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GIRO 2011
Risk Appetite Working Party
Chair – George Orros



Risk Appetite for a General Insurance Undertaking

12 October 2011

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GIRO 2011 **Risk Appetite Working Party**

George Orros – Chair

Veekash Badal
Martin Burke
Matthew Byrne
Frank Chacko
Michael Garner
Paul Kaye
David Noel

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Format

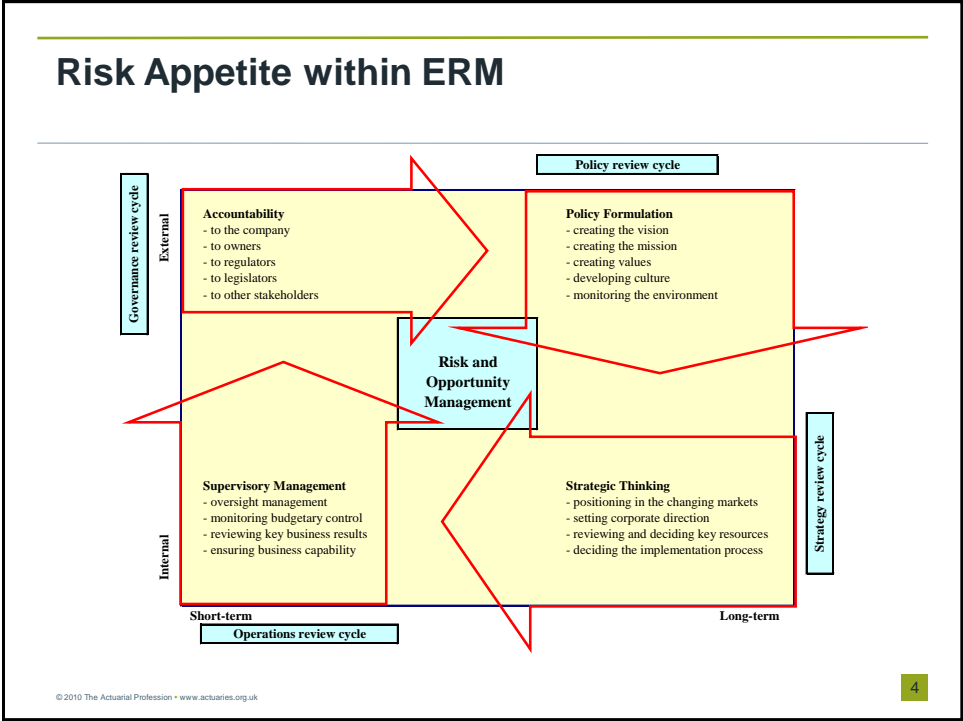
- 1. Risk Appetite within ERM George Orros
- 2. Risk Appetite Concepts Michael Garner
- 3. Risk Aversion, RA Articulation & Effectiveness Paul Kaye
- 4. Risk Appetite Characteristics and Disclosure Martin Burke

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Risk Appetite within ERM

George Orros



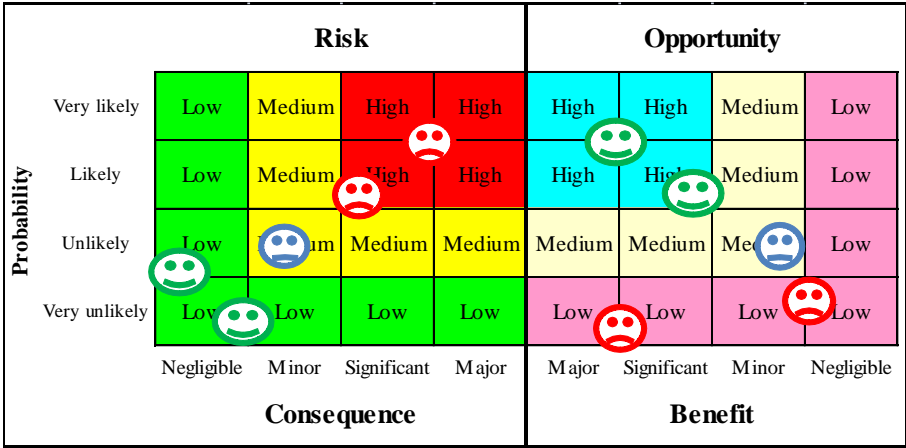
Risk Appetite within ERM

Probability	Risk				Opportunity				
	Very likely	Low	Medium	High	High	High	Medium	Low	
	Likely	Low	Medium	High	High	High	Medium	Low	
	Unlikely	Low	Medium	Medium	Medium	Medium	Medium	Low	
	Very unlikely	Low	Low	Low	Low	Low	Low	Low	
		Negligible	Minor	Significant	Major	Major	Significant	Minor	Negligible
Consequence					Benefit				

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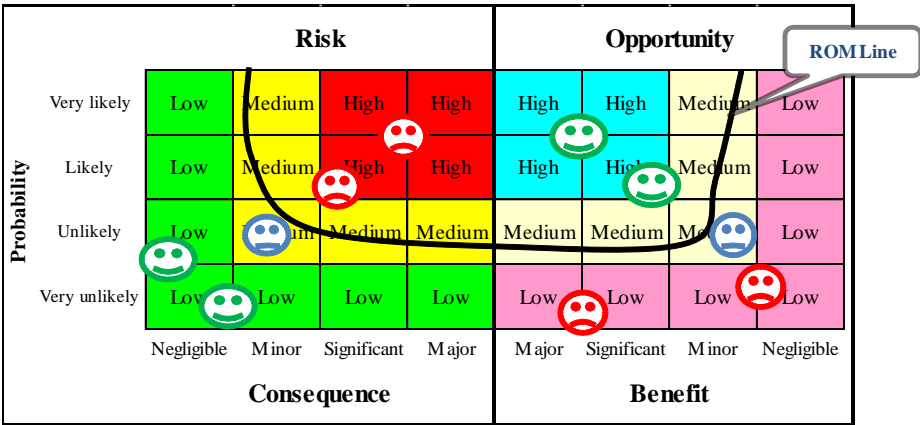
Risk Appetite within ERM



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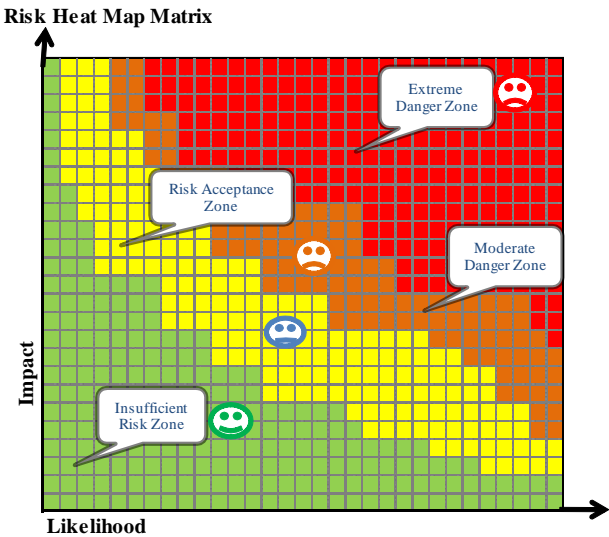
Risk Appetite within ERM



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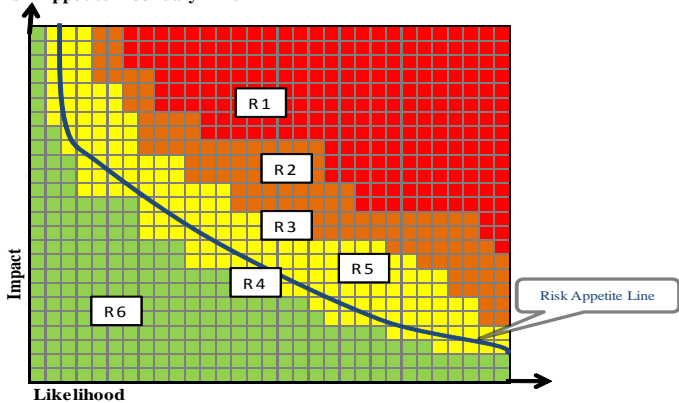
Risk Appetite within ERM



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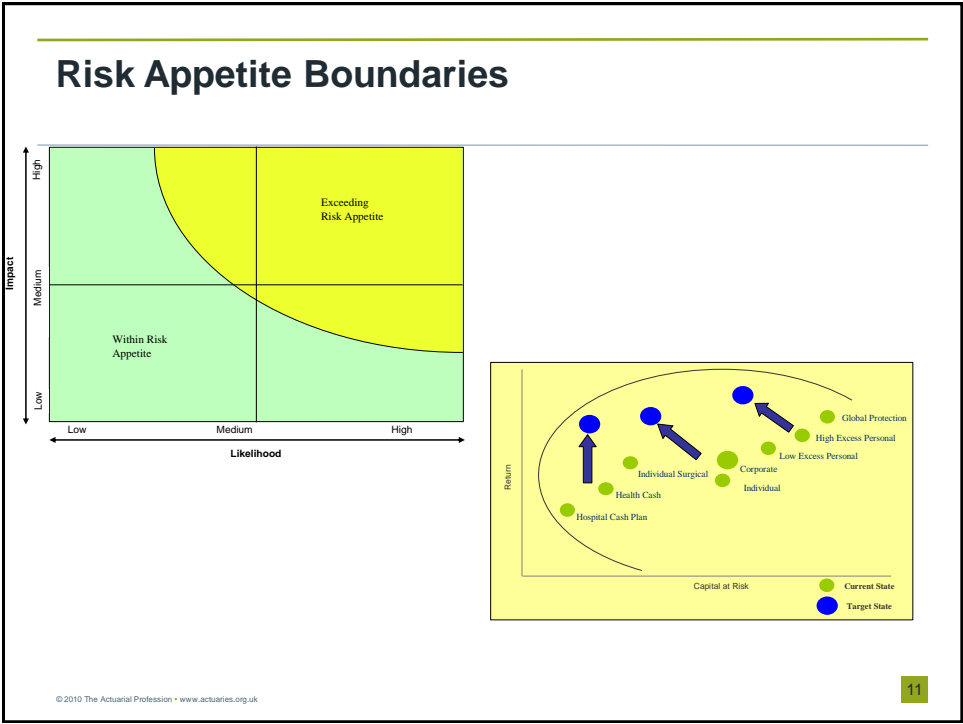
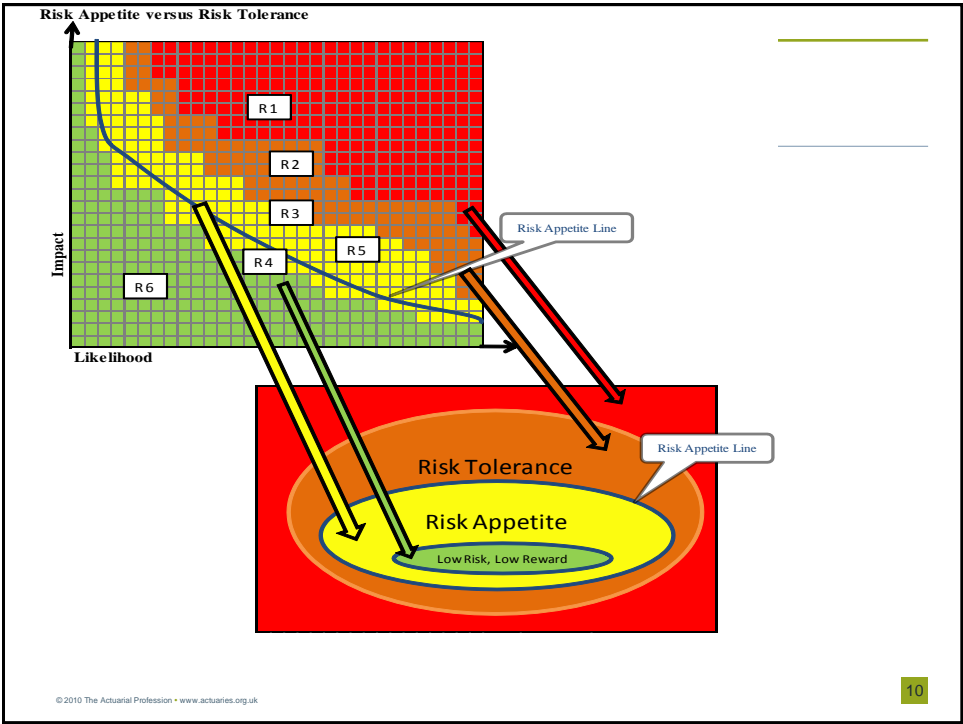
Risk Appetite Boundary Line

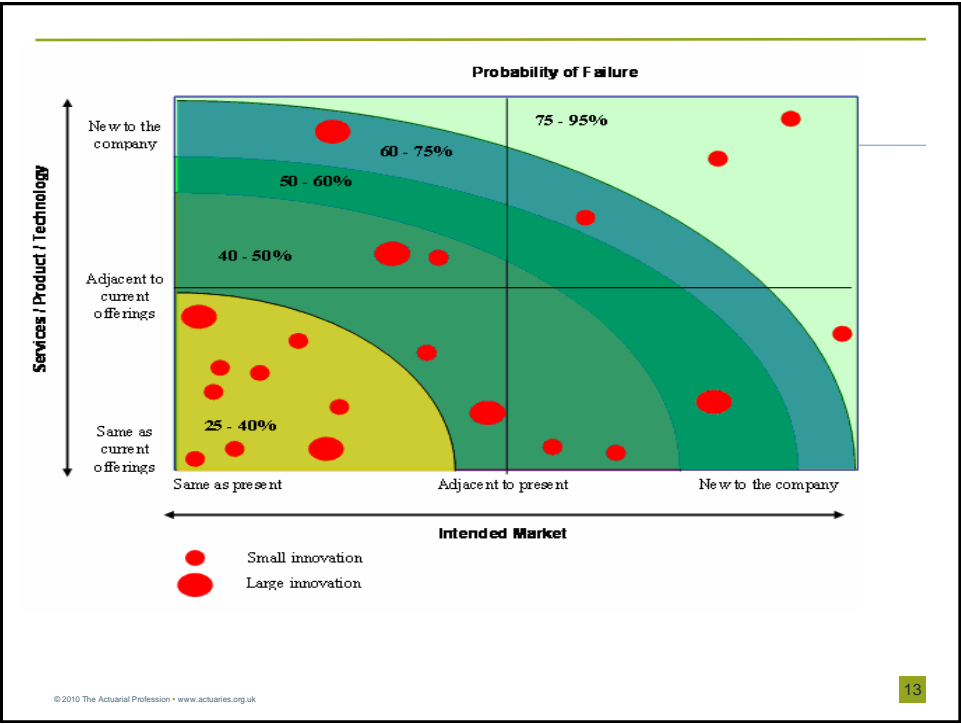
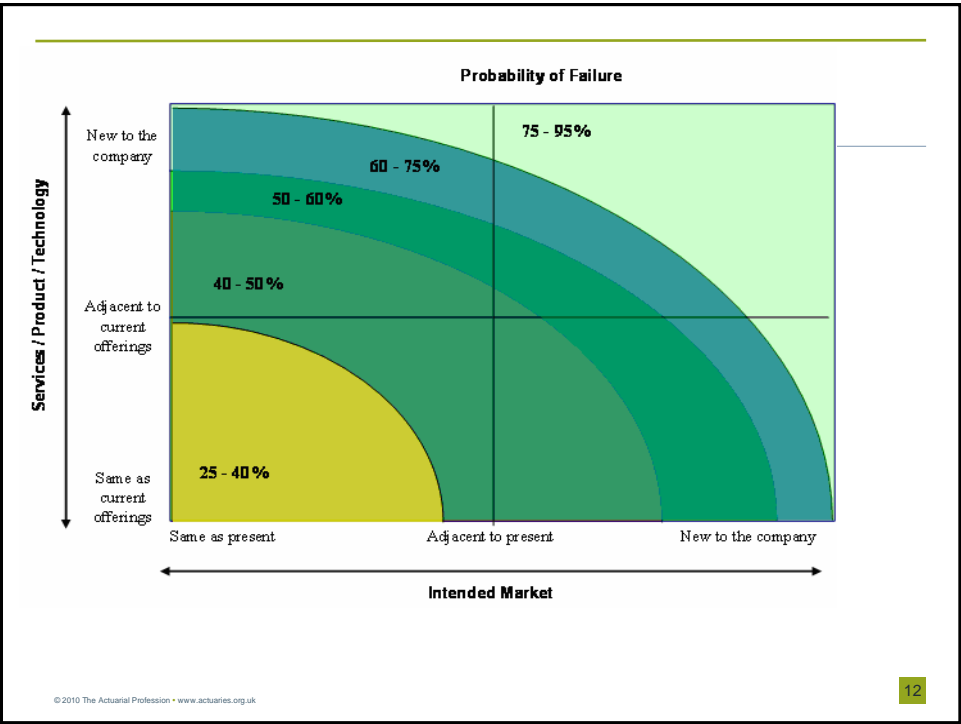


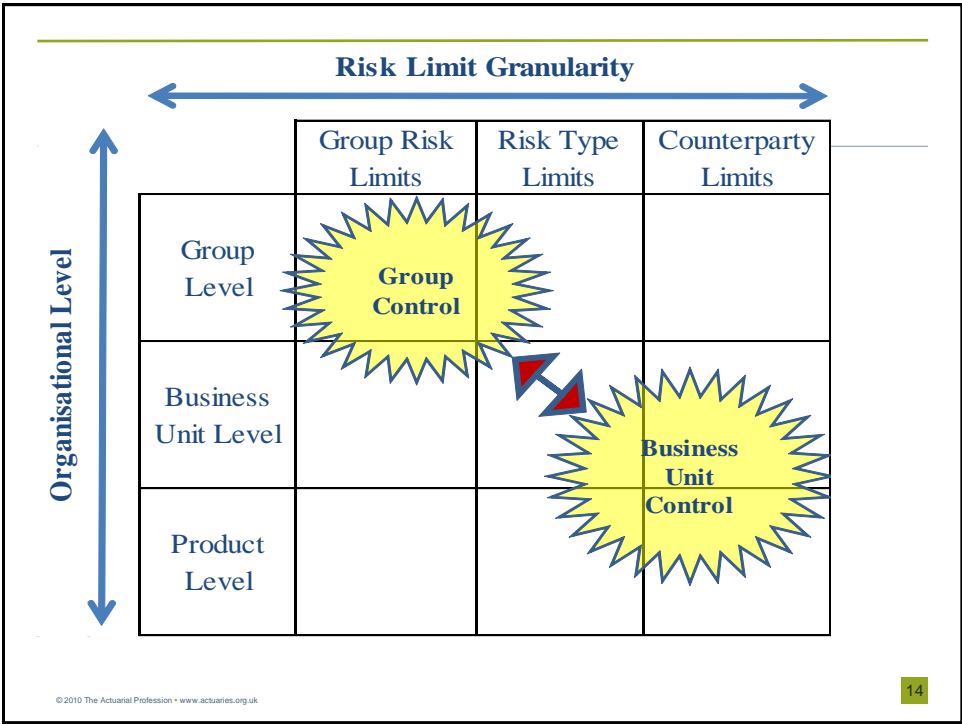
- Risk 'R1' exceeds the risk tolerance, so terminate / avoided / transfer out to another enterprise.
- Risk 'R2' in moderate danger zone; validate risk positioning and consider terminate / avoid / transfer out.
- Risk 'R5' within acceptable zone, so acceptable balance to the enterprise between risk and reward.
- Risk 'R6' is too simple for enterprise, so transfer out to another corporate 'parent' that can add more value.

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What is the Risk Appetite of an enterprise?

“There is no single value that can be used to determine a firm’s risk appetite. If it were, then stochastic dominance could be used to decide which risks to accept and which to avoid. Risk appetite must consider the income statement for measuring the effect of a risk on earnings, the balance sheet for determining the impact of risk on key financial ratios, and even off balance sheet items that could affect an organisation’s financial position. Thus, risk appetite has multiple dimensions that are based on multiple data sets of financial data.”

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Risk Appetite Concepts

Michael Garner

Capacity, Tolerance, Appetite and Limits

Capacity

Ultimate ability to assume and absorb risk

Tolerance

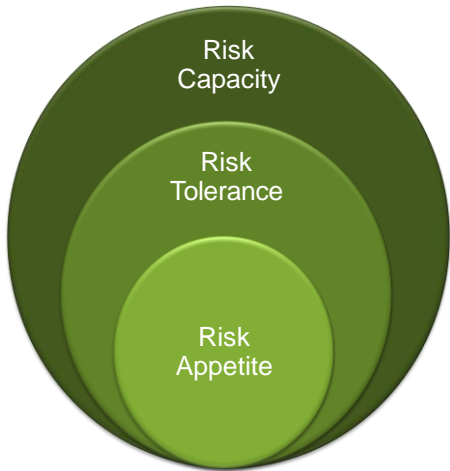
Undesirable risk that is tolerated

Appetite

Desirable risk, subject to the reward being adequate

Risk Limits

Silo-based criteria to help guide transactional risk-taking

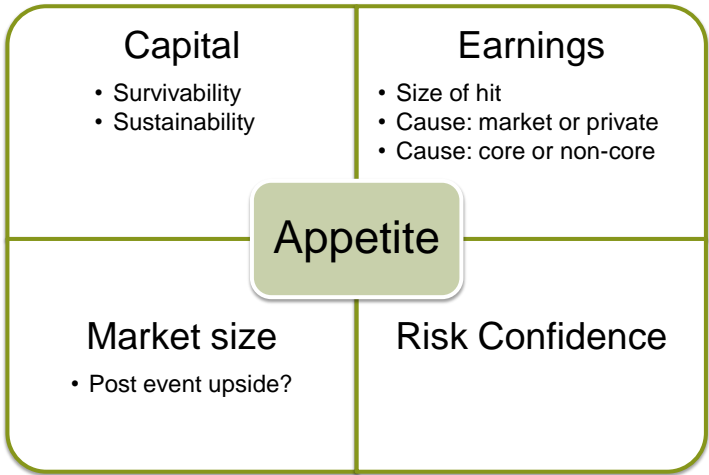


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Drivers of Risk Aversion, Risk Appetite Articulation and Effectiveness

Paul Kaye

Risk appetite drivers



Risk Appetite Articulation and Effectiveness

- Not possible to be prescriptive over best practice
- But ten criteria proposed to assess Risk Appetite statements and their use

Articulation

an assessment of six theoretical aspects covering scope, coherence and usefulness

Effectiveness

an assessment of four practical aspects covering the implementation within the organisation



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Articulation: the Coherence criteria



Vertical Coherence

- ✓ Statement includes more granular risk appetite guidance
- ✓ Consistent and connected with corporate objectives
- ✗ No consistency or connection between corporate objectives and detailed risk guidance and limits
- ✗ No detailed risk guidance and limits

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Articulation: the Coherence criteria



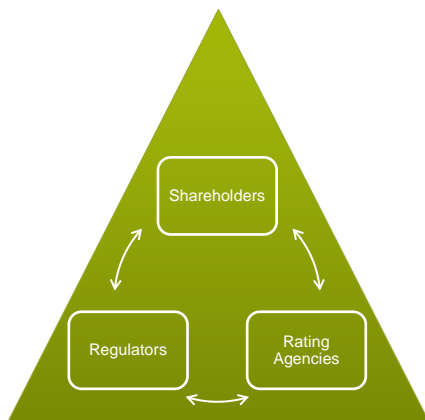
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Horizontal Coherence

- ✓ Appetite consistent across risk types (does not imply the same)
- ✓ Appetite consistent across business units / portfolios
- ✓ Apparent how appetite sits in the context of business strategy
- ✗ Variations in appetite without reason or consideration

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Articulation: the Coherence criteria



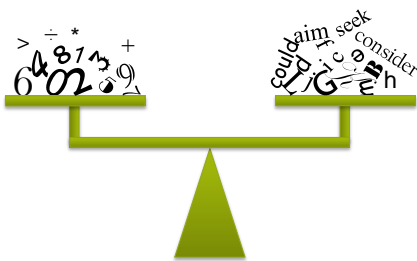
Stakeholder Coherence

- ✓ Consideration and reconciliation of all different risk perspectives
- ✓ External reconciliation: investors, policyholders, regulators, rating agencies
- ✓ Internal reconciliation: group and local management
- ✗ Potential stakeholder conflicts not recognised or addressed in a meaningful way

Articulation: Analytical Balance

Quantitative

Qualitative



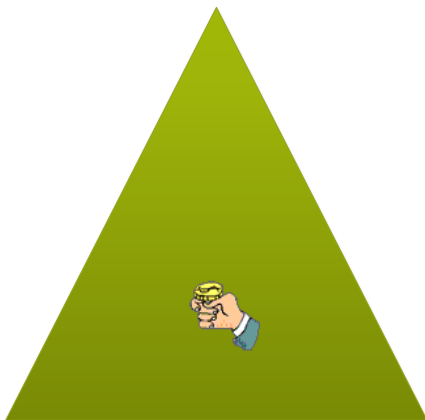
Analytical Balance

- ✓ Appropriate use of quantitative measures and qualitative considerations
- ✗ Over reliance on quantitative measures: confused or poor decision making (or “rules” being partly ignored)
- ✗ Over reliance on qualitative considerations: limited practical guidance

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Articulation: Decision Support



Decision Support

- ✓ Full range of risk related decision support: underwriting, portfolio management, capital management, reinsurance, asset allocation, etc...
- ✗ Risk appetite focus on risk control only

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Articulation: Governance



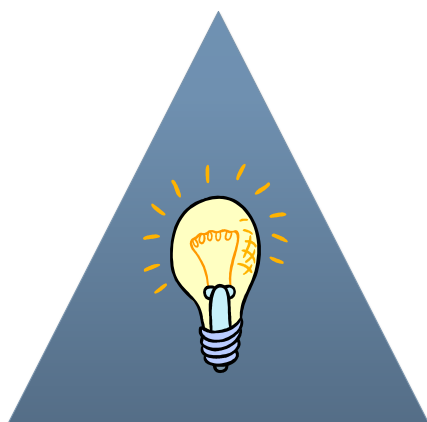
Governance

- ✓ Clear responsibilities for assessing, measuring and monitoring actual risk v risk appetite
- ✓ Escalation procedures where potential risk appetite breaches
- ✓ Escalation procedures where limitations in decision support
- ✗ Focus on defining risk appetite without a view of its administration

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Effectiveness: Awareness



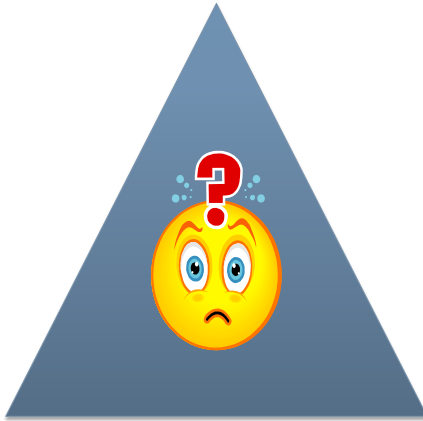
Awareness

- ✓ Established what each role / level of responsibility should know about the risk appetite policy
- ✓ All individuals know relevant parts of risk appetite policy
- ✗ Little or no knowledge of risk appetite policy beyond board and risk management roles

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Effectiveness: Usability



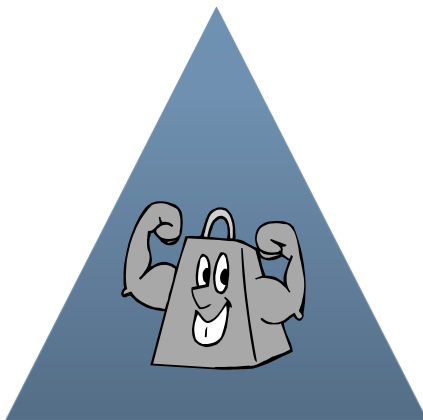
Usability

- ✓ Risk appetite consequences understood
- ✓ Authority requests escalated in accordance with risk appetite governance
- ✗ Practical implications of risk appetite not understood
- ✗ Limitations in decision support

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Effectiveness: Influence



Influence

- ✓ Decisions informed by risk appetite
- ✓ Organisation operates within stated risk appetite
- ✗ Risk appetite statement seen as compliance requirement

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Effectiveness: Credibility



Credibility

- ✓ Trusted by stakeholders
- ✓ Actual event outcomes in line with disclosed appetite
- ✗ Limited evidence of risk appetite being used to inform decisions
- ✗ Regular adaptations of risk appetite

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Risk Appetite Characteristics, Risk Appetite Disclosure

Martin Burke

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Risk Appetite Characteristics

Size of General Insurance Undertaking

Small

Pros

Nimble
Less complex politics
Risks closer to surface
Geographic proximity

Cons

Expertise / Expense?
Growing pains
Formal processes observed?
Large firm concepts?

Large

Pros

More stable business
More influential
Genuine peer review
Critical mass

Cons

Overly complex / confused
Longer change cycle
Communication more challenging
May be more widely spread

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Risk Appetite Characteristics

- Tail
- Maturity
- Diversity
 - Business lines
 - Geography
- Profile
- Structure
 - Ownership
 - Platforms
- Market
- Stakeholder point of view

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Risk Appetite Disclosure

- **Consistency**
 - Lack of accepted definition
 - Quantitative & Qualitative
 - Interchangeable terms
 - Strategic or Tactical focus
- **Part of a wider framework**
- **Considerable detail in Appendix to paper**

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Questions or comments?

Expressions of individual views by members of The Actuarial Profession and its staff are encouraged.

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