetite will prove quite challenging to those who have yet to experience using it.

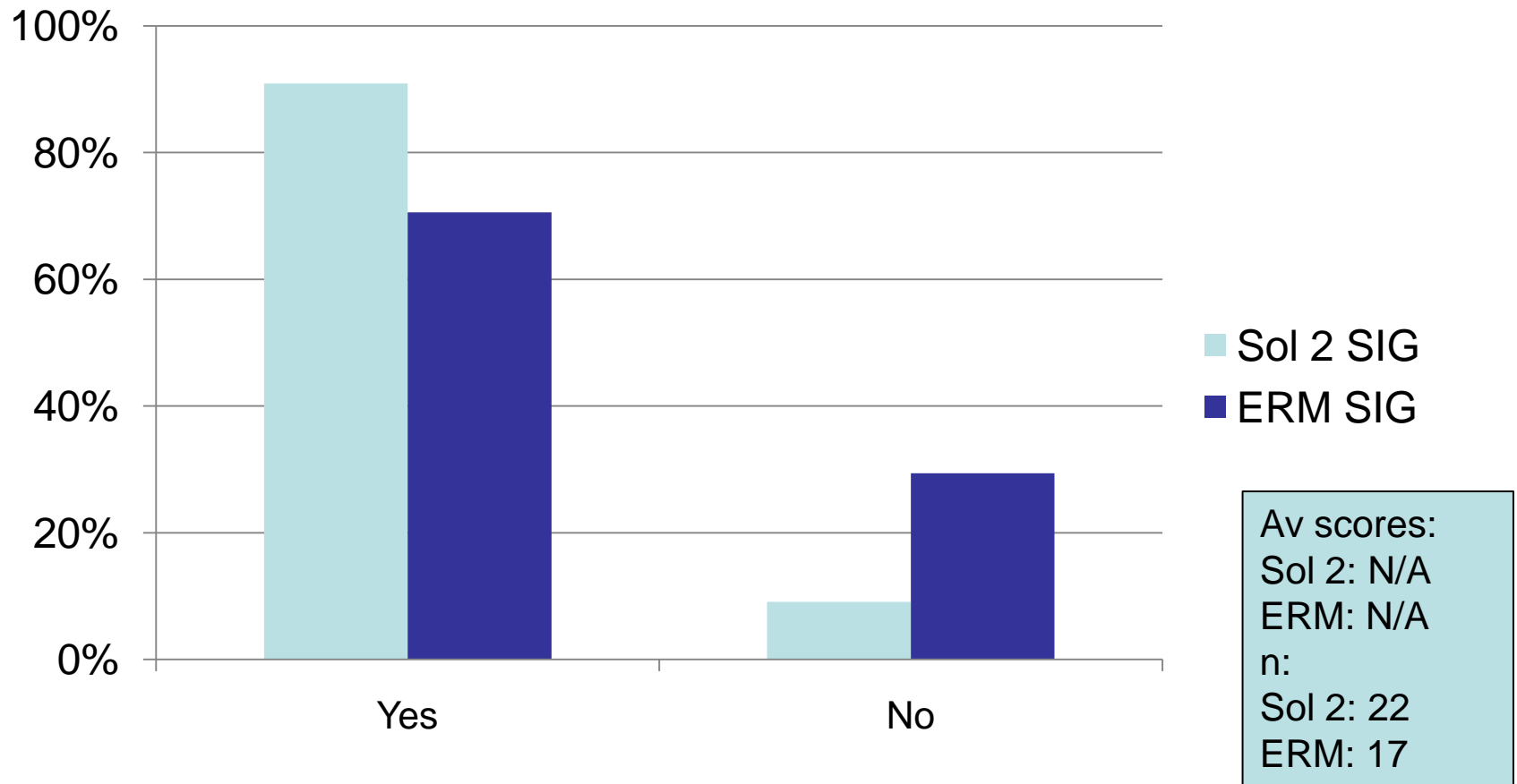
Q15: Do you think there are any critical elements missing from the guidance in the consultation paper?



Q16: If you have answered yes, then what do you think is missing?

- Relationship with financial metrics VV qualitative ones
- Application and flexibility in a model - its a bit prescriptive in places
- Over importance of Risk MI.
- As per responses above - more practical guidance and further detail on risk maturity.
- Culture, Human Resources...setting out some generic type qualitative statement

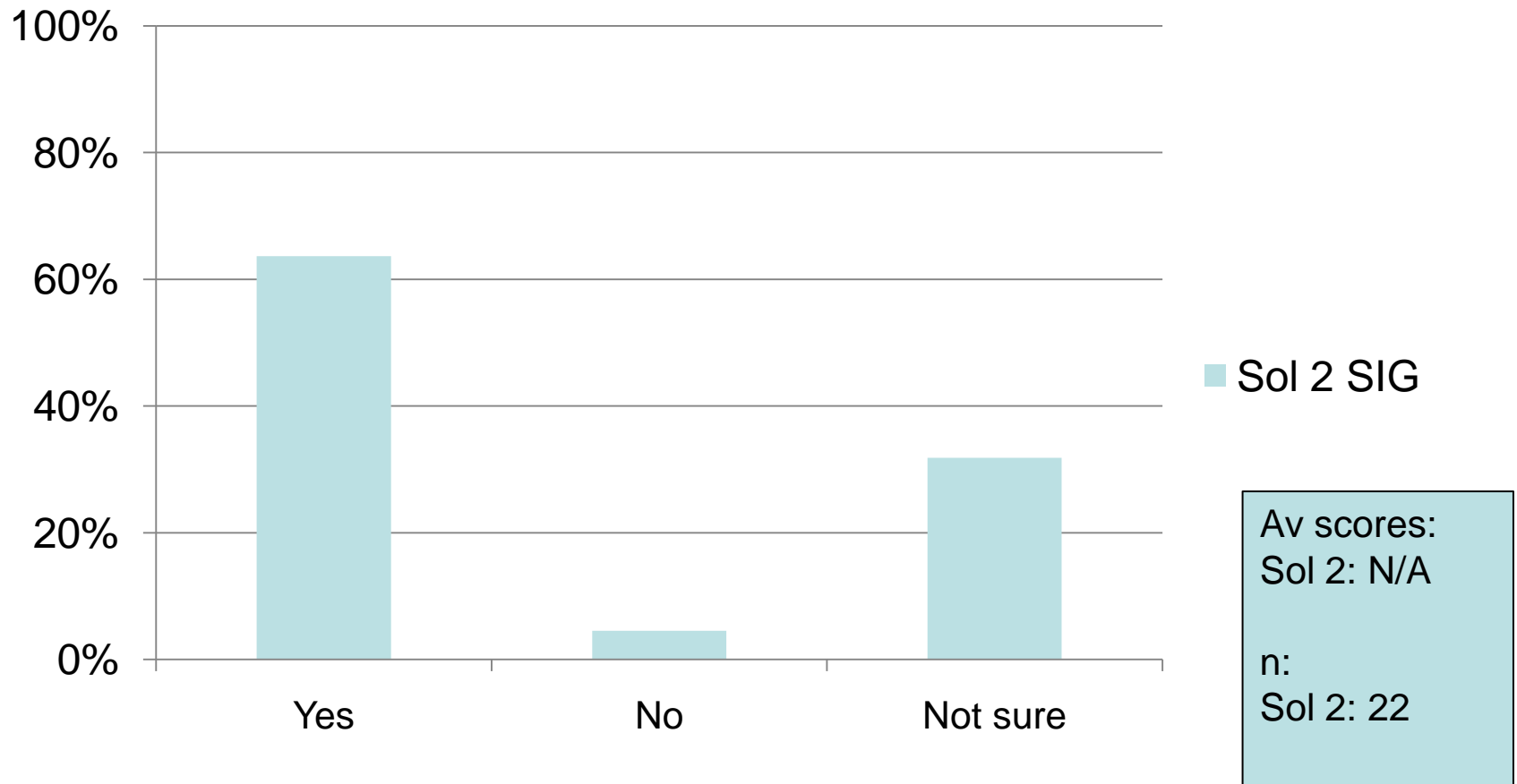
Q17: Would you find it useful to have a short form version (say 2-4 pages) of the Risk Appetite guidance to show to your directors?



Q18: Do you have any examples of risk appetite in action that could be used to illustrate the IRM paper?

- Possibly - subject to confidentiality issues
- Not yet but am working on it
- Is the current level of risk within appetite, just outside or completely within - provides indication of what people are accepting and why
- Yes. Risk appetite set as expression of Economic Capital. This is a result of a study of the discounted cash flow model.
- Note - whilst I have read the paper, I have not yet considered it fully in the context of our business and therefore some of my answers may change if the survey was completed again in the future
- We have no appetite to achieve less than x% of
- "% Return on capital
- "% Erosion of Net Assets"

Q19: Will the approach set out in the Risk Appetite consultation paper help with regard to Solvency II?



# Risk Appetite

## A consultation document



Institute of Risk Management  
6 Lloyd's Avenue  
London  
EC3N 3AX  
United Kingdom

### Personal Contact Details

Richard Anderson

Deputy Chairman of the Institute of Risk Management &  
Managing Director – UK, Crowe Horwath Global Risk Consulting

[richard.anderson@crowehorwathgrc.net](mailto:richard.anderson@crowehorwathgrc.net)

Mobile: +44 7807 780284

A horizontal bar composed of four colored segments: light green, medium green, teal, and dark blue.

The Institute of Risk Management