

# YARDSTICK FOR ERM: RISK APPETITE

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Alvin Soh, FSA, CERA

## Disclaimer

The opinion expressed in this presentation and in the following slides are solely of my personal view and do not represent that of my employees or of any parties.

## Three topics are covered in this session:

1. Unbundling risk
2. Setting risk appetite
3. Applying risk appetite

### 1. Unbundling “risk”: Basics

The analysis of risk can be “unbundled” into 2 components:

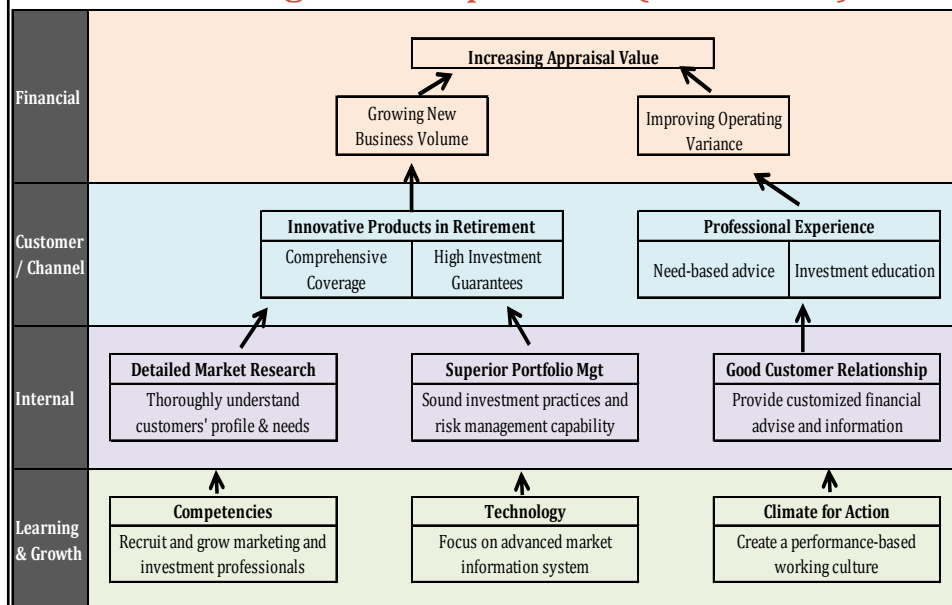
- Expectation of the future
- Potential Deviations from expectation

## 1. Unbundling “risk”: Expectation

The “expectation” of an organization is usually evaluated in the strategic planning process, constantly evolving to answer the following two questions:

- What should our organization be?
- What do we need to do now to be there in the future?

## 1. Unbundling “risk”: Expectation (Illustration)

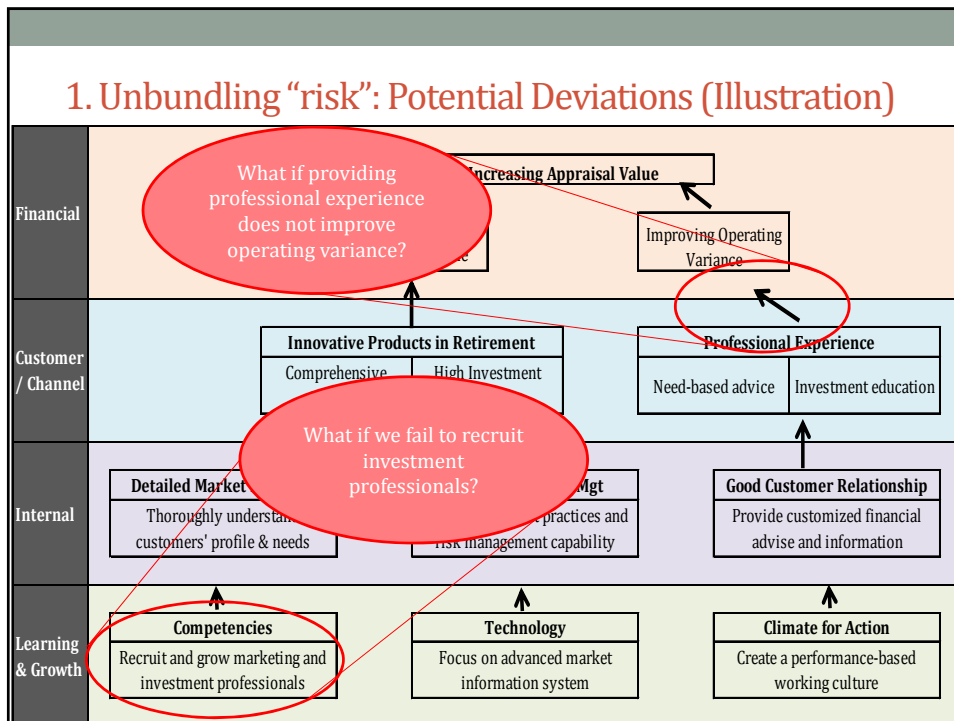


## 1. Unbundling “risk”: Potential Deviations

The “potential deviations” is referencing to the “expectation” of an organization, evolving to pose the following questions:

- What if our plan is not working?
- What if our plan is not expected to work?

## 1. Unbundling “risk”: Potential Deviations (Illustration)



## 2. Setting Risk Appetite: Basics

There are three things we know about the future:

- It cannot be known;
- It will be different from the present; and
- It will be different from the expectation of the future

Hence, ERM is about taking actions in the present so that the potential deviations fall within certain acceptable range.

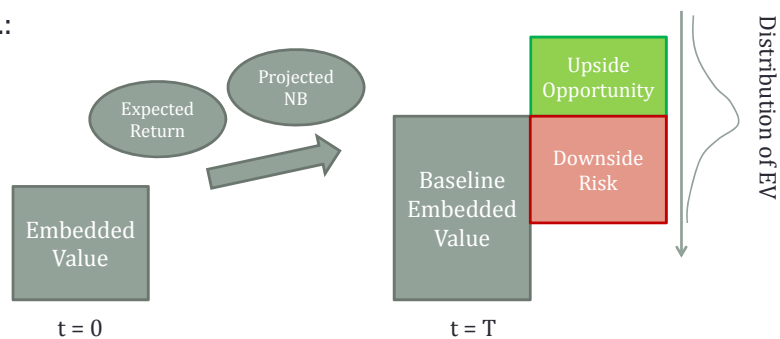
The risk appetite defines that “acceptable range”.

## 2. Setting Risk Appetite: Dimensions

Risk appetite consists of 3 inter-connected dimensions:

- Theme;
- Time horizon;
- Tolerance level

E.g.:



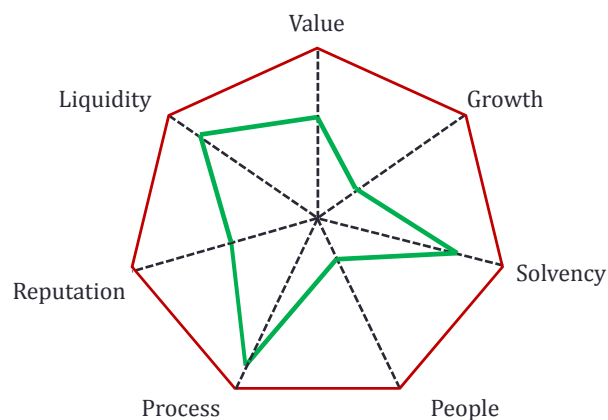
## 2. Setting Risk Appetite: In other “words”

Company XYZ shall not tolerate decisions or activities that causes its:

- Embedded Value (theme)
- over 3 years horizon (time horizon)
- to exceed \$100m in a 1-in-10 scenario (tolerance level)

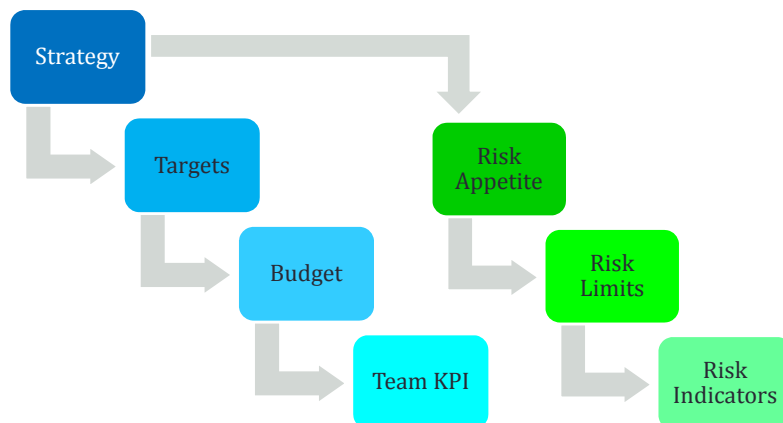
## 3. Applying Risk Appetite: Basics

The key goal of ERM process is to ensure that the risk exposure is within the risk appetite:



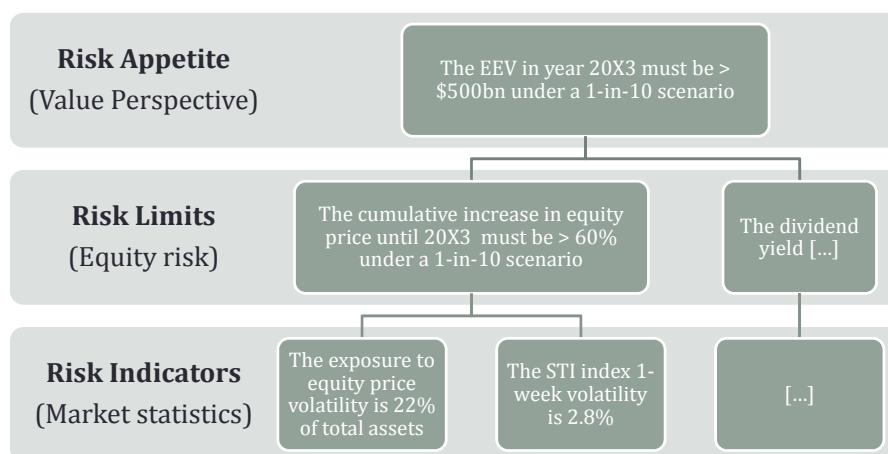
### 3. Applying Risk Appetite: Link to Strategy

The link between the risk appetite and strategy is the concurrent development of team KPI and risk indicators using a “stepping-down” approach:



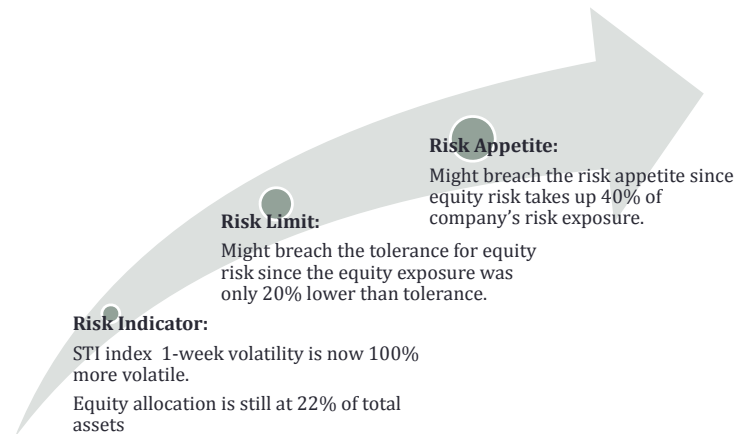
### 3. Applying Risk Appetite: Calibrating Risk Profile

The relationship (or distance) between risk exposure and risk appetite needs to be calibrated regularly to ensure relevance:



### 3. Applying Risk Appetite: Monitoring Risk Profile

The use of risk indicators in the light of risk appetite triggers awareness and timely response:



### Conclusions

The effectiveness of risk appetite is driven by:

- Relevance to organizational goal (vs. historical data)
- Responsiveness to changes (vs. periodical assessment)
- Facilitation of decision-making