

Risk appetite

Getting in shape – building and sustaining your risk appetite

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Building a better
working world

Getting in shape – building and sustaining your risk appetite



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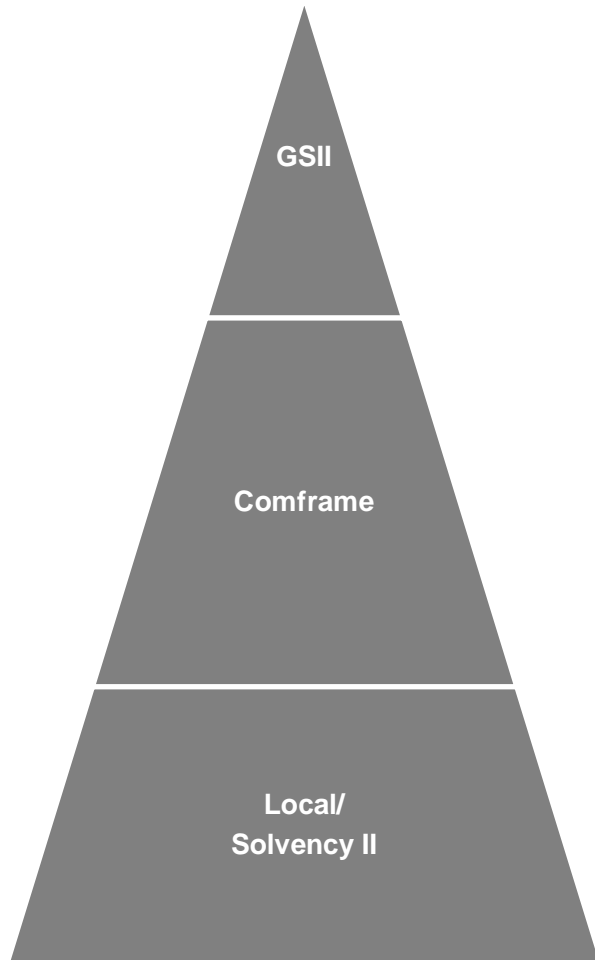
Agenda

- I. Regulatory update
- II. Background and context
- III. Embedding risk appetite
- IV. Hard to measure risks
- V. Risk culture
- VI. Summary
- VII. Q&A

Regulatory Update

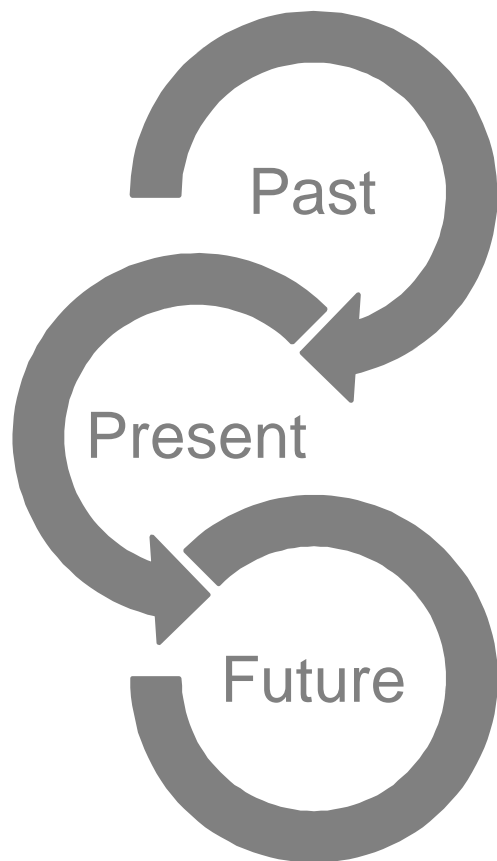


Regulatory update



Source	Scope	Measurement and capital	Other
FSB	Designation by IAIS	As per Comframe [BCR]/HLA /ICS	Resolution plan; recovery plan; systemic risk management plan; liquidity risk management plan
IAIS	\$50bn assets \$10bn GWP 3 territories	TBD - Field testing being initiated [BCR]/ICS	Legal and management structures; governance; enterprise risk management; public disclosure and group reporting
EIOPA / EU	European Domicile GWP > EUR 5mn Gross TP > EUR 25mn	SII Balance Sheet MCR/SCR	ORSA; public disclosure via SFCR

Context - Past, Present and Future



Financial Crisis:

- I. Correlation to maturity of RAF
- II. Sovereign Exposures
- III. Guarantees
- IV. Failures in insurance

Post Crisis Insurance :

- I. Low Interest Rates
- II. Conduct Risks
- III. Operational Risks
- IV. Control failures

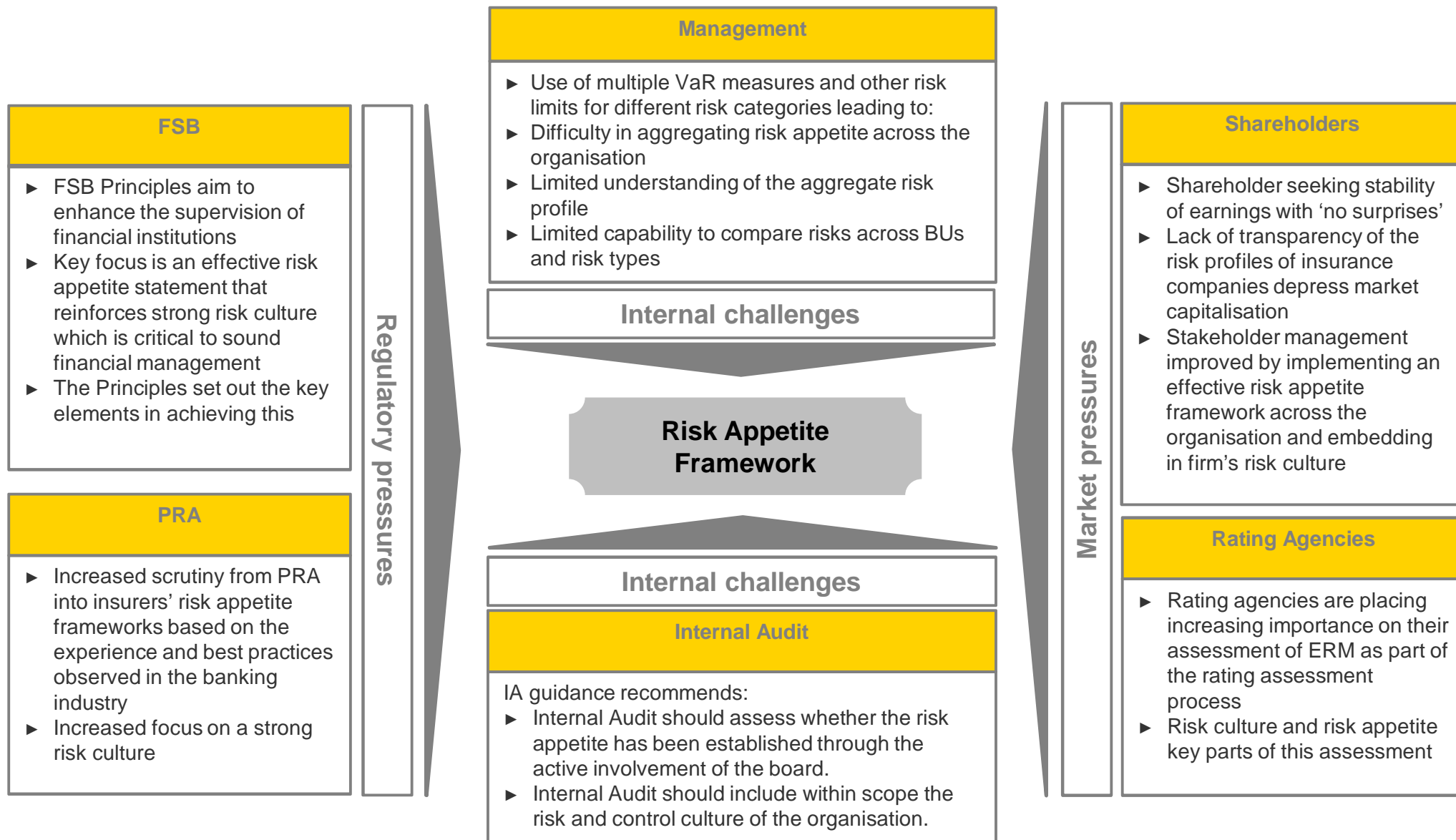
Current and Emerging Risks :

- I. Strategic Risks
- II. Cyber Risk
- III. Regulatory Risks
- IV. Program Risks



need for
effective RAF

Agents and agencies driving the agenda



Areas requiring a significant effort to achieve an effective risk appetite framework (from EY Risk Appetite Survey)

Alignment with FSB attributes for risk appetite frameworks

FSB Principles

Ineffective/partially effective attributes

Effective risk appetite framework

- Framework communicated across the organisation
- Embedded and understood across the organisation
- Facilitate embedding risk appetite in risk culture

Effective risk appetite statement

- Quantitative statements with due consideration to reputational & conduct risk
- Firm wide statement consistent with legal entities' strategy and risk limits

Top three challenges to risk appetite implementation

Key challenges for risk appetite implementation

- Effectively cascading the risk appetite statement throughout the organisation
- Using the risk appetite framework as a dynamic tool for managing risk
- Expressing risk appetite for different risk types

Key areas of challenge

1. Qualitative aspects of risk appetite

- Communicating risk appetite framework across the organisation and embedding risk appetite within risk culture

2. Quantitative aspects of risk appetite

- Ensuring risk appetite statement consistent with strategy and cascading it down to business units / legal entities and across risk types

EY 2013 survey findings – what works !

“Getting a risk appetite framework in place is a key element for building a strong risk culture...”

“While the board should have a clear risk appetite statement, a junior underwriter probably just needs to know his limits...”

“What we have done.....is have much better clarity around the organisation in terms of roles and responsibilities...”

“The value was in the journey not the outcome.”

“There’s no silver bullet.....at the end of the day its really how people behave.”

“The best driver is consequences for people who fail to deliver on their accountability”

“We have our risk appetite, our strategic planning and financial planning fully integrated....”

“We have a framework which is well embedded with the plan but have identified improvement potential in the risk culture awareness of organisation so everybody in the company gets it.”

Roles and responsibility

Linkage to strategy and planning

Embedding RA into operational processes

Strengthening communication

Measurement and reporting

Behaviours and attitudes

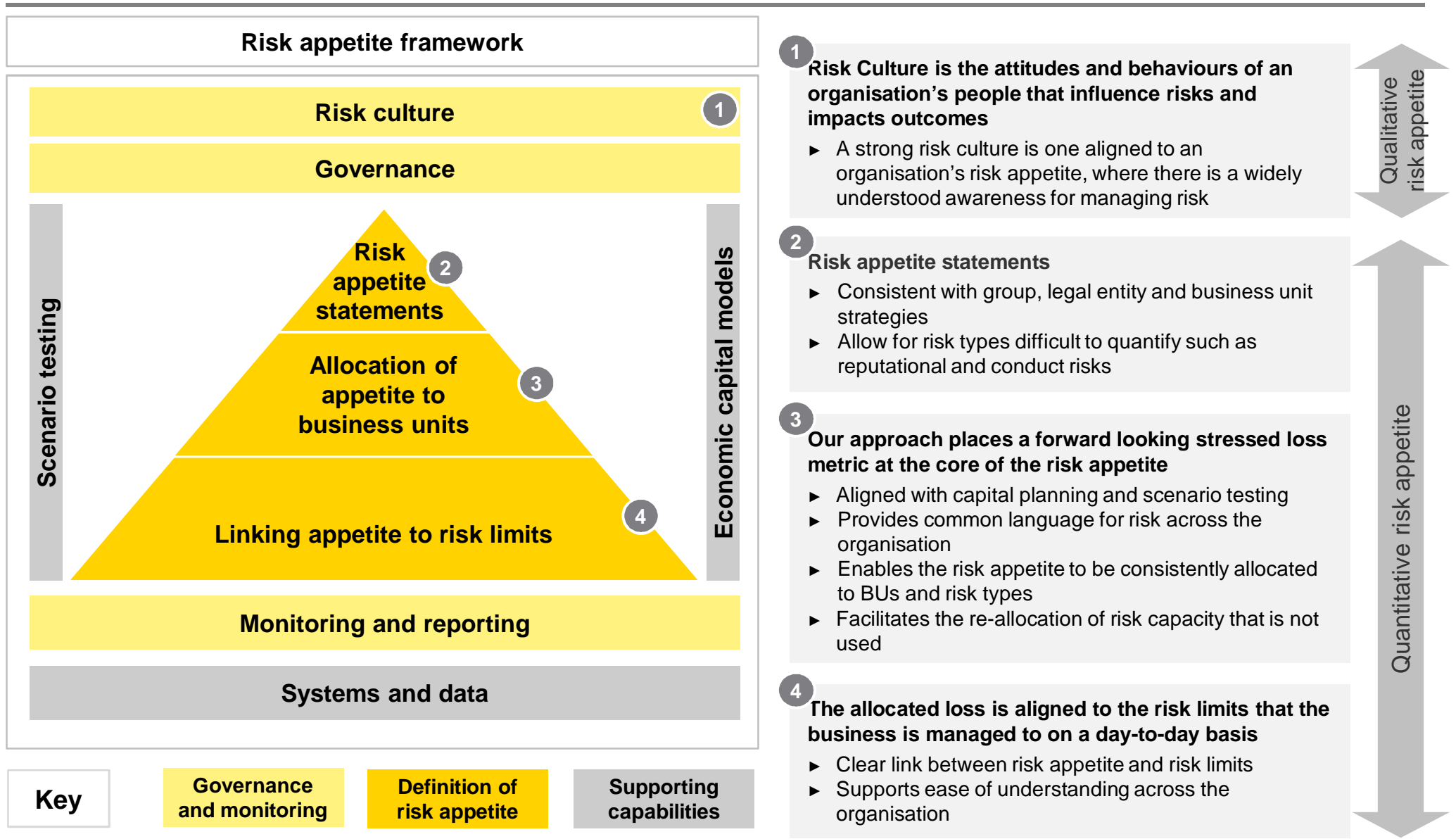
Accountability

Recurrent themes

Embedding risk appetite



Holistic approach to risk appetite



Risk capacity and risk appetite

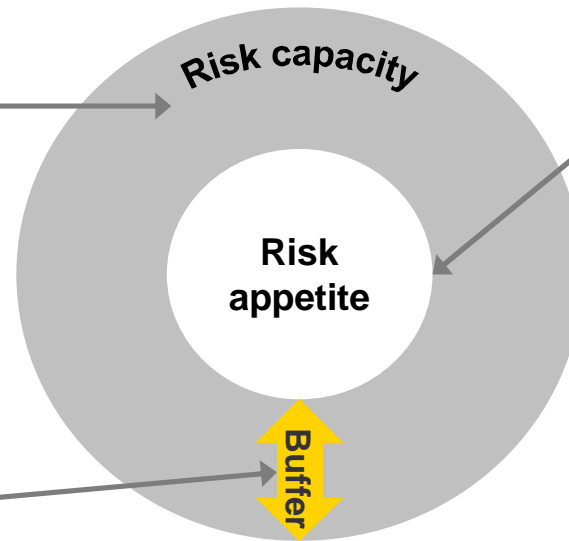
These are based on the industry-consensus FSB definitions

Risk capacity

- ▶ Maximum loss a firm can sustain and still remain viable as a business (ie without breaching regulatory capital, liquidity and conduct constraints)

Risk appetite

- ▶ Aggregate amount of risk a firm is willing to assume within its risk capacity to achieve its strategic objectives and business plan



Buffer

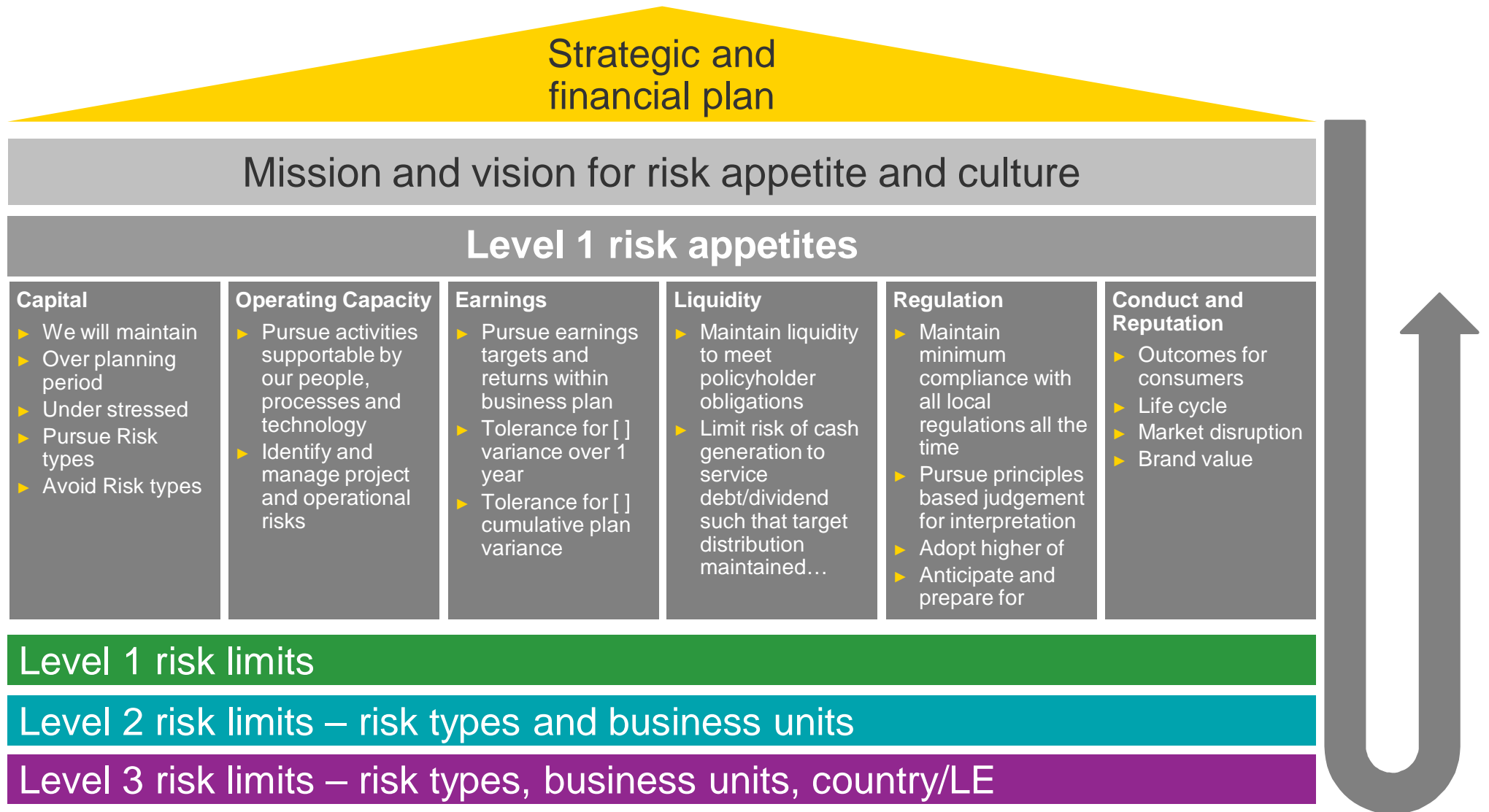
- ▶ Funds held above risk appetite due the uncertainty in the determination of risk appetite and risk capacity

Organisations need to be clear on what they are willing to lose, for example:

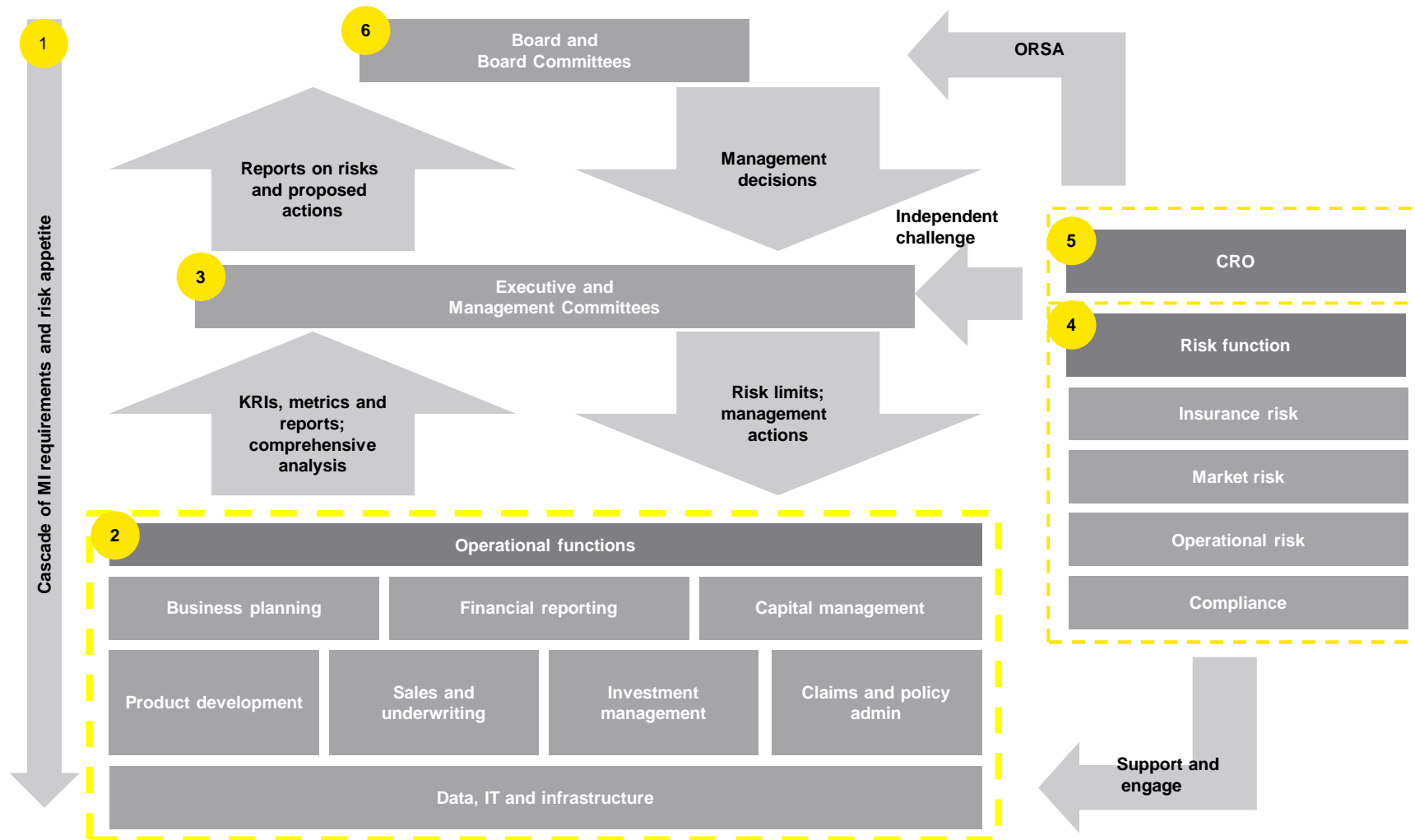
- (1) Over one year under normal conditions
- (2) In a downturn scenario
- (3) In an extreme scenario and still maintain viability as a business

Together, these define a target operating range for this business

Building a risk appetite statement – top down



Risk MI fully aligned to the governance and decision making setup of the organisation



Stakeholders require different information at different frequencies

Daily/weekly dashboard

- ▶ Early warning information specific to urgent issues and events
- ▶ Conclusions and action items

Monthly

- Similar to weekly information, however amended with:
- ▶ Risk dashboard setting for key risk Indicators:
 - ▶ Current exposure and changes against previous reporting period
 - ▶ Comparison against plan
 - ▶ Comparison against agreed limits
 - ▶ Information and high level analysis on important risk exposures

Quarterly

- ▶ Provide an update to the EC/Management Team and Board on development of risk profile and capital against plan
- ▶ Provide information on key risk issues that require attention
- ▶ Inform/facilitate capital allocation process
- ▶ Short 'facts and figures' dashboard to provide a snapshot of limit usage and Solvency position

Annual

- ▶ Internal analysis for Board/EC audience on the solvency position and medium term risk threats, which require management attention (Group, BU and LEs)
- ▶ Forms the basis of forward looking information in the ORSA
- ▶ Strongly linked to the business planning process and incorporating risk analysis of the plan relative to risk tolerance and limits
- ▶ Includes risk limits, top risks, scenario testing and potential management actions

Risk dashboard – Example

Overview of risk profile against plan and appetite

Executive summary

Overall

- ▶ Text

Financial markets

- ▶ Text

Business development

- ▶ Text







Hot topic of the month

- ▶ Text

Watch list of KRI's related to Top Risks

- ▶ Text

Stress and scenario testing

Base scenario	Exposure		Comparison against		RAG status	
	Current period	Previous period	Plan	Limit	Current period	Previous period
Solvency capital coverage ratio	x	x	x	x		
Earnings at risk	x	x	x	x		
Liquidity coverage ratio	x	x	x	x		

- ▶ Solvency coverage ratio: changes in the level of exposure since previous valuation period are due to:
 - ▶ x
 - ▶ x
- ▶ Earnings at risk: changes in the level of exposure since previous valuation period are due to:
 - ▶ x
 - ▶ x
- ▶ Earnings at risk: changes in the level of exposure since previous valuation period are due to:
 - ▶ x
 - ▶ x

Risk dashboard – Example

Risk dashboard by risk driver

Required Capital (£,m)	Exposure		Comparison against		RAG status	
	Current period	Previous period	Plan	Limit	Current period	Previous period
Market risk					●	●
Interest rate risk	x	x	x	x	●	●
Spread risk	x	x	x	x	●	●
Equity risk	x	x	x	x	●	●
Underwriting risk					●	●
Mortality risk	x	x	x	x	●	●
Lapse risk	x	x	x	x	●	●
Counterparty default risk	x	x	x	x	●	●
Operational risk	x	x	x	x	●	●
Emerging risks	x	x	x	x	●	●
TCF & operational risk	x	x	x	x	●	●

Interest rate risk

- ▶ Key changes in interest rate level and trend
- ▶ Impact of key drivers on capital, earnings and liquidity
- ▶ Follow-up on implemented mitigation actions and related impact
- ▶ Planned mitigation actions (owner, timeline and related impact)

Lapse risk

- ▶ Key changes in policyholder behaviour:
 - ▶ Drivers
 - ▶ Products affected
- ▶ Impact of key drivers on capital, earnings and liquidity
- ▶ Follow-up on implemented mitigation actions and related impact
- ▶ Planned mitigation actions (owner, timeline and estimated impact)

Spread risk

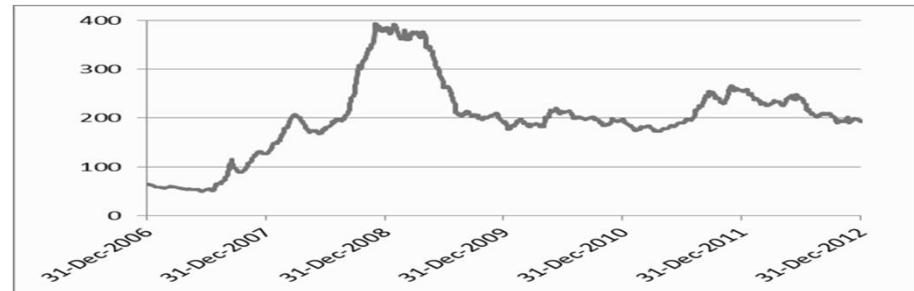
- ▶ Key changes in the creditworthiness of counterparties:
 - ▶ Exposure to top material counterparties
 - ▶ Restrictions issued for further investments with these counterparties
- ▶ Impact of key drivers on capital, earnings and liquidity
- ▶ Follow-up on implemented mitigation actions and related impact
- ▶ Planned mitigation actions (owner, timeline and estimated impact)

Risk dashboard – Example

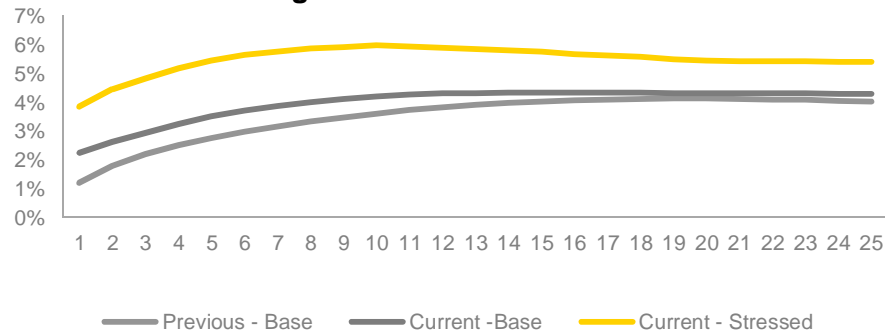
Stress and scenario testing

Stressed scenarios	Stress scenario 1 RAG status		Stress scenario 2 RAG status		Stress scenario 3 RAG status	
	Stressed	Current	Stressed	Current	Stressed	Current
Solvency capital coverage ratio	●	●	●	●	●	●
Earnings at risk	●	●	●	●	●	●
Liquidity coverage ratio	●	●	●	●	●	●

Stress scenario 2: Significant credit spread widening (2008 crisis)



Stress scenario 1: significant increase in interest rates

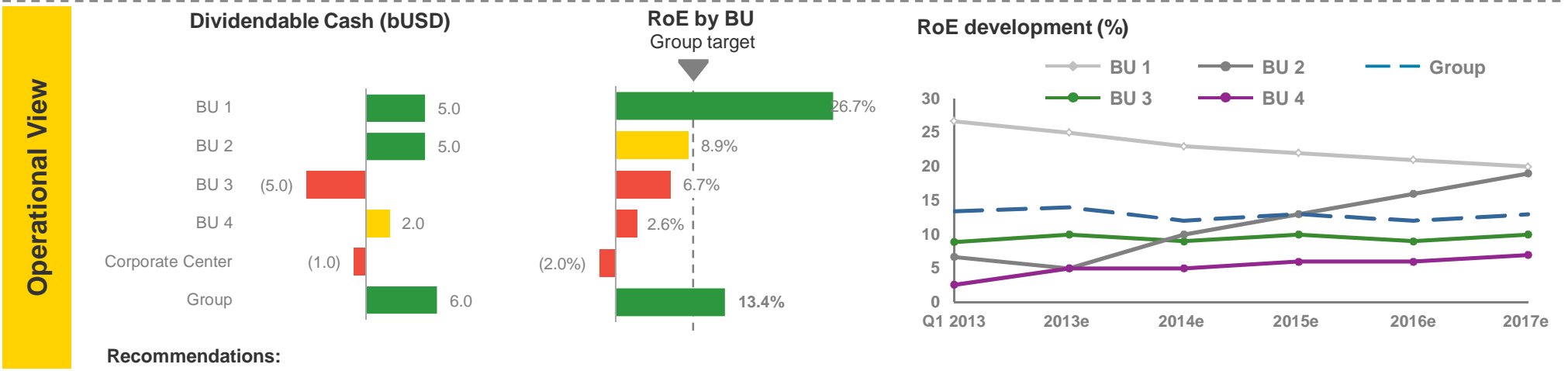
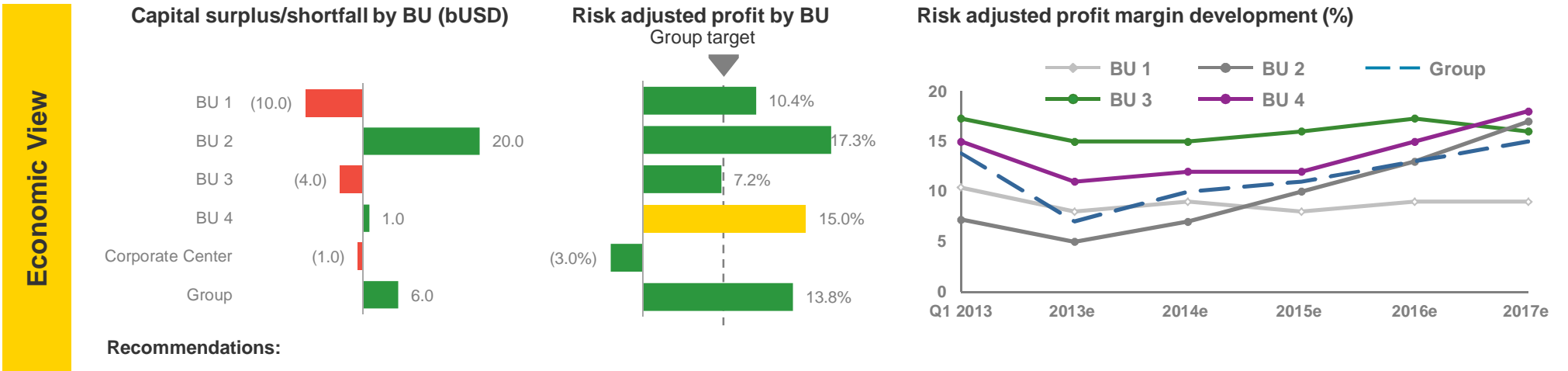


Stress scenario 3: Government default on largest 3 exposures

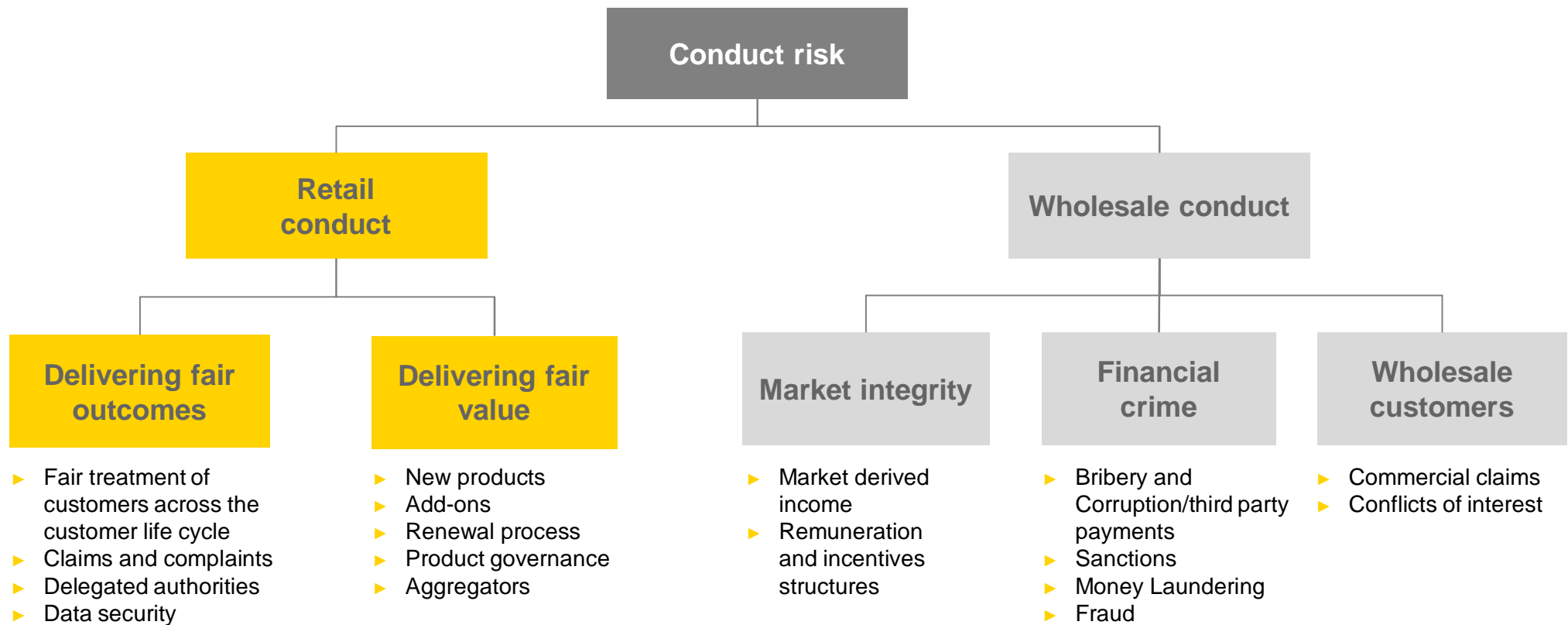
	Country 1		Country 2		Country 3	
	Stressed	Current	Stressed	Current	Stressed	Current
Value of holding						
Profit share impact						

Risk dashboard – Example

Capital management dashboard by major BU



Conduct Risk – definition and scope



Firms must be clear on conduct risks within their business and reflect them within their risk management frameworks so they can measure and manage them adequately and appropriately

Moving towards conduct risk

Firms have used both top down and bottom up approaches in designing and implementing a conduct risk framework:

Top down approach

Board direction on how to embed good consumer outcomes in the business



Design and implementation of a Conduct risk framework



Bottom up approach

Review of individual risk framework components

Board sets clear vision and overall strategy and direction for the management of conduct of business risk by addressing the following:

- ▶ Main areas of conduct risk in the business – retail and wholesale
- ▶ Overall approach (e.g., 'TCF plus' or other..)
- ▶ How to put the customer at the 'heart of the business'
- ▶ What the 'tone from the top' should be
- ▶ What level of control and oversight the Board expects from the business and assurance functions, and the level of reporting they expect
- ▶ How to embed and evidence a positive risk culture

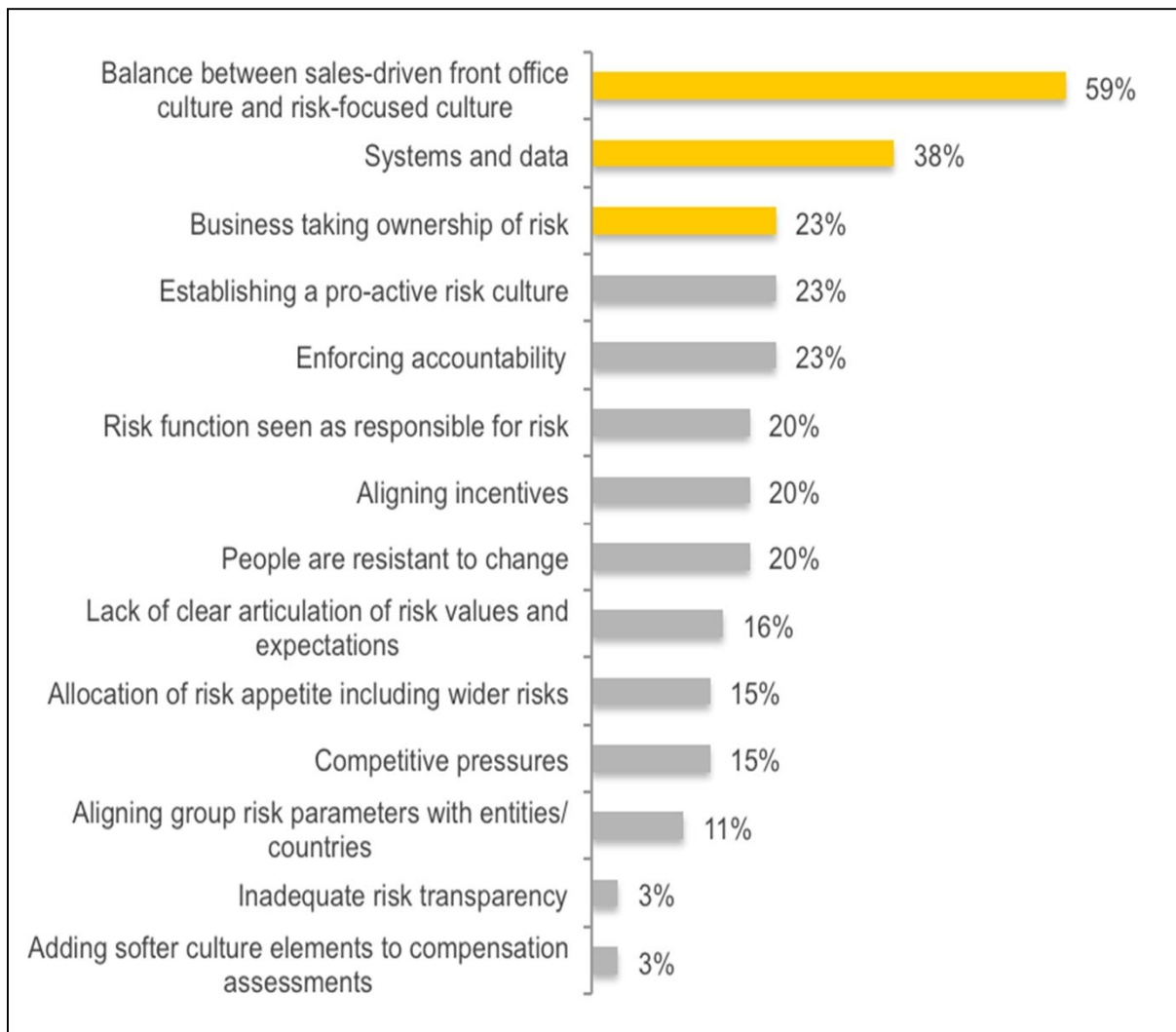
Individual components of the Risk Management Framework are assessed to determine how conduct risk should be incorporated, including:

- ▶ Controls over the product life cycle
- ▶ Conduct of business policies
- ▶ Conduct risk appetite statement
- ▶ Conduct risk MI
- ▶ Processes for identification, assessment, measurement, monitoring and management of conduct risk
- ▶ Oversight and challenge by Compliance and Risk; assessment by Internal Audit

Risk culture



Top challenges to strengthen risk culture: Responses to the 2013 IIF Survey



* Each institution could select three challenges

- ▶ General shift from creating frameworks and policies, to changing behaviour to operate appropriately within these
- ▶ Still a tendency towards compliance rather than understanding among first line risk takers
- ▶ Focus on behaviours, ownership
- ▶ Systems and data remain a hindrance to adequate reporting necessary to implement the frameworks,

Risk culture indicators – how do we measure

Signs indicating attitudes and behaviours may impact outcomes *negatively*

- ▶ Over confidence and unauthorised dealings
- ▶ Intolerance of open discussions and challenge
- ▶ Outliers, areas outside of governance structure
- ▶ Disregard for the views of the Risk community
- ▶ Ineffective escalation and fear of bad news
- ▶ Mis-alignment of incentives
- ▶ Unclear level of tolerances.

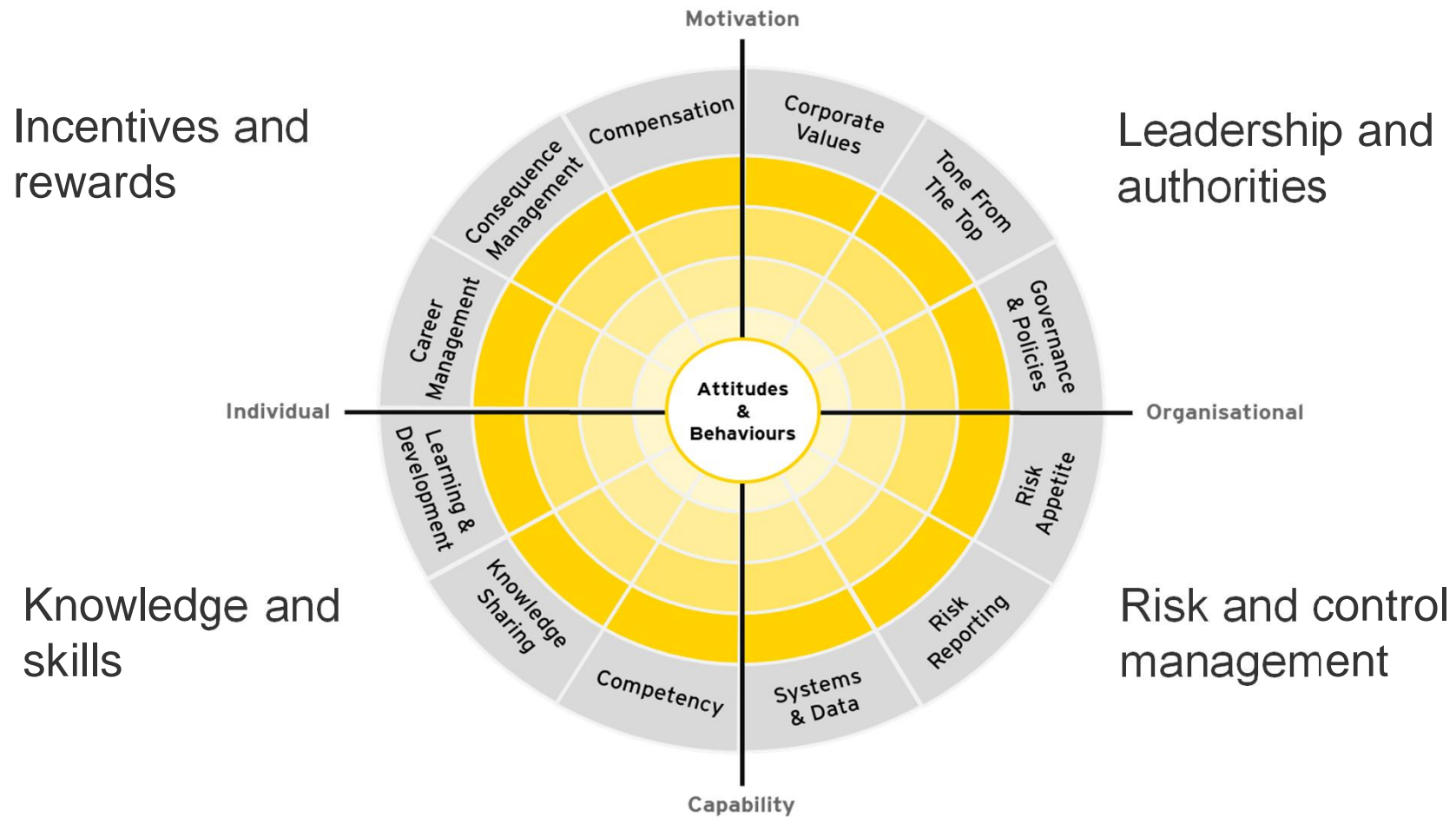
Areas where attitudes and behaviours have most potential to impact outcomes *negatively*

- ▶ New business outside the scope of core activities
- ▶ Fast growing existing business
- ▶ Geographically 'remote' business
- ▶ Personnel with closest access to customers
- ▶ Commission-based personnel
- ▶ New people in fast growing division.

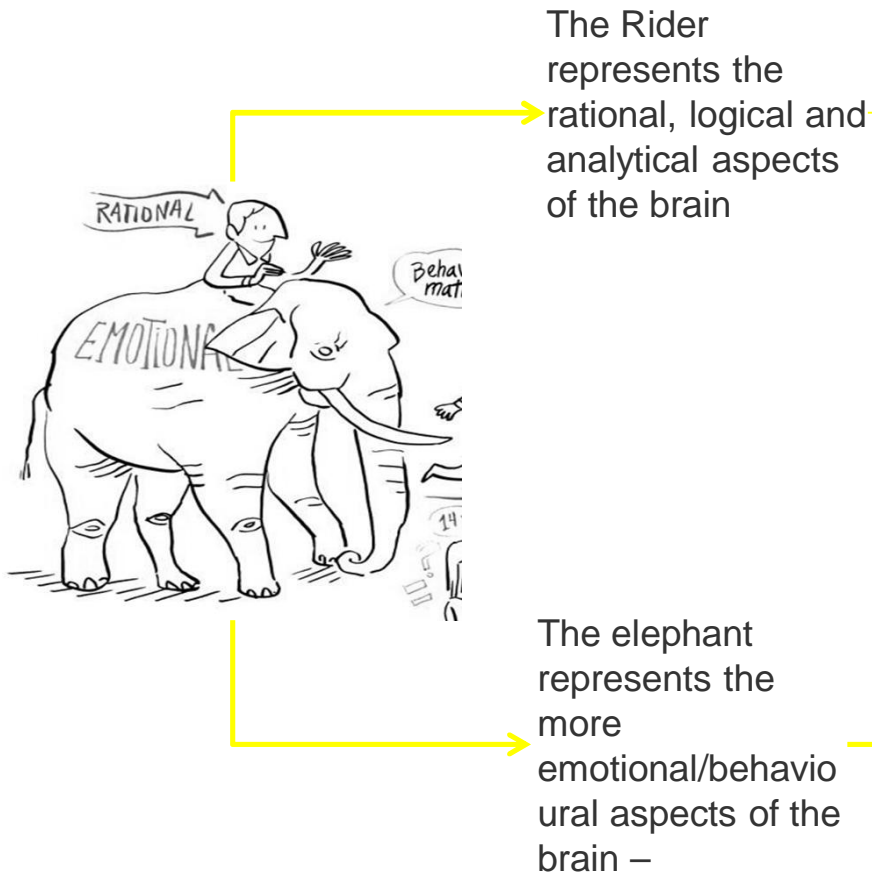
Signs indicating attitudes and behaviours may impact outcomes *positively*

- ▶ Tone-at-the-top continuously provides leadership around the importance of risk management
- ▶ Corporate values promote good behaviours and stress the importance of risk management
- ▶ People not only understand but are motivated to apply rules around appetite and limits consistently
- ▶ Delegation of authority is designed to embrace various points of view and enable consensus on key capital deployment and risk management decisions
- ▶ Management focuses on risk in reporting and controls
- ▶ Examples of good risk management are shared openly and encouraged across the organisation
- ▶ Individuals are provided with the ability to learn more on what good risk management looks like
- ▶ Management provides business and support functions with appropriate level of risk resources
- ▶ Management reinforces the linkage between career opportunities, incentives, rewards and practices of sound risk management.

Influencing culture – the EY Risk Culture model



Designing initiatives to change behaviour requires consideration of behavioural economics



Most initiatives undertaken by firms assume people are rationally driven by incentives and punishment. This leaves them ineffective in many cases

Effective cultural change initiatives require influencing emotional as well as rational centres

Messenger	We are heavily influenced by who communicates information
Incentives	Our responses to incentives are shaped by predictable mental shortcuts such as loss avoidance
Norms	We are strongly influenced by what others do
Defaults	We 'go with the flow' of pre-set options
Salience	Our attention is drawn to what is novel and seems relevant to us
Priming	Our acts are often influenced by sub-conscious cues
Affect	Our emotional associations can powerfully shape our actions
Commitments	We seek to be consistent with our public promises and reciprocate acts
Ego	We act in ways that make us feel better about ourselves

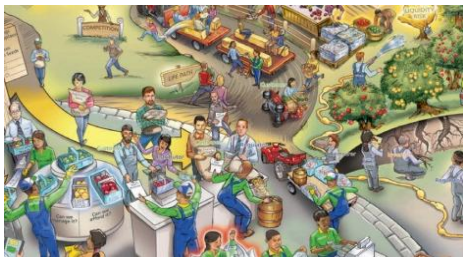
Ways you can improve your risk culture – how do we change

- ▶ Improve communication on risk
- ▶ Establish a risk culture component within existing risk frameworks
- ▶ Conduct employees survey and testing to assess and reinforce risk awareness
- ▶ **Execute customized training on risk culture and risk appetite**
- ▶ **Establish a common framework to assess and monitor risk culture, and embed in the employee lifecycle**

Example initiative 1

Customized training on risk appetite logic

Communication of Risk Appetite

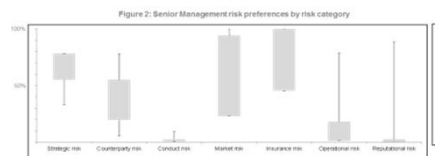
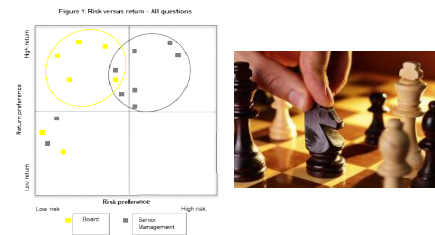


Capital & Scenario Challenge



Proactive	Reactive	Risk drivers	Return / Value Types
<ul style="list-style-type: none"> Investment (short term / long term) Product allocation Acquisitions Pricing for margin versus market share Self insurance levels Cost management (operates) Financing / capital 	<ul style="list-style-type: none"> Fixed / natural disaster Economic and market shock Competitor moves Regulatory / political change Taxation / del Business shock (e.g. major contract loss) Infrastructure failure Skills shortage 	<ul style="list-style-type: none"> Liquidity Credit Labour Financial Insurance Reputational Strategic Operational Technology Environmental 	<ul style="list-style-type: none"> Growth Business Operating Profit Net Profit After Tax Return on equity Earnings Before Interest and Tax Market share Fixed Total Equipment Credit rating Corporate sustainability

Risk preference Workshops



Creating Future Value



Example initiative 2

Measurement and embedding in employee lifecycle

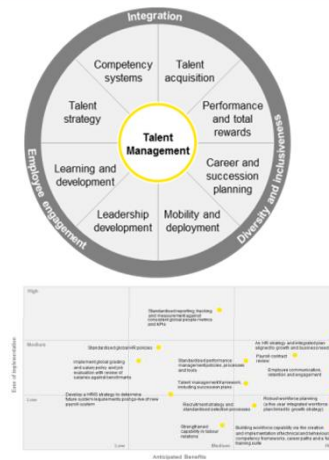
Assessment and design of the measurement process

Step	Identification of	Overview	Example Criteria	Risks Covered
1	Identifiers, Senior Management & Key Control & Infrastructure Function personnel	<ul style="list-style-type: none"> The WETA is largely consistent with the current FSB policies Additional committees to be considered for non-actual taken risks 	<ul style="list-style-type: none"> Members of management body Member of senior management Heads of control & infrastructure functions Heads of business units Members of key risk committees 	All
2	Key material risks down to business unit & risk taking role types across the organization	<ul style="list-style-type: none"> Analysis of focus the key risks using a top down approach to Business unit and service line level Capital allocation/ Other data is analysed to identify key risk areas 	<ul style="list-style-type: none"> Top 80% of risk & profitability metrics (e.g. IFRS, P&L, by business unit) Under writing authority limits and limit utilization 	<ul style="list-style-type: none"> Insurance Risk Market Risk Credit Risk
3	Identified Key Risk Takers for Insurance and other significant risks	<ul style="list-style-type: none"> Identifying individuals who counterparty insurance & other significant risks Key Risk Committee required to identify individuals based on reporting line - homonymous sign-off 	<ul style="list-style-type: none"> E.g. Ability to countermanage a percent of capital (or P&L) 	<ul style="list-style-type: none"> Insurance Risk Market Risk Credit Risk
4	Back-testing	<ul style="list-style-type: none"> Compensation back-testing to be performed Overall back testing based on key risk metrics and other financial metrics 	<ul style="list-style-type: none"> Performed using FSB and other relevant guidance and to ensure qualitative identified and excluded are rationalized Ensure that the identified back test aligned to the risk and business profile of Delta FA 	All risk types using compensation, IFRS and financial data
5	Documentation of Rationale for Key Risk Taker Identification			

Key Risk Taker	Identified	Approved	Reviewed	Approved	Reviewed	Approved	Reviewed
Key Risk Taker	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Key Risk Taker	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Key Risk Taker	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Key Risk Taker	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Defining effective measurement criteria

Embedding assessment into employee lifecycle



Leveraging to report on risk culture

Industry Distribution	Revenue Distribution	Category Distribution
<ul style="list-style-type: none"> Current number of employees per FTI within each industry Number of FTIs that have employees per FTI within each industry Number of employees within each FTI within each industry 	<ul style="list-style-type: none"> Current number of employees per FTI within each revenue Number of FTIs that have employees per FTI within each revenue Number of employees within each FTI within each revenue 	<ul style="list-style-type: none"> Current number of employees per FTI within each category Number of FTIs that have employees per FTI within each category Number of employees within each FTI within each category

Summary



Summary

- ▶ Strategy
- ▶ Risk appetite framework
- ▶ 3 E's – Existing, effective, Efficient
- ▶ Culture

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