Embedding Risk Appetite in decision making – Approach & Challenges

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Introduction to Risk Appetite

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What is Risk Appetite Framework?

Risk Appetite Framework

- Risk appetite statement documents the risks that an organization is willing to accept.
- An organization’s strategic goals should be the driver of its risk philosophy.
- Without a risk appetite statement, there may be an insufficient basis for managing risk, which could lead to an inconsistency in decision making.
- Developing a risk appetite statement requires significant knowledge of the business and specific expertise in the disciplines of risk management.

A risk appetite statement should:

- come from the Top and be reviewed and approved by the Board of Directors, at least annually.

- be in line with the organization’s strategy, objectives and key stakeholder demands.

- cover key risks and is the cornerstone / bedrock of an effective risk management.

- reflect the resources required to measure and manage the company’s risks.

Why is Risk Appetite Framework important?

What's at stake?

1	**Reputation:** Adverse incidents can lower business volumes and earnings.
2	**Governance:** Ensuring effective board governance is becoming priority.
3	**Intelligence:** Boards increasingly ask questions about magnitude of risk undertaken.
4	**Institutional Investor:** The focus on risk management is a top governance priority of institutional investors / capital markets.
5	**Convergence:** Boards increasingly need to understand where concentration risk prevails and to what degree.
6	**Regulatory Requirements:** A risk appetite process is legislated in few countries.

How Risk Appetite fits in an Enterprise?

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Risk Appetite Framework to mitigate the risks faced by a firm:

Feedback loop

Enterprise Strategy → Risk Appetite and Tolerance → Risk Management Process → Risk Policies and Standard → Decision Making

Review of Risk Management Policy and suggesting best practices.

Layers of risk appetite framework

Step 1 › **Step 2** › **Step 3** › **Step 4** › **Step 5**

- **Step 1:** Review the risk preferences and existing key risk indicators
- **Step 2:** Review the risk appetite statements for any modifications
- **Step 3:** Recommend the methodology on arriving at thresholds of risk indicators
- **Step 4:** Ensure thresholds and metrices are benchmarked with the industry
- **Step 5:** Recommend a review mechanism ensuring appetite statements are embedded in the overall ERM framework

How 'Risk Appetite' acts as a Value enabler…

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Key steps:

1. *Bottom-up analysis of the company's current risk profile*
2. *Interviews with the Board of Directors regarding the level of risk tolerance.*
3. *Alignment of risk appetite with the company's strategy*
4. *Implementing the risk limits and tolerances*
5. *Establishment risk-monitoring processes.*
6. *Communication with senior management for their buy in.*

Cost savings from risk mitigation

+

Revenue enhancements from risk insights

+

Reduced cost of risk capital

−

Cost of risk operations

=

Increased risk adjusted returns

Benefits:

- ✓ *Optimized risk adjusted returns*
- ✓ *Positive impact on KPIs*
- ✓ *Lower cost of capital*
- ✓ *Integral part of financial planning exercise*
- ✓ *Reduced regulatory scrutiny*
- ✓ *And more…*

Thank You

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