

The Actuarial Profession
making financial sense of the future

ORSA Seminar
Anthony Bentley



Risk Appetite

The cornerstone of the ORSA

29 September 2011

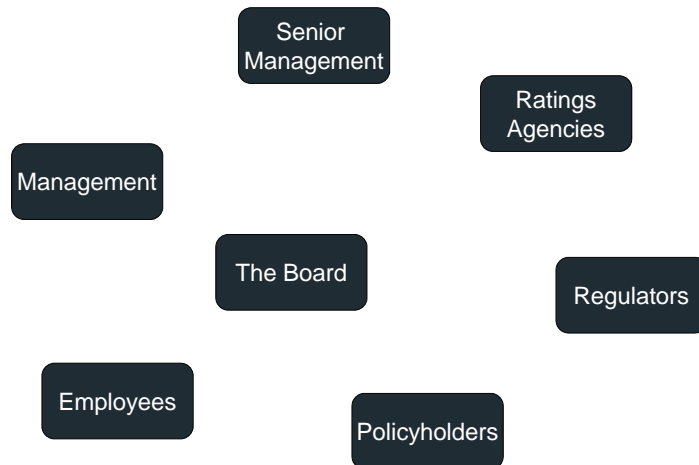
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Risk appetite - What is it?

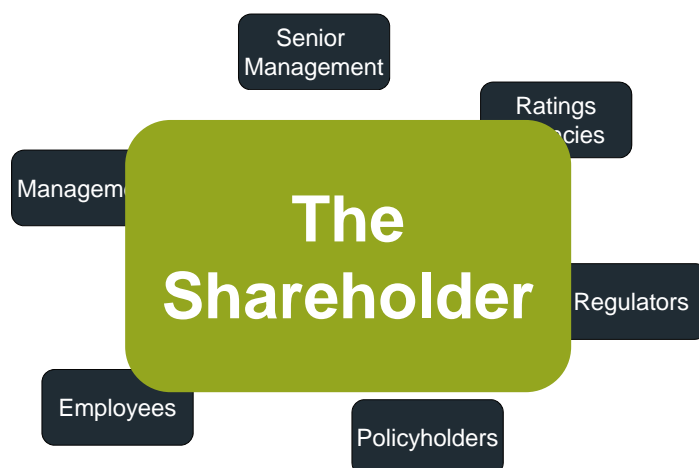
A risk appetite statement describes the risks an enterprise is willing to accept in order to achieve its objectives

- Other definitions
 - Risk capacity** – the amount of risk an organisation can feasibly accept given its resources and environment
 - Risk tolerance** – the amount of risk an organisation is willing to accept
 - Risk Limits** – granular policies that limit the amount that specific risk-related activities are undertaken

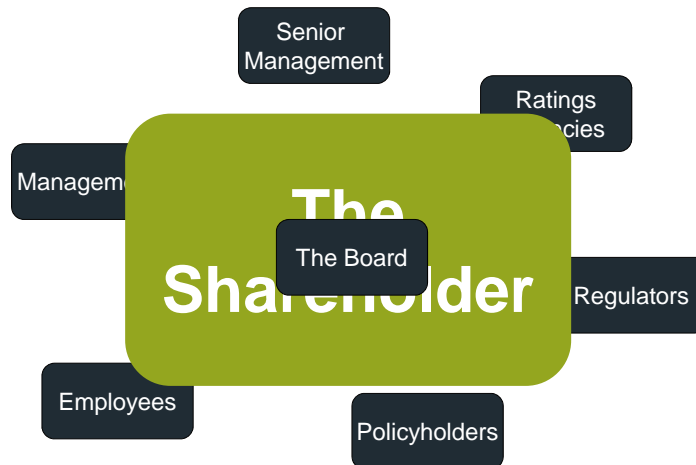
Stakeholders and governance



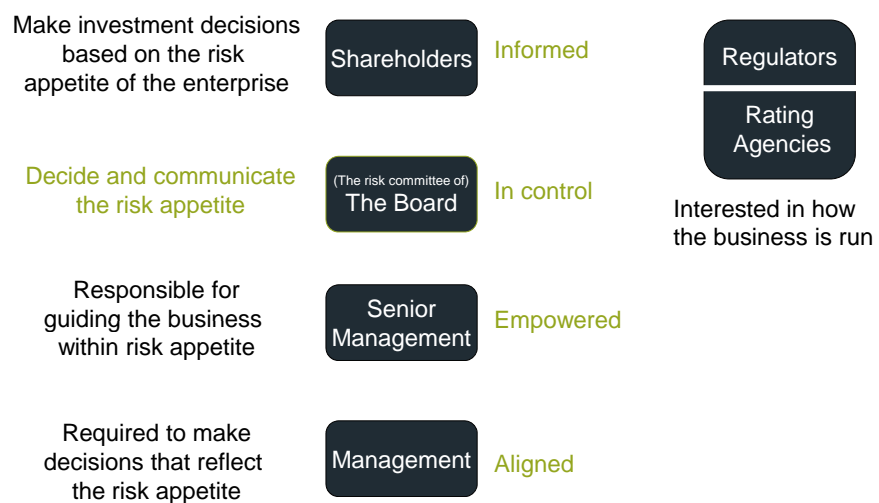
Stakeholders and governance



Stakeholders and governance

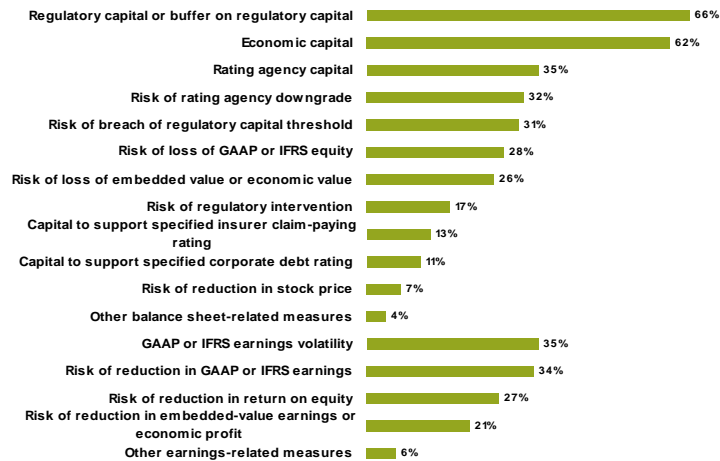


Stakeholders and governance



Components and measures

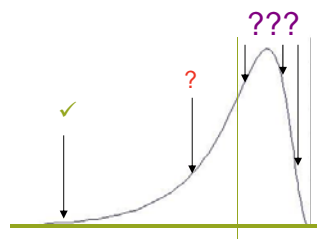
Which of the following measures of risk are used in your risk appetite/tolerance statement?



Source: Towers Watson ERM Survey

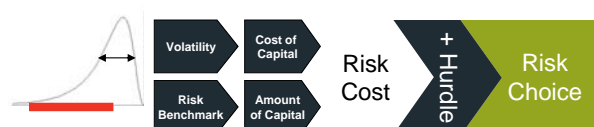
Components and measures

- How much risk?
 - Capital at risk
 - Stress tests
 - Earnings at risk
 - Earning volatility



- EC
- IFRS
- Statutory

- Which risks?
 - Required/Target return on capital
 - Risk segmentation
 - Where?



Choosing the levels

- Do you work bottom up or top down?



- Are these targets or limits?

- Consider corridors
e.g. Expense ratio



- Time horizon

Using it

Key Interfaces

- Planning
- Remuneration
- Risk Limits
- Subsidiary statements

All involve translating from 'lagging' to 'leading' measures

Planning

- Calculate risk measures on your planned basis
- The risk profile implied by the plan should remain in appetite
- This may involve a significant change to the focus of planning work



Strategy



Risk Appetite

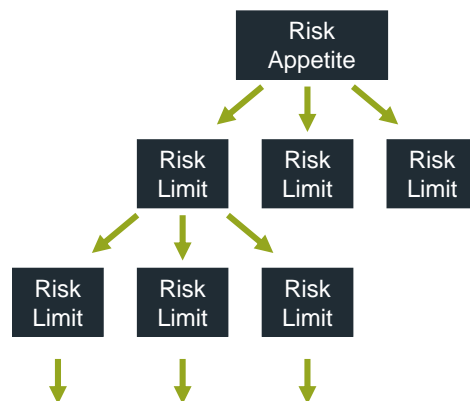
Plan Risk Profile

Plan

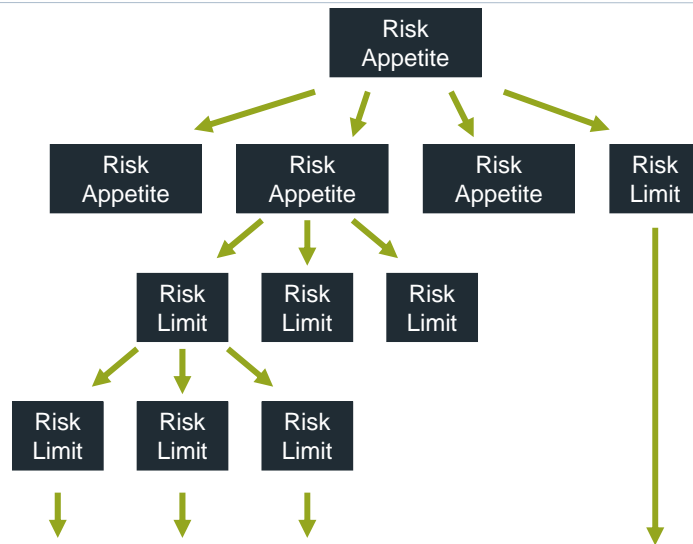
Risk becomes a driver to the planning process

Risk Limits

- Limits may be based on
 - Existing limit systems
 - Business plans
 - Direct appetite measures
- Document the linkage to appetite
- Prefer leading measures



Subsidiary appetites



Disclosure

Risk appetite: core characteristics

- Strong balance sheet
- Strong brand
- Healthy capital position
- Conservative liquidity management
- Risk must be commensurate with returns
- Robust Group structure of separate legal entities
- The customer group and global product mix should produce sustainable long term earnings growth
- Risk diversification

The GRC monitors the Group's risk appetite and satisfies itself that executive management has taken account of the future macroeconomic and financial environment in identifying top and emerging risks.

From the core characteristics of the Group's risk appetite (see table above), our strategic and operational objectives are determined which are consistent with the Group's risk appetite. These objectives are summarised in the table below:

Strategic and operational objectives

Earnings	1. Generate sustainable economic profit commensurate with the risks taken
Capital and liquidity	2. Maintain capital in excess of regulatory requirements and a long term debt rating of AA
	3. Maintain a strong tier 1 ratio comprising a high proportion of core tier 1
	4. Maintain a well diversified funding structure with a particular focus on advances to core funding ratios
	5. Off balance sheet vehicles should not be material in size relative to the total balance sheet
	6. Manage impairments and expected losses within the Group's tolerance
Impairments and expected losses	7. Manage all risk categories within the risk appetite
Risk category and diversification	8. Harness benefits from business diversification to generate non-volatile and sustainable earnings
	9. Compete for business with international customers where market connectivity is critical; businesses with local customers where we have local scale, and products where global scale is critical to effectiveness
Scenario and stress testing	10. Use robust and appropriate scenario stress testing to assess the potential impact on the Group's capital adequacy and strategic plans

Source: HSBC
Report & Accounts
31/12/2010

Categories	Components	Statement/Trigger	RA Profile 2010	Status
1. Earnings & share price	Economic profit	• Generate sustainable EP over invested capital and achieve EP spread within range of x% to x%		●
	Return on equity	• ...		●
		• ...		●
	Earnings volatility	• ...		●
	Share price volatility	• ...		●
	Profit growth	• ...		●
2. Capital & liquidity	Capital and leverage ratios	• Tier 1 corridor = x% and x% of Pillar 1 RWAs • ... • ...		●
	Liquidity and funding	• Ratio of net liquid assets to customer liabilities within x% to x%		●
		• Advances-to-deposits ratio in the range of x% to x%		●
	Securitisation	• Total assets of HSBC's off-balance sheet securitisations should not exceed x% of total on-balance sheet assets (US\$y BN)		●
	Risk benchmarks for capitalisation	• Group to be solvent at: 99.9% for regulatory capital (RC), 99.95% for economic capital (EC)		●
		• ...		●
3. Impairments, provisions and expected losses	LICs and other credit risk provisions	• Loan impairment charges should not exceed x% of operating income		●
	Expected Losses	• EL to exposures to be at most x% above ROP projections		●
4. Segmentation	Regions & Customer Groups	• ...		●
		• ...		●
5. Strategic investments	Market value of investments	• ...		●
6. Stress testing	Stress testing scenarios	• Stress - capital position post mitigation in line with Tier 1 ratio =x% to x%		●
		• ...		●

Learning points

- Measures are much more meaningful with numbers
- Flexibility is essential
 - But the right kind of flexibility
 - Expect to review regularly
- Be upfront about work in progress
 - But don't avoid it

Challenges

- Consolidation
 - Homogenising multiple entities and portfolios
 - Structural FX risk
- Conflicting requirements
 - Simplicity / applicability
- Conflicting measures
- Calculation difficulties and delays
- Treatment of expected capital movements

Questions or comments?

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

The views expressed in this presentation are those of the presenter.

