



RIMS
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Developing and Articulating a Risk Appetite

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Today's Agenda

- Key Components of Managing Risk to Appetite and Tolerances
- A Management Perspective
- The Board's Perspective
- Discussion
- Questions

Why Care About Risk Appetite?

- Securities regulators (ASIC and ASX) want increasing disclosure and transparency
- Credit rating agencies are increasingly focused on effective risk management
- Institutional Investors are increasingly interested in evidence that board risk oversight is carried out effectively
- Internal auditors are obligated to assess and report on the effectiveness of risk management processes
- Various sources of board risk oversight expectations are impacting board directors “duty of care” obligations

One Approach to Risk Categories



Strategic

- Acquisitions
- Business Model
- Competition
- Demographic Changes
- Disruptive innovation
- Market
- Etc.



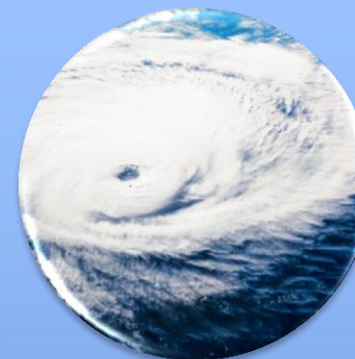
Operations

- Customer service
- Infrastructure
- Processes
- System capabilities
- Talent
- Etc.



Financial

- Capital
- Cash flow
- Credit
- Debt obligations
- Foreign exchange
- Liquidity
- Etc.



External

- Economy
- Environment
- Geopolitical
- Regulatory
- Tax policies
- Weather events
- Etc.

ONE BASIS FOR TOLERANCE SETTING

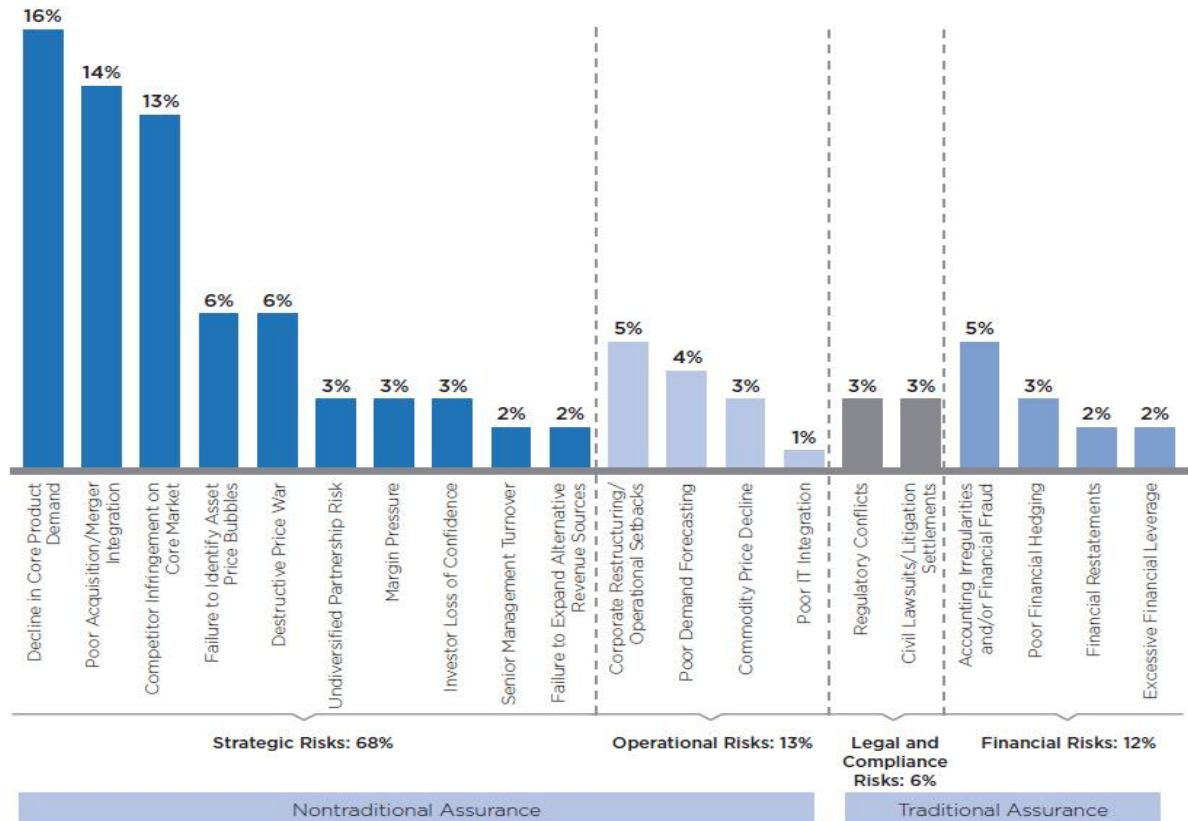
Value Destruction By Risk Type

Strategic risks continue to have greater negative impact on stock price than more easily auditable risk areas.

- This analysis looks at root causes underlying market capitalization declines of 50% or more in a single year.
- Percentages refer to frequency of occurrence of each factor in the sample population.

ROOT CAUSES OF DECLINE

Market Capitalization Decline Drivers
Top 20% of Fortune 1,000 (1998-2009)



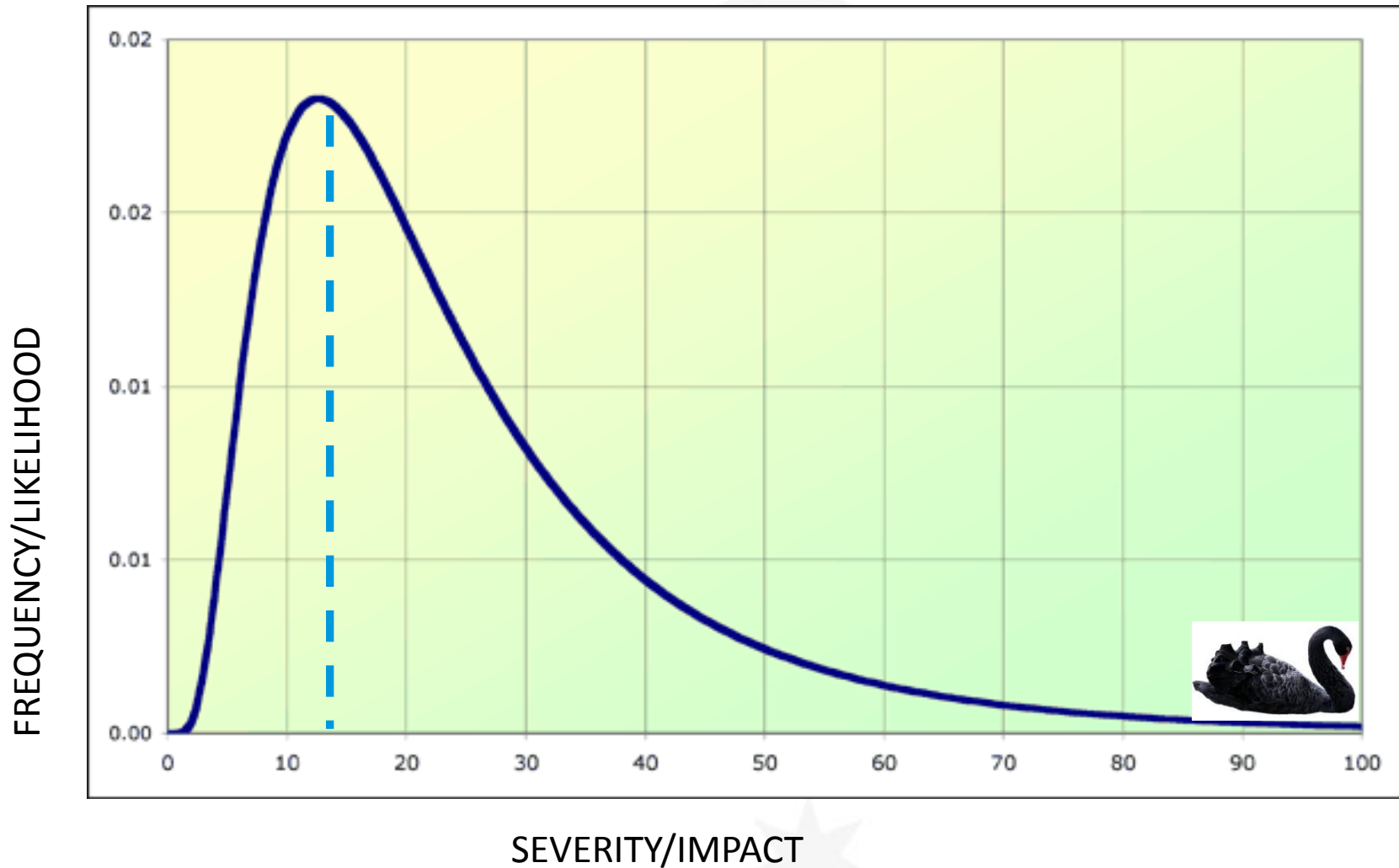
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From the AUDIT DIRECTOR ROUNDTABLE* of the FINANCE AND STRATEGY PRACTICE
www.adr.executiveboard.com

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Source: Corporate Executive Board

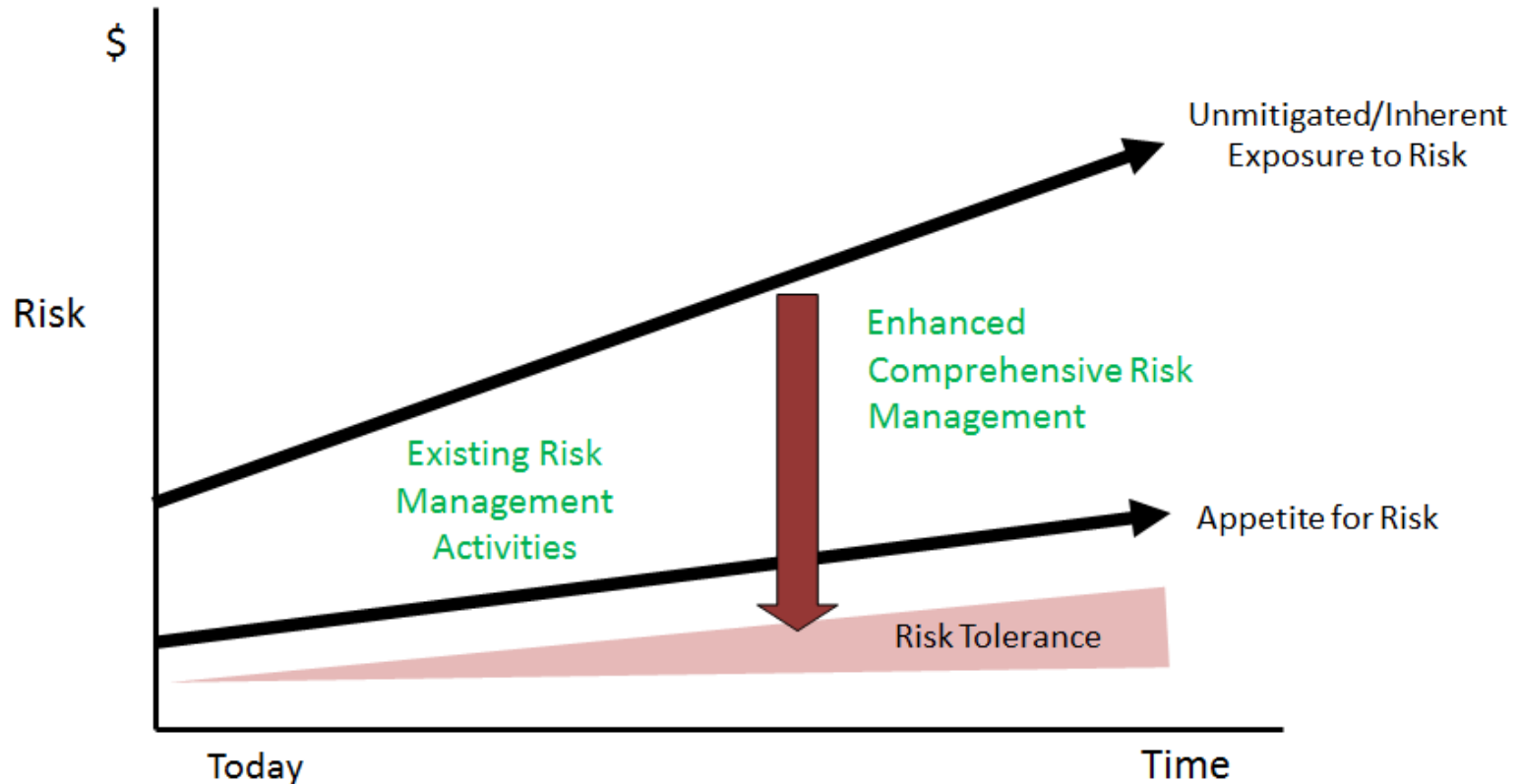
Choosing Your Risk Range Focus



Key Questions Addressing Risk Taking

- How much risk *are we taking?*
- How much risk *can we take?*
- How much risk *do we prefer to take?*
- How much risk do we *need to take* to reach our strategic goals?
- Which risks **do we want to take** and which risks are unacceptable to take and why?
- **What is the gap** between capacity and need?
- What actions can we take to **close the gap** to align with needs and stay within legal limits and preferences?
- If the gap is large between need and capacity, **which strategies need to be modified and how?**
- What **stakeholders will be most affected** by these modifications?

Risk Exposure, Appetite and Tolerance



Two Distinct Components

Quantitative

- Growth Targets
- Earnings Volatility
- Debt Covenants
- Risk Adjusted Cost of Capital
- Liquidity Position
- Risk-Reward Trade-offs criteria

Qualitative

- Reputation
- Customer Satisfaction
- Health and Safety
- Culture
- IT Security
- Corporate Culture
- Regulator Compliance

Common Methods for Expressing Risk Appetite

- Setting a boundary on a risk map
- Economic capital measures/balance sheet-based
- Changes in credit rating levels
- Profit and loss measures
- Value based measures (based on probability of ruin or total cost of risk)
- Limits/targets or thresholds for key indicators (e.g., +/- 50% probability of increasing [EBIT/earnings etc. by x%
- Qualitative statements (e.g., zero tolerance for regulatory breaches or loss of life)

Essential Elements & Challenges of Appetite Frameworks

Key Elements of an Effectively Managing Risk to Appetite and Tolerance

- Defining Acceptable Boundaries
- Calculating and Articulating Tolerances
- Developing a Risk Portfolio View of Exposures
- Addressing Gaps Between Acceptable and Actual Risk Levels

Key Challenges of Risk Appetite Frameworks

- Understanding and driving consistency of terms
- Variations in appetites among stakeholders
- Quantifying all significant risks
- Relating appetite and tolerances to strategic goals
- Embedding into the culture

Risk Appetite – The Board's Perspective

- Why do you need a Risk Appetite?
- What is risk appetite vs. tolerance
- Differing roles - Board and Management
- What does the Board do in this area
 - Develop the appetite
 - Communicate with Management
 - Receive regular reports
 - Update the appetite as appropriate

Risk Appetite – The Board's Perspective

- Alignment with Strategy
- The risk appetite statement
- Who is involved



Key Challenges for Greater Effectiveness

Risk challenges are increasingly priorities for execs and boards, including:

- Understanding what risks are most threatening to mission accomplishment
- Connecting actionable risk information to goals & strategy
- Managing critical risk interdependencies
- Managing risks to appetite and tolerance strategies
- Getting ahead of emerging risks
- Controlling risks brought to the firm by third parties
- Fostering a strong ethics and risk culture
- Addressing low-frequency, high-impact risks proactively
- Providing timely information on key risks not effectively mitigated

Risk Appetite – The Board's Perspective

- How do you go about it?
- Consider:
 - Shareholders
 - Strategy
 - Environment
 - Organisational Capability
 - Risk Culture



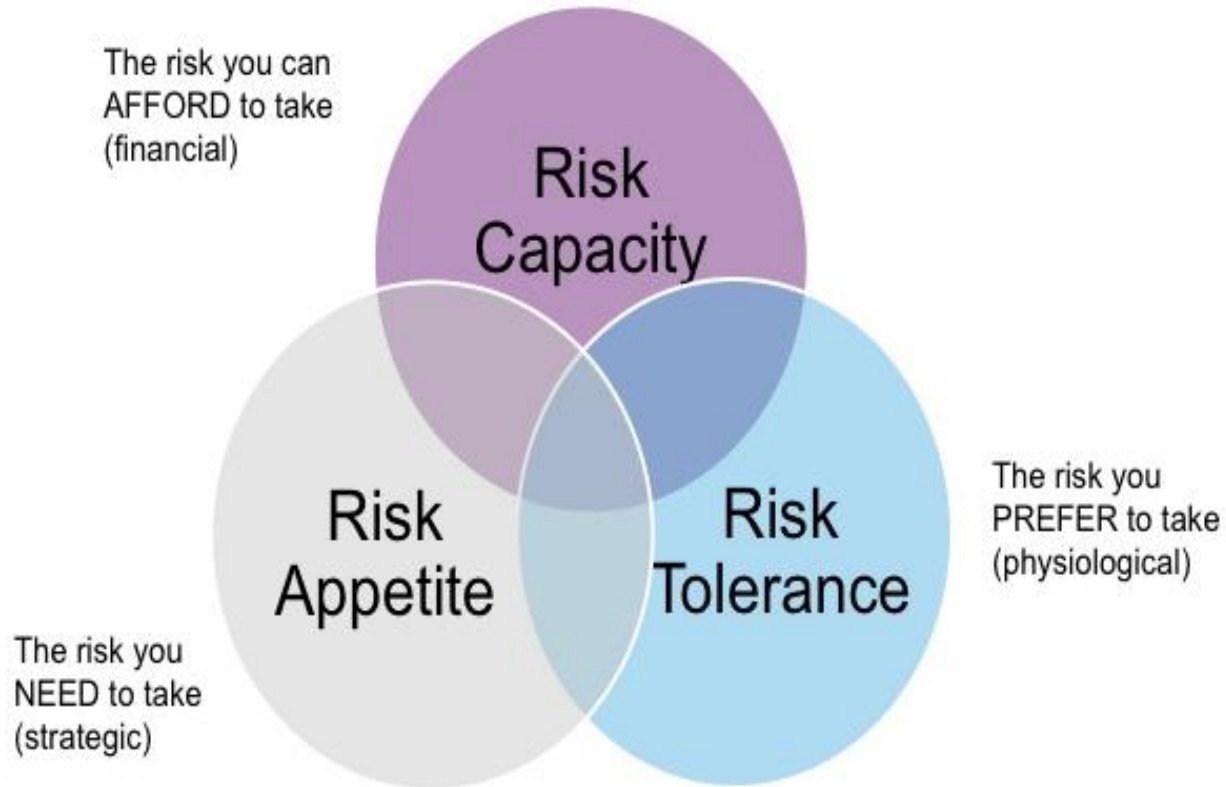
Risk Appetite – The Board's Perspective

- How do you go about it?
 - Determine exactly what is your risk capacity
 - Identify the risks for the organisation and determine the significant ones



Risk Appetite – The Board's Perspective

The interaction of Risk Appetite, Tolerance and Capacity



Source : AON

Risk Appetite – The Board's Perspective

- Types of risks
 - Strategic
 - Financial
 - Operational
- What is risk appetite used for?



Risk Appetite – Management's Perspective

Q&A



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