

**The Actuarial Profession**  
making financial sense of the future

Plenary 4 – Articulating risk appetite  
Justin Skinner (QBE European Operations), Paul Barrett (Chartis Europe)

**GIRO Conference and Exhibition 2011**

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## Agenda

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- Overview of risk appetite – Justin Skinner
- Chartis risk appetite case study – Paul Barrett

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## What is risk appetite?

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- There are two fundamental concepts that underpin a company's business objectives:
  - Business strategy
  - Risk appetite
- Risk appetite gives the boundaries that a company can operate its business strategy within to achieve its business objectives

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## Why bother? The carrot

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- Could remove some over-controlled risks because they are well within risk appetite -> **Efficiency saving**
- Could take on more risk in a particular area because there is spare risk appetite -> **Increase return**
- Could take on more risk since it does not impact overall risk profile -> **Increase return** with minimal increase in risk through diversification
- Clearly defined risk appetite should help **protect individuals/functions** on the Board if the risk manifests itself

## Why bother? The stick

- CEIOPS-DOC-29/09:
  - An effective risk management system requires at least the following:
    - a) A clearly defined and well documented risk management strategy that includes the risk management objectives, key risk management principles, **general risk appetite** and assignment of risk management responsibilities across all the activities of the undertaking and is consistent with the undertaking's overall business strategy;"

## What do companies do?

- Risk appetite is mentioned in pretty much every (re)insurance company's 2010 report and accounts
  - Most are not particularly helpful to the external reader, e.g. RSA – "The Group risk appetite is set and monitored at both a Group and regional level and is annually reviewed and signed off by the Board Risk Committee and Group Board. It sets business volumes for certain higher risk insurance classes, stipulates loss retention limits, reinsurance protection, targets for credit rating and solvency margins and other measures."
  - Some have some information
  - Most don't have too much detail or insightful information into a company's risk appetite
- Solvency II will likely change this...

## Risk Appetite – Statement

Our Risk Appetite Statement specifies the types of risks and the overall risk profile the Company is willing to accept in pursuit of its strategic objectives. We then translate the risk appetite into specific limits for major risk types and events.

We <b>will</b> take risks that:	<ul style="list-style-type: none"> <li>• Are <b>aligned with strategic objectives</b>, growth or innovation opportunities in specific markets, or where we have or can develop a competitive advantage</li> <li>• Are <b>well understood by underwriting/investment teams and by management</b>, and where we have organisational capabilities to manage them well</li> <li>• Are <b>properly priced</b> to provide an adequate risk-adjusted return on capital</li> </ul>
We <b>will not</b> take risks that:	<ul style="list-style-type: none"> <li>• Expose us to an <b>unacceptable level of risk to our reputation and brand</b> thereby impairing our ability to compete effectively</li> <li>• Expose us to an <b>unacceptable level of legal, regulatory or accounting risk</b></li> <li>• <b>Do not comply with regulatory requirements</b>, (FSA rules, FOS determinations etc.)</li> </ul>

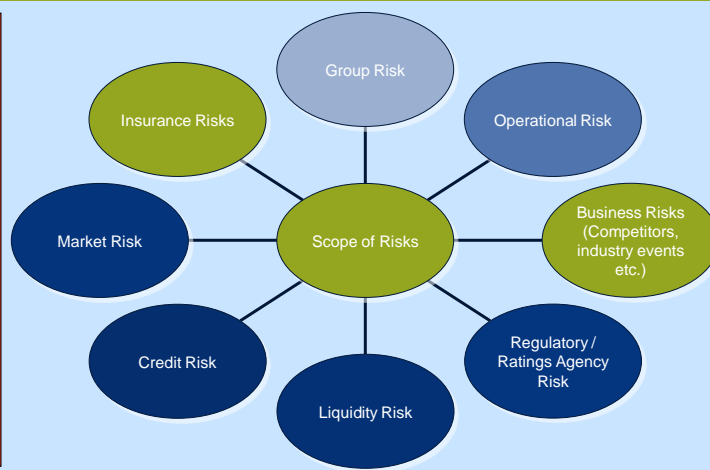
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## Scope of the Chartis risk appetite

Covers our **whole risk profile**.

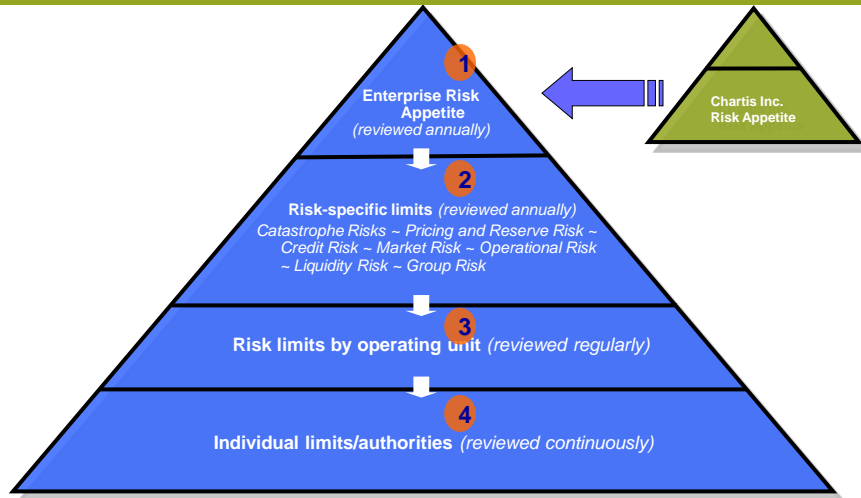
### Scope Across:

- All business segments
- All locations
- Risks to future income, not just current monetary losses
- Risks from external events, even if out of our control
- Risks due to third parties, such as competitors, suppliers / vendors, regulators, etc.



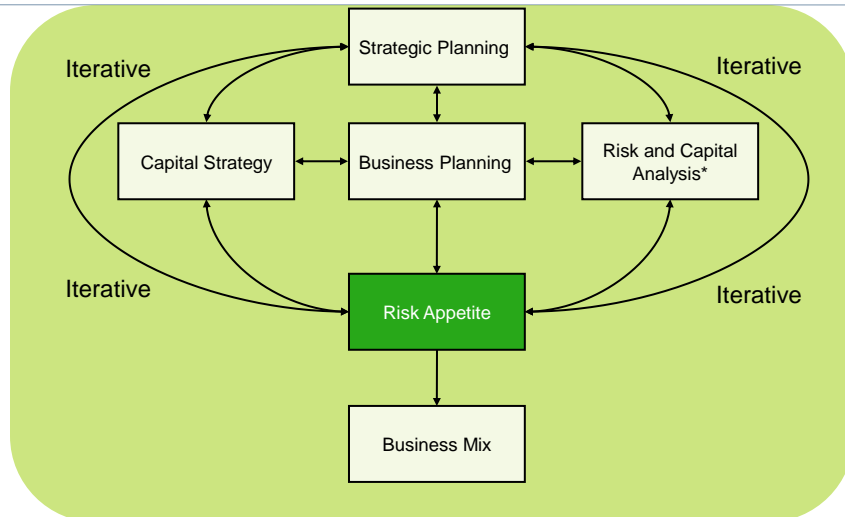
## Risk Appetite Structure

The risk appetite statement is constructed in a top-down manner in four stages:



## Embedding the risk appetite

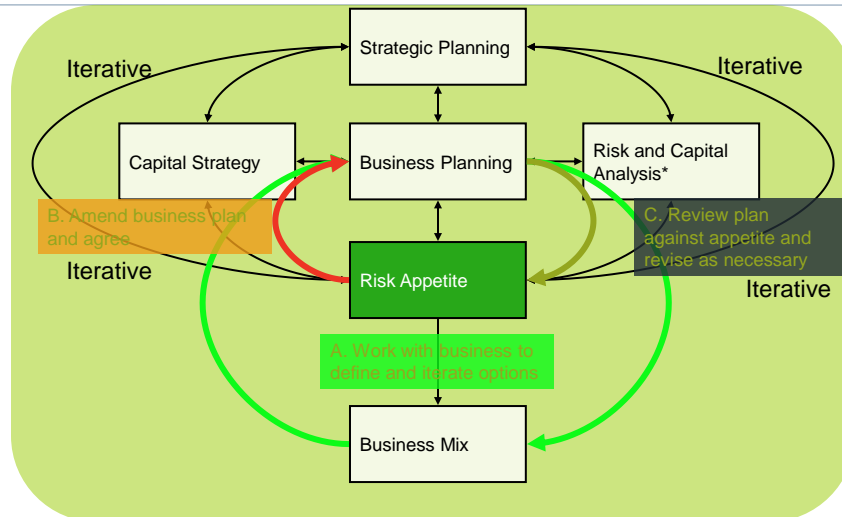
Links to existing processes:



\* Including the Risk and Capital Modelling

## Embedding the risk appetite

Links to existing processes:

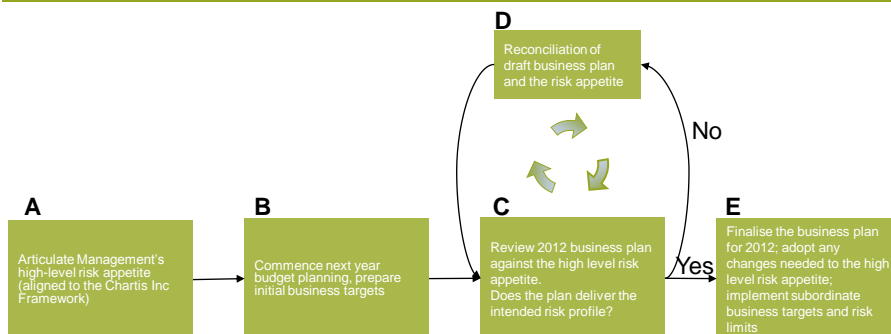


\* Including the Risk and Capital Modelling

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## Risk Appetite

Reconciliation of the draft business plan with risk appetite is one of the core uses of the Economic Capital Model (ECM) and helps to ensure that the business plan produced is consistent with the level of risk we have agreed to.



- A. Management agree on the risk appetite for the company
- B. Budget planning commences for the following year
- C. ECM compares the business plan to the risk appetite to ensure the plan is achievable within the set parameters
- D. Adjustments are made to the plan or the appetite to try to align the two
- E. The business plan is finalised and is in line with the risk appetite

## Risk Appetite – Statement

*Chartis Risk Appetite Statement has been adopted by Chartis Risk and Capital Committee. The statement provides the basis and framework for the business mix / portfolio optimization, annual planning, and the development of risk limits at operational level.*

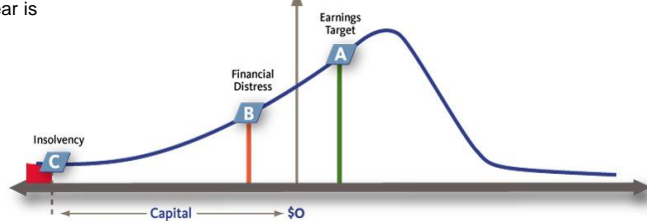
**Chartis will manage its aggregate risk profile by ensuring that:**

- A** The probability of meeting annual earnings target is greater than 50%
- B** The probability of breaching the SCR during the year is less than 6%
- C** The probability of breaching the SCR during the year is less than 0.5%

Assumptions	EE and AAL per Plan		AAL and EE per Model	
(1) Available Capital	1,200,000		1,200,000	
(2) Expected Earnings	100,000		95,000	
(3) AAL	30,000		40,000	
(4) Projected equity	1,270,000		1,250,000	
(5) SCR	900,000		900,000	
(6) MCR	200,000		200,000	

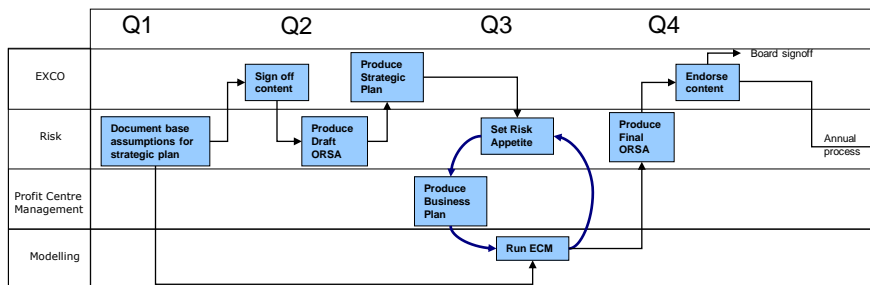
  

Risk Appetite Curve Points	Profit/Loss	Percentile	Profit/Loss	Percentile
(7) Point A - Target Earnings	70,000	44.34%	55,000	50.00%
(8) Break Even	-	79.34%	-	79.34%
(9) Point B - Financial Distress	- 370,000	96.11%	- 355,000	94.07%
(10) Point C - Regulatory Intervention	- 1,070,000	99.98%	- 1,050,000	99.96%



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## ORSA and Risk Appetite: roles and responsibilities



*A high level view of the proposed ORSA production through the year*

**EXCO** Set risk appetite, sign off planning assumptions, produce strategic plan, sign off final ORSA  
**Risk Team** Advise / propose risk appetite, coordinate with ECM team, profit centres and functions, produce ORSA document  
**Profit Centres** Produce business plans  
**Modelling Team** Run ECM, provide expert judgement for the ORSA

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