Risk Appetite Survey
Current state of the Insurance Industry

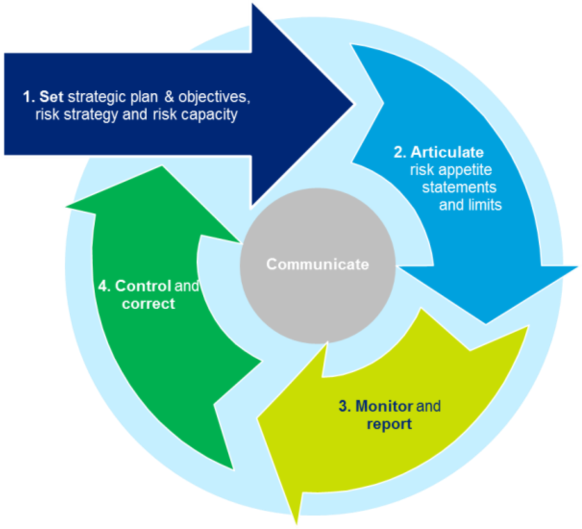
Deloitte Belgium and The Netherlands – Financial Services Industry
The survey was conducted during July 2013 till December 2013

Introduction

The regulatory landscape for insurance firms – be it speeches, working papers and draft or final regulation – is full of references to risk appetite, its benefits, uses, applications and case studies of failed firms whose weak risk appetite frameworks played a part in their downfall. When firms are criticised for shortcomings in their risk management, an appetite framework is commonly prescribed as a cure by regulators. And yet, there remains a surprising variety of opinion about what it actually means to establish and embed a proper risk appetite framework.

Everyone these days seems to agree that risk appetite frameworks are good things – even if no-one can quite agree what a good one looks like. The purpose of this survey is to provide a current state of the risk appetite frameworks at insurance companies active on the Belgian and Dutch market and investigate if there is an emerging consensus on the core concepts of a risk appetite framework amongst insurance companies.

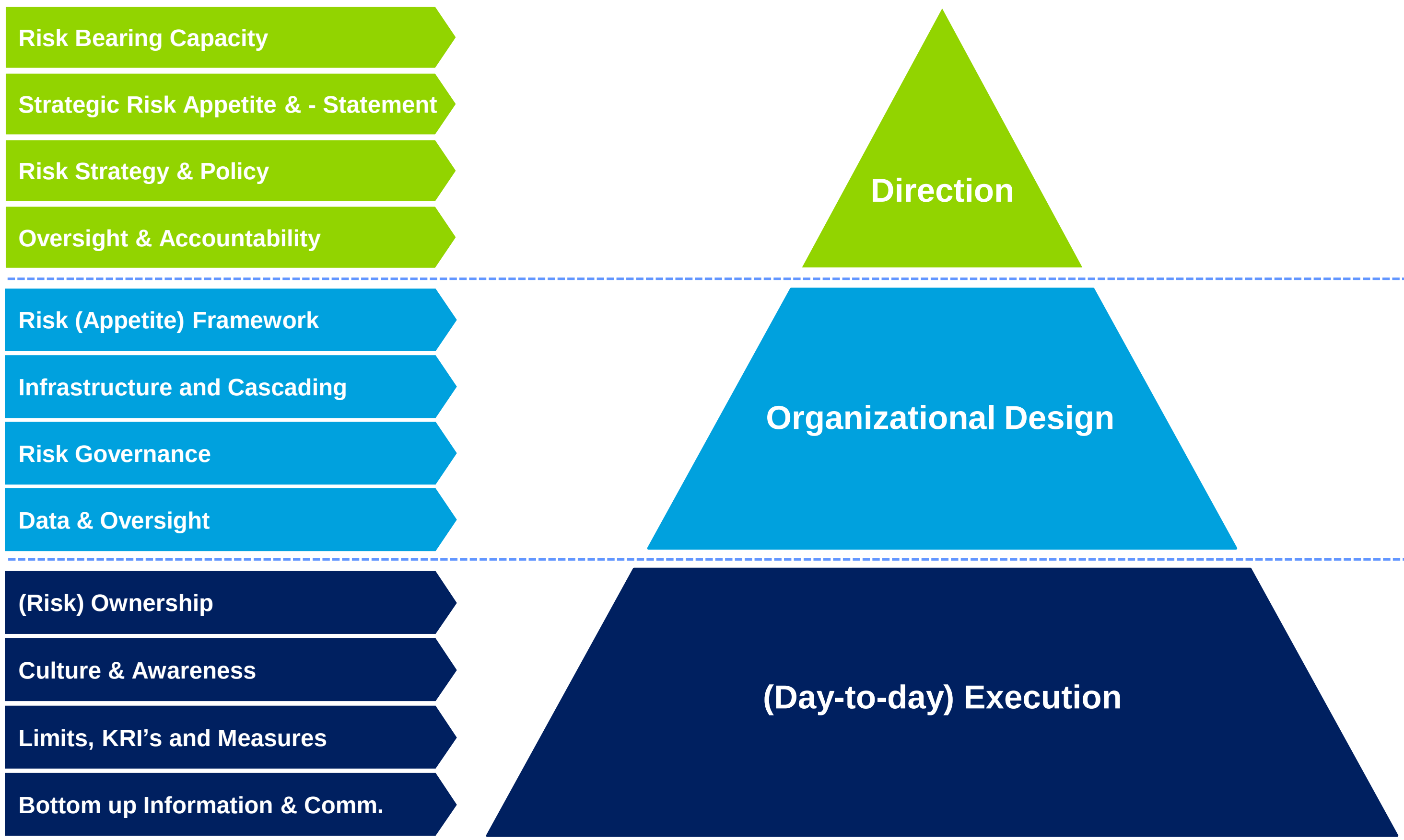
We surveyed 12 firms' current practices and views on key stages in implementing and running a risk appetite framework and are very grateful to all survey correspondents for their contribution to this research. We hope you find this study helpful to reflect your company risk framework to ensure that risk appetite is the way its people talk, think and do risk.



Arno De Groote
Partner Enterprise Risk Services

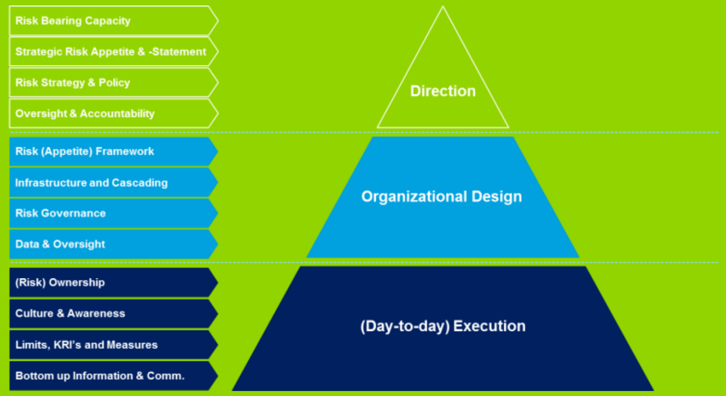
Contents

In this survey we analysed the following themes:



0

Executive Summary



Executive Summary

Risk Strategy & Policy

Strategic plan & objective as root for Risk Appetite

The financial crisis evidenced that there was a disparity between the risks that their firms took and those that their boards of directors perceived the firms to be taking. The risk appetite is considered by the survey respondents as an important tool to improve Boardroom understanding of the risks the firm as a whole is taking, and to facilitate the communicating and cascading down of the strategic plan and appetite for specific risks.

67 %(*) have a risk appetite to improve Boardroom understanding of the risks

Risk appetite should be closely aligned to the pursued strategy. The first step in linking risk to strategy is the explicit articulation of risk appetite in order to establish a benchmark with which actual risks can be compared. This is confirmed by the survey respondents: the strategic business plan is the second most common source for defining the risk appetite, preceded by the solvency measures. This is both the case for the Belgian and Dutch respondents.

75% directly link the risk appetite to strategic objectives

The existence of an integrated risk appetite in the planning & budgeting process can be an indicator of the level of awareness and whether the risk appetite is effectively used within an organisation. One fourth of the participants indicated that the risk appetite process is only to a limited extent part of the Finance Planning and Control cycle.

25% have no or little alignment with planning & budgetting.

Financial institutions develop an effective Risk Appetite Framework (RAF) when it is institution-specific and reflects its business model and organisation, as well as enables financial institutions to adapt to the changing economic and regulatory environment in order to manage new types of risk. Most insurance companies take developments in the external environment into account when establishing their risk appetite.

92% respondents assess the external environment when establishing the risk appetite

(*) % of the survey respondents

Executive Summary

Risk Appetite Statement

The formulation of a Risk Appetite Statement

The Risk Appetite Statement is often defined as the 'articulation' of the risk appetite in written form. The risk appetite statement should be easy to communicate and therefore easy for all stakeholders to understand. Almost seventy percent of the surveyed institutions believe the definition of risk appetite used within the organization is commonly known and recognised in the organization.

67% believe to have a clear and understood risk appetite statement

As also expressed by the FSB, qualitative statements should complement quantitative measures; set the overall tone for the financial institution's approach to risk taking; articulate clearly the motivations for taking on or avoiding certain types of risks, products, country/regional exposures, or other categories. In all surveyed institutions the risk appetite is of a qualitative nature; this is in line with our banking sector survey.

42% have a balanced statement with quantitative and qualitative elements

Most of the companies have further translated the risk appetite to a more tactical / operational level. All of the financial institutions indicated that the translation was done top-down. Most of the insurance companies performed a bottom up translation, although those are mostly large institutions.

58% define appetite top-down and bottom-up

Risk Bearing Capacity

Defining the Risk Bearing Capacity

A risk appetite framework is function of not only the willingness to take either a high or a low level of risk, but also the ability – quantitatively and qualitatively - to take risks. For most of the respondents this was linked to a definition of available capital. Internal capital needs were mostly expressed in terms of a Solvency II internal economic capital model.

83% of the respondents use SCR as a primary measure to assess risk bearing capacity

Executive Summary

Oversight and accountability

Risk Governance, oversight and accountability

According to the FSB, Boards that approve the risk appetite statement tend to have a higher level of understanding of the financial institution's risk appetite than when it is 'received' or 'noted'. The Board of Directors or a Board Level Risk Committee are considered by all institutions as ultimate accountable bodies for approving the Risk Appetite Statements. Line Management, Executive management, Risk Manager or Internal Audit are never granted accountability to approve the risk appetite statement. The Board only very rarely has a role in setting Risk Appetite limits. The Risk teams, together with Finance are considered to be the drivers for establishing the Risk Appetite. More than 80% of the participants indicated that the Board of Directors receives at minimum on a quarterly base reports with an overview if tolerance limits were respected or not.

As a best practice, the FSB requires the board of directors to establish the institution-wide risk appetite framework and approve the risk appetite statement, which is developed in collaboration with the chief executive officer (CEO), chief risk officer (CRO) and chief financial officer (CFO).

100% of Boards approve the limits.

82% of Risk,

55% of Finance,

18% of CEO/Exco involved in establishing the risk appetite

Risk Appetite Framework

Granularity of the risks in the Risk Appetite Framework

Most insurance companies have defined the most common risk types in their risk appetite definition and have translated these into risk measures for market, counterparty default, insurance and operational risks. Most insurance companies also defined measures at the level of different lines of business. Some companies also noted to have measures in place for financial reporting and regulatory risks.

40% (BE) -70% (NL) defined a risk appetite and a measure for strategic risk

Data & Oversight

The attention to data management and data quality, including the roles and responsibilities regarding data has increased due to the introduction of Solvency II. Larger companies usually have done more investments to date regarding data control and have a more formalized approach.

71% large, and

40% small insurers formalized the responsibilities for data

Executive Summary

Infrastructure and Cascading

The articulation of the risk appetite in operational limits

The cascading of high level statements down through the business is aimed at developing and implementing a comprehensive and coherent structure. It is also key to enabling transparency and communication of the firm’s risk profile as it creates a firm-specific common risk appetite language.

75% have tolerance limits per risk type

The firm's business dimensions (such as business model, customer profile, limits and controls, concentrations, competitive position and financials) provide the necessary framework for which measures and limits are articulated to allow risk appetite to be monitored and controlled in day-to-day risk management processes.

The objective of tolerance limits is to constrain risk-taking within the risk appetite, taking into account the interests of all stakeholders. Limits should be measurable even through qualitative assessments.

Limits, KRI’s and Measures

Limits should not be overly complicated, ambiguous, or subjective. Most common tool used by the survey respondents to report the risk profile are traffic lights based on quantitative figures.

100% have a clear link between the limits and the risk appetite

Several methods and techniques are used to articulate the risk appetite into operational limits: there is a clear distinction between large and small companies; the top 3 used by large companies are stress tests (86%), professional judgement (71%) and Var methodologies for market risk (71%). Stress tests have not been mentioned by small companies.

Executive Summary

(Risk) Ownership

Monitoring the risk profile

Risk appetite limits, if breached by the firm's risk profile, necessitate immediate escalation and corrective action. A risk appetite framework allows the firm to identify and determine the relative positions of its risk capacity, risk profile and risk appetite when evaluating and pursuing its strategy and to take corrective action where necessary.

67% has an escalation procedure when crossing a limit or tolerance.

All of the surveyed insurance companies use KRI's to monitor limits and two thirds of the institutions have an escalation procedure when crossing a limit or tolerance. Surprisingly, more than 40% of the respondents indicated that no action plan is defined should the risk profile not be in line with the desired Risk Appetite.

42% has no predefined action plan when limits are breached

Various practices exist to assess (ex-post) the adequacy of risk mitigation. A discussion in the risk committees seems to be the most common practice.

There are large differences within the insurance industry regarding the level of automation for monitoring tolerances and limits. More than half of the respondents indicated that the monitoring of the tolerances and limits is not or only slightly automated.

58% mention that the monitoring of limits is not or only slightly automated.

Culture and Awareness

Reviewing the effectiveness of the Risk Appetite Framework

A risk appetite framework is not a one-off process and needs to be embedded within the financial institution. The insurer should not only monitor the risk profile within the the boundaries of the risk appetite, but should also timely review and adjust its risk appetite (statement). Most participants however indicated that the risk appetite has a limited iterative character.

58% have no or limited iterations to review the risk appetite

Latest regulatory thinking

The Financial Stability Board (FSB) conducted a cross-sectoral peer review of risk governance and the benefits that can be drawn from a fully operational and firm-wide embedded Risk Appetite Framework. The findings from this review gave rise to the publication of the FSB's 'Principles for An Effective Risk Appetite Framework' in November 2013. The FSB Principles set out key elements for: (i) an effective risk appetite framework, (ii) an effective risk appetite statement, (iii) risk limits, and (iv) defining the roles and responsibilities of the board of directors and senior management

The International Association of Insurance Supervisors (IAIS) was ahead of the game and had developed basic concepts and requirements relating to risk appetite and tolerance in its 'Insurance Core Principles' (published in October 2011, revised in October 2013). Work on the subject is set to continue at the national and international level and more specific requirements regarding risk appetite and tolerance have been submitted for consultation in the IAIS's most recent draft of its 'Common Framework for the Supervision of Internationally Active Insurance Groups', published in January 2014.

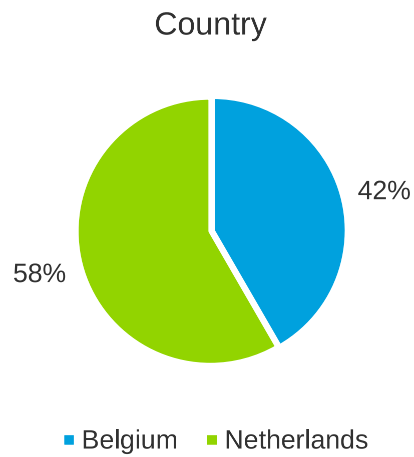
1

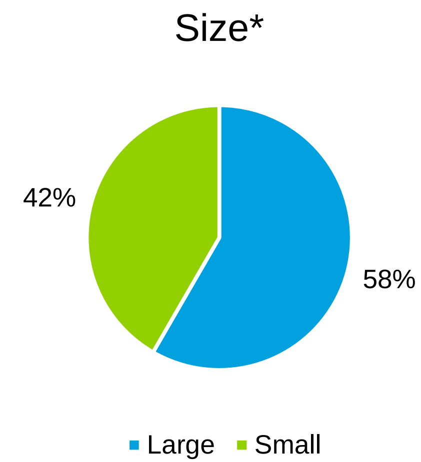
Survey respondents

Respondents

Belgian and Dutch insurance companies:

- groups headquartered in Belgium or The Netherlands,
- stand-alone Belgian or Dutch entities, and
- Belgian or Dutch subsidiaries of international groups.



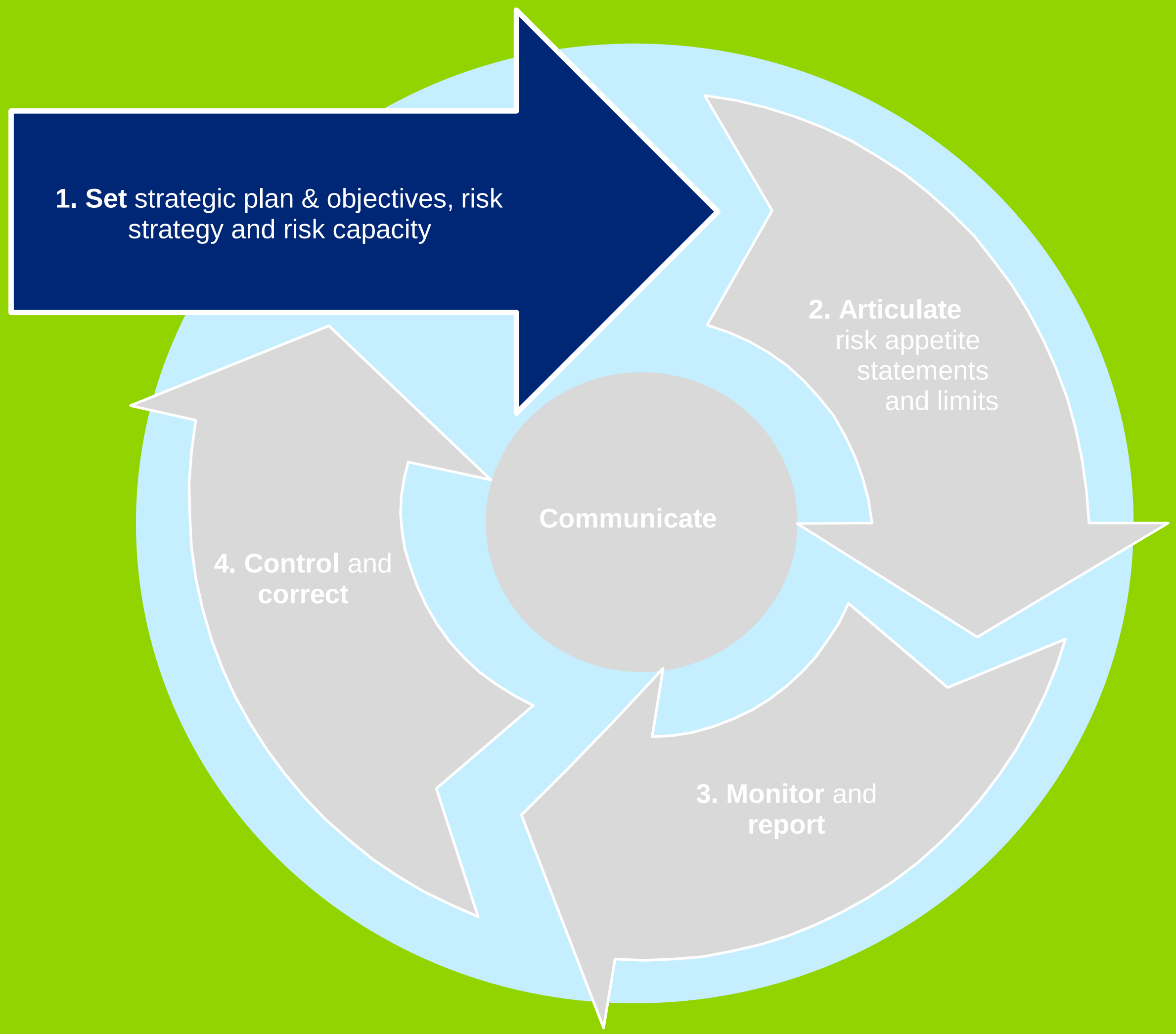


(*) Large Companies have more than € 1 bio GWP in 2012. Proportion of large companies is comparable across BE and NL participants.

Responsibilities of the respondents:

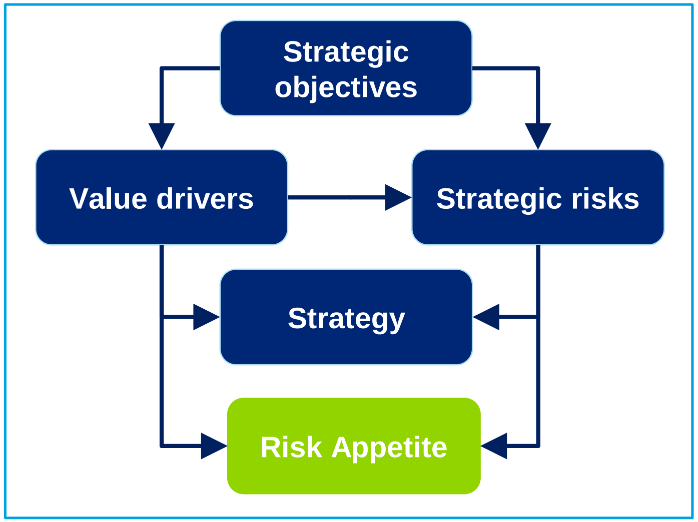
Involvement matrix	Must be consulted	Accountable to approve	Responsible to execute the task	Responsible for the coordination	Not involved
Setting strategic plan & objectives	36%	0%	18%	0%	45%
Setting the risk strategy and risk bearing capacity	33%	0%	17%	42%	8%
Articulating the risk appetite statement	18%	18%	27%	36%	0%
Articulating the risk appetite statement in operational limits	25%	8%	25%	33%	8%
Monitoring risk appetite levels and reporting on risk appetite	0%	17%	42%	25%	17%
Controlling and correcting the risk appetite	27%	18%	18%	27%	9%

2



1. Set strategic plan & objectives, risk strategy and risk capacity
2. Articulate risk appetite statements and limits
Communicate
3. Monitor and **report**
4. Control and **correct**

Content of this section



Risk appetite should be closely aligned to the pursued strategy. The first step in linking risk to strategy is the explicit articulation of risk appetite in order to establish a benchmark with which actual risks can be compared.

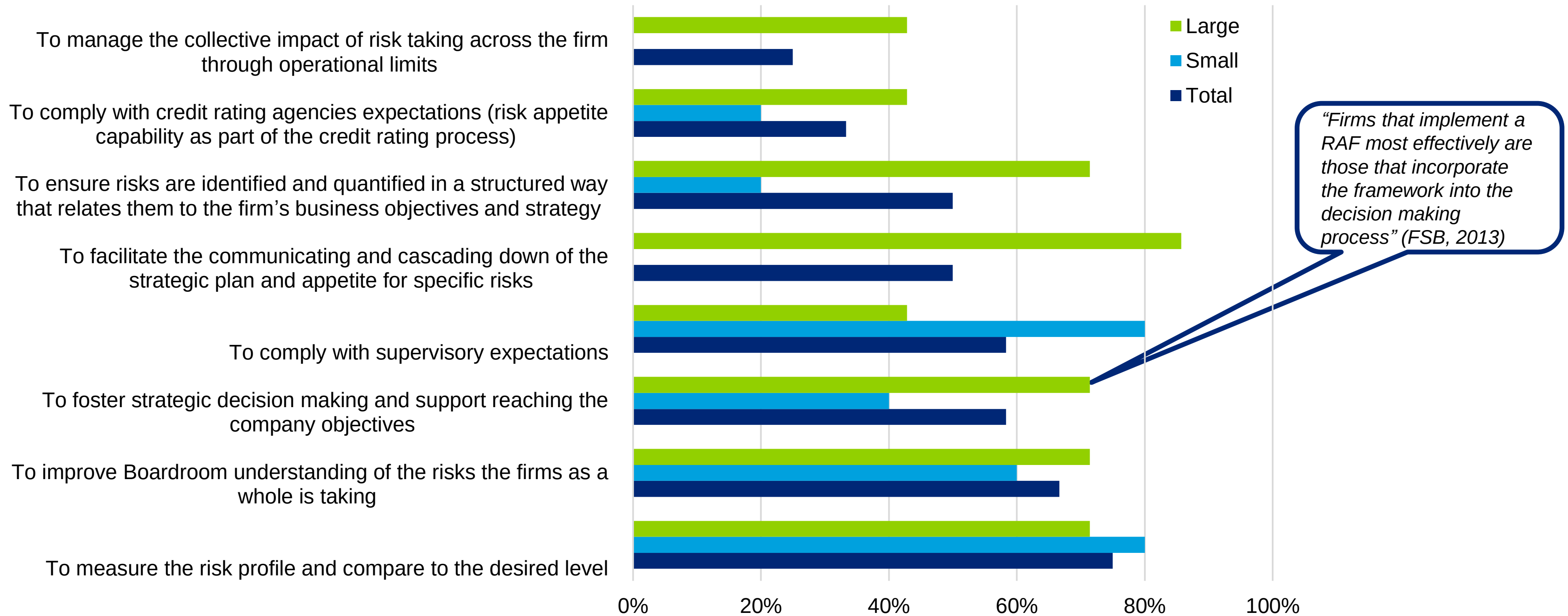
In this section we surveyed **how the firm's strategic plan and objectives, which are approved by the Board, are taken into account** to define the Risk Appetite, i.e. the risk a firm is willing to take in the pursuit of its strategy.

We also looked into the **different sources of information**, next to the strategic plan, used by insurance companies in establishing the Risk Appetite, and how this process is **integrated into business** processes.

But firstly we looked into the **business reasons, drivers for having a Risk Appetite Framework.**

Risk Appetite

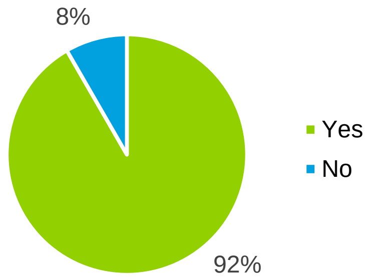
Why has your organization formulated a Risk Appetite?



Although the major drivers to formulate a risk appetite are important across segments and relate to measuring the risk profile and improve boardroom understanding of the risks taken by the company, small companies identify compliance as a major driver while large companies put more emphasis on the link with business objectives and strategy, including the communication and cascading down of the strategic plan and appetite for specific risks.

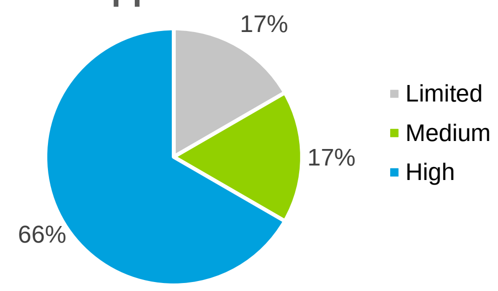
Strategic plan & objective as root for Risk Appetite

Do you have a risk appetite framework in place?



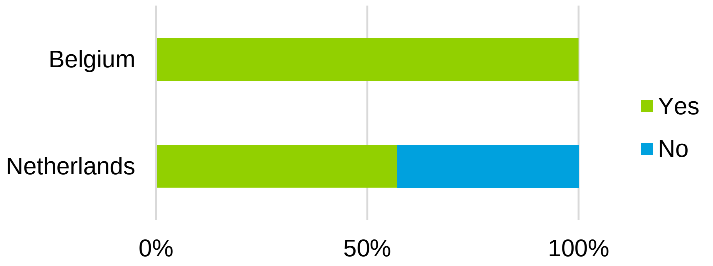
The vast majority of the respondents indicated they have a risk appetite framework in place.

To what extent has the strategic plan & objective of your organisation acted as a starting point for establishing the Risk Appetite?



All of the participants indicated that the strategic objective of their organization was used to some extent as starting point for establishing the risk appetite. The majority of the participants indicated that the strategic objective is a major building block (starting point) in the risk appetite establishment.

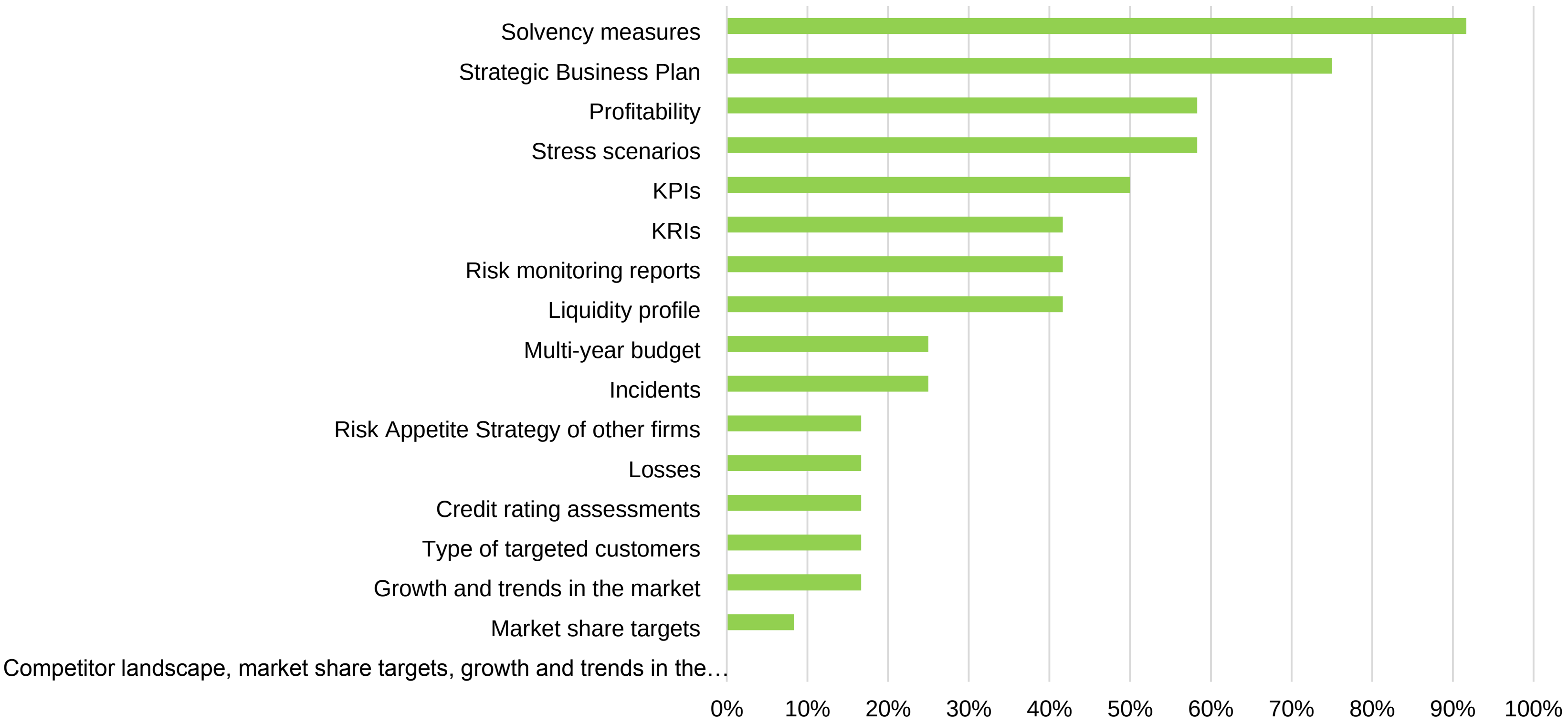
Is a strategic risk assessment part of the Risk Appetite process?



The majority of the respondents indicate that strategic risk assessment is part of their risk appetite process. Although all Belgian participants indicated this, it is only the case for 57% of the Dutch participants.

Strategic plan & objective as root for Risk Appetite

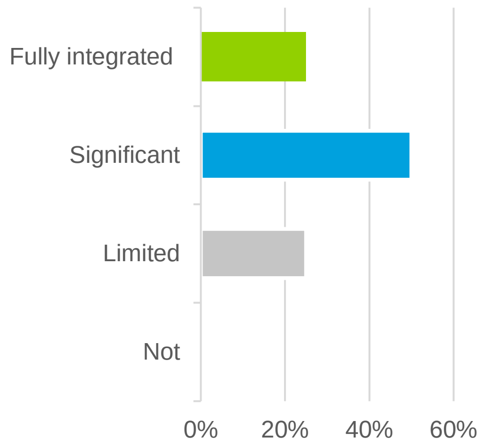
Which information (sources) are used in establishing the Risk Appetite?



The information sources most commonly used within the insurance industry are (1) the solvency measures, (2) the strategic business plan, (3) profitability and stress scenarios. This is both the case for the Belgian and Dutch respondents. The Risk Appetite Strategy of other firms has only been mentioned by small firms.

Finance Planning & Control cycle and external environment

To what extent is Risk Appetite part of the Finance Planning & Control cycle within your organisation?

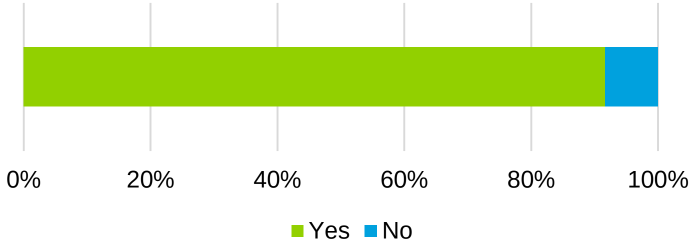


The existence of an integrated risk appetite in the planning & budgeting process can be an indicator of the level of awareness and the whether the risk appetite is effectively used within an organisation.

One fourth of the participants indicated that the Risk Appetite process is only part of the Finance Planning and Control cycle to a limited extent.

The extent of how the Risk Appetite is embedded in the Finance Planning and Control cycle various significant amongst participants.

Have developments in the external environment and their impact on your organisation been taken into account in establishing the Risk Appetite?

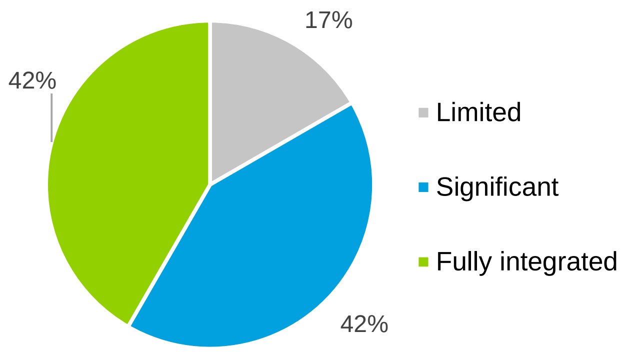


The vast majority of the participants indicated that the external environment has been taken into account in the risk appetite.

In an environment with low interest rates, financial and Sovereign debt crises and regulatory pressure on for example distribution (e.g. MIFID) and solvency (Solvency 2), this is not a surprising result.

Risk Appetite and Own Risk and Solvency Assessment

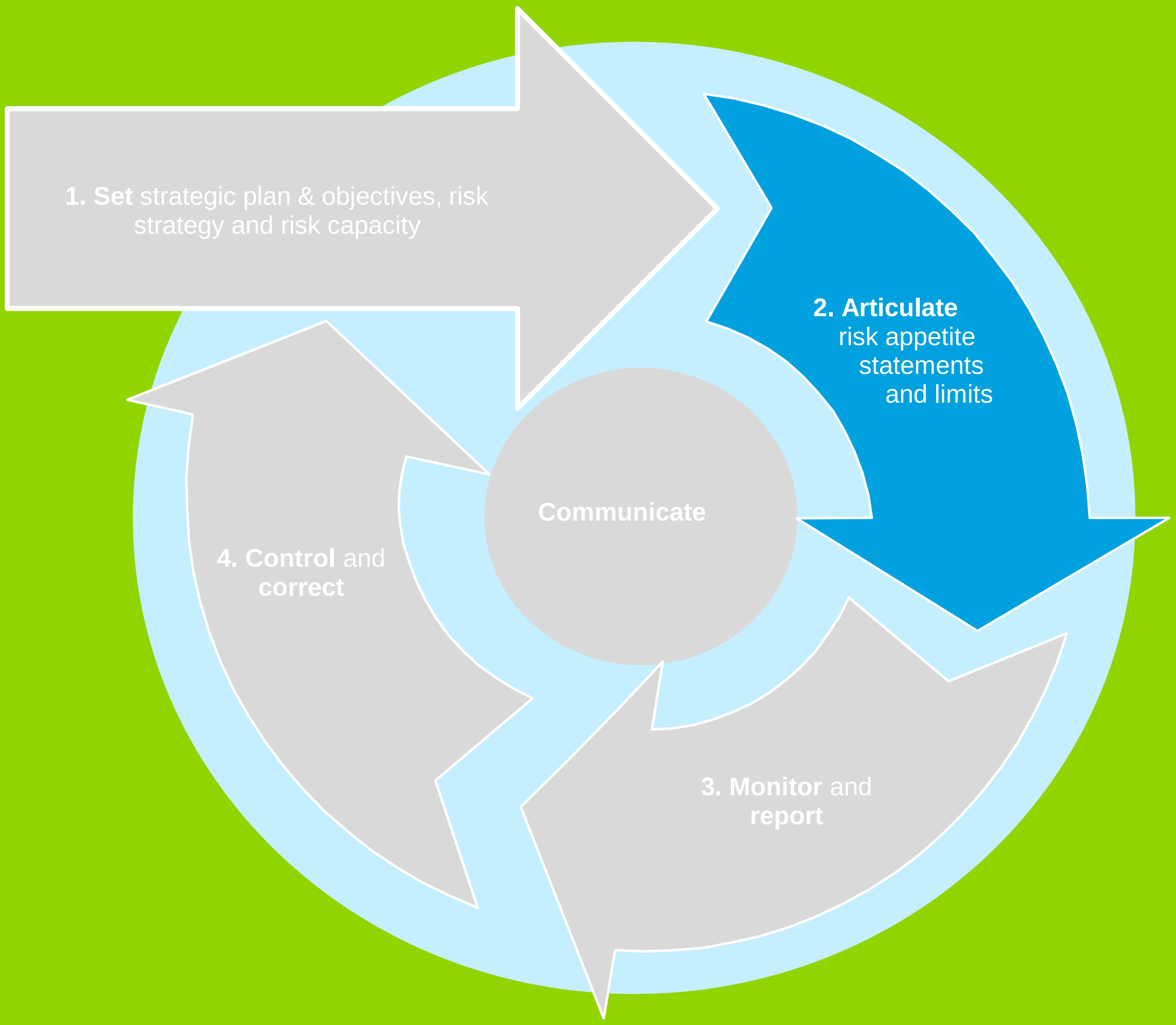
To what extent is Risk Appetite part of the current Own Risk Solvency Assessment?



A essential element of the system of governance in the Solvency 2 framework is the Own Risk and Solvency Assessment (or FLAOR – Forward Looking Assessment of Own Risks). Although the implementation date of Solvency 2 is postponed to 2016, companies should be compliant with the system of governance in 2014.

All of the participants indicated that the Risk Appetite is part of their current ORSA exercise. The level of integration is however different amongst participants. No significant differences were observed between Belgian and Dutch or large and small companies.

3



1. Set strategic plan & objectives, risk strategy and risk capacity
2. Articulate risk appetite statements and limits
3. Monitor and **report**
4. Control and **correct**
Communicate

Content of this section

Typically one has a hierarchy of risk appetite statements, starting with high-level risk appetite statements which then cascade down to directional, specific and finally detailed risk appetite statements. Developing risk appetite statements requires business input and understanding across the firm, driven by both top down leadership and bottom up management involvement.

The cascading of high level statements down through the business is aimed at developing and implementing a comprehensive and coherent structure. It is also key to enabling **transparency and communication** of the firm's risk profile as it creates a firm-specific common risk appetite language. In this section we analysed whether the risk appetite statement within the organization is commonly known and recognised in the organization, and looked into some **examples of risk appetite statements** used by insurance companies.

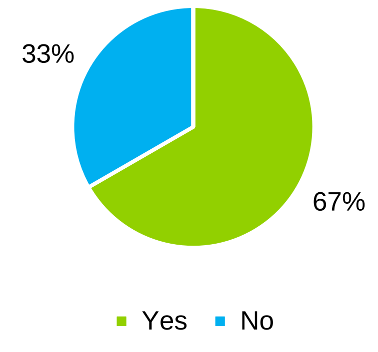
The risk appetite statement is a quantitative and qualitative articulation of risk appetite in written form, generally expressed as the acceptable range for the firm's risk profile between upper and lower risk appetite limits. We survey **for which risks** the respondents defined the risk appetite and do have a **quantitative or qualitative** measure in place.

Finally, we looked into **how tolerance limits are established** per risk category.

Risk Appetite Statement

Do you believe the definition of Risk Appetite used within your organization is commonly known and recognised in the organisation?

The “Risk Appetite Statement” is often defined as the ‘articulation’ of the risk appetite in written form. The risk appetite statement should be easy to communicate and therefore easy for all stakeholders to understand. Illustrations of risk appetite statements are included on the next page.

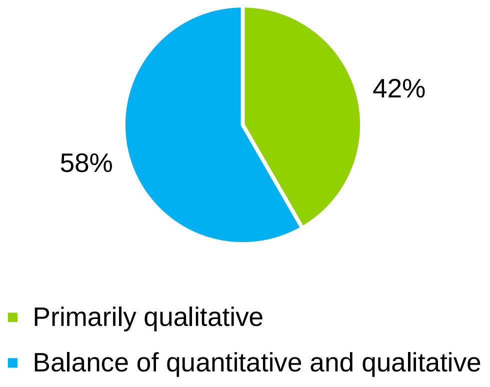


Are the statements in the risk appetite primarily of a qualitative or of a quantitative nature?

58% of the respondents indicate that their risk appetite is mainly a balance between quantitative and qualitative elements.

For the 42% of the companies, the risk appetite statement is mainly of a quantitative nature.

This is in line with our banking survey on the Belgian market.



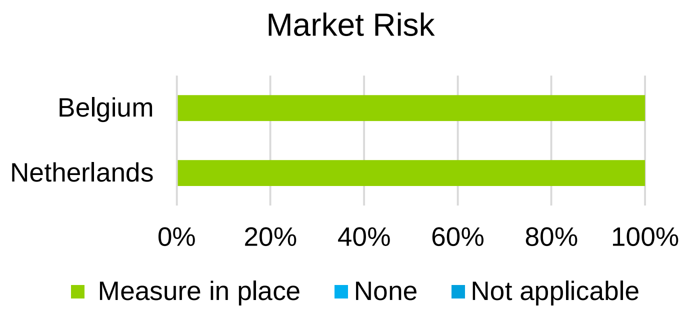
Risk Appetite Statement

Illustrations of the definition of Risk Appetite within insurance companies (grouped by similar statements)	
Focus on business strategy and objectives	• Risk appetite is the amount of risk that an organisation is willing to seek or accept in the pursuit of its long term objectives. • Risk appetite is the amount of risk, in qualitative terms, the Group is willing to accept in pursuit of its strategic business objectives. The Group's risk appetite takes into account the Group's financial goals, plus the capital structure to execute the business strategy and fulfill regulatory requirements. • The level of reasonably foreseeable risk the institution is willing to accept, given her predefined activities, in the pursuit of the business objectives. • The amount and type of risk that the Group is able and willing to accept in pursuit of its strategic objectives. • Risk appetite is the maximum risk that the company is willing to accept in pursuit of its chosen business strategy.
Focus on risk strategy	• This is defined as our Risk Target Profile that reflects our risk preference as defined during the risk strategy setting process. This has been defined also in quantitative ranges where possible.
Focus on Management understanding	• To ensure an integrated view of the different risks the company is facing and better materialize the link between two dual concepts: expected return and risk. This framework is key for the Board of Directors to fully understand and regularly monitor the risk exposure of the company and to ensure that all strategic decisions taken are consistent with their objectives in terms of risk appetite.
Focus on metrics	• It is a translation of Risk Appetite Statements (that are derived from the Corporate Strategy) into a limited list of key performance & key risk indicators (with tolerance levels). • The aggregate level of risk the company is willing to take. Defined as in line with capital adequacy, rating target, risk adjusted profit and return on equity/capital target. • The financial definitions are still in a preparation phase and hence not yet been approved by the board. The proposal expresses the risk appetite as mostly strategic financial goals (sustainable value, sustainable SII, sustainable SI, earnings stability, sustainable liquidity, covering assets). The non financial definitions (reputation, HR,..) are completed.

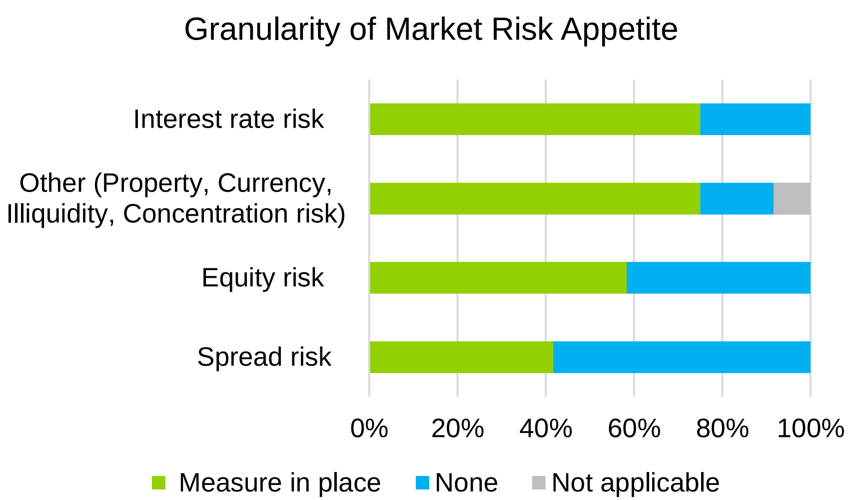
Granularity of the risks in the Risk Appetite Framework

For which risks have you defined the Risk Appetite and do you have a measure in place?

Market Risk



All of the participants mentioned to have market risk measures in place. As market risk is usually the largest risk insurance companies are facing this is no surprise.



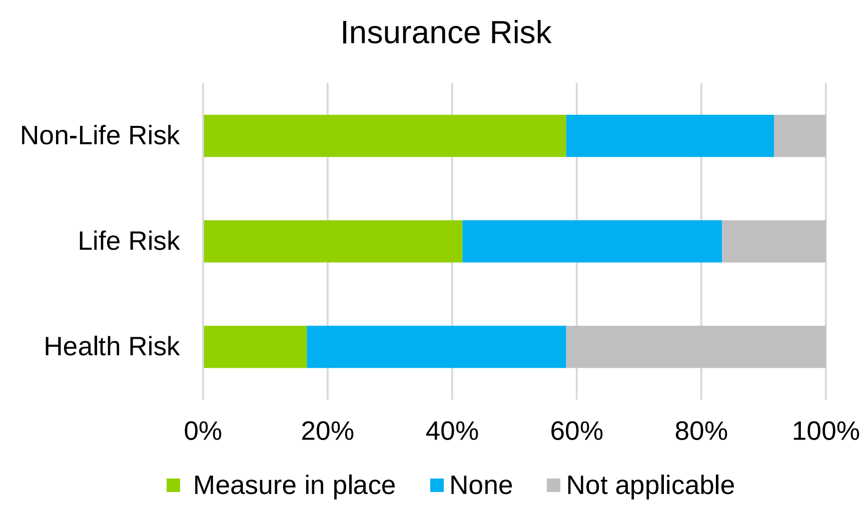
Most of the participants have defined their market risk appetite at a more granular level and have put measures in place.

Although in both countries most respondents have defined measures for interest rate risk (BE 80%; NL 71%) and other market risks - Property, Currency, Illiquidity and Concentration (BE 60%; NL 86%), this is not the case for the Dutch respondents for Equity (BE 80%; NL 43%) and Spread risk (BE 60%; NL 29%).

Granularity of the risks in the Risk Appetite Framework

For which risks have you defined the Risk Appetite and do you have a measure in place?

Insurance Risk



Most of the participants active in non-life business (58%, 8% is not active in non-life) have risk appetite measures in place for non-life risk. Although this is the case for 86% of Dutch non-life companies, only 25% of the Belgian respondents active in non-life have defined a risk appetite measure at the level of their non-life risk.

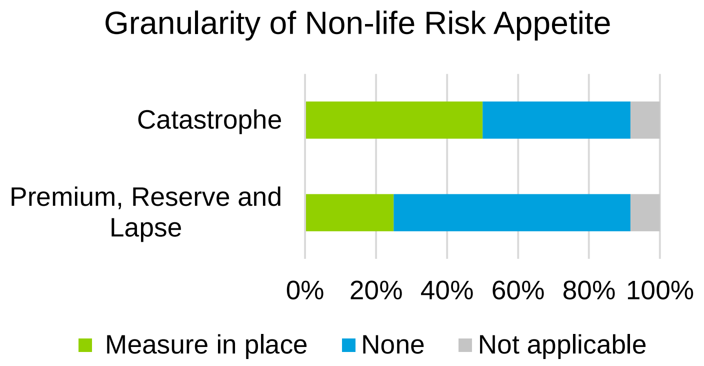
Half of the respondents active in life business have defined their risk appetite in terms of life risk.

29% from the participants with health business in their portfolio have defined a risk appetite measure on it, from which half of those follow up their risk appetite at a more granular level (SLT, non-SLT and catastrophe).

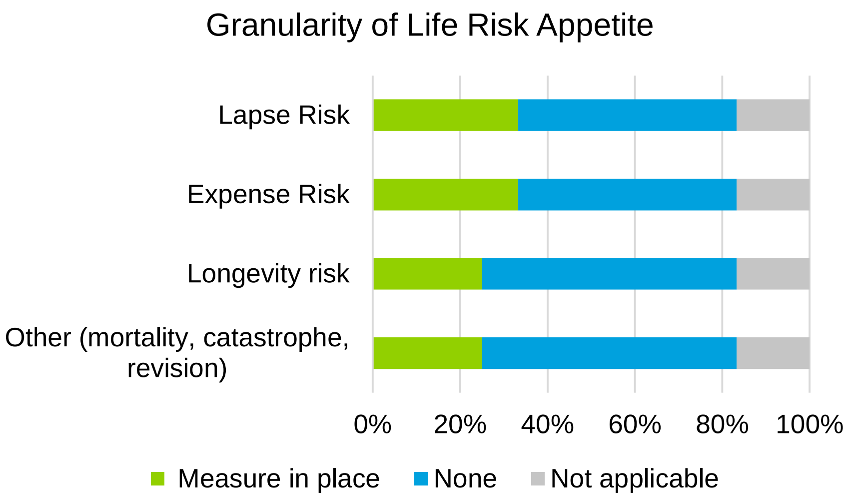
Granularity of the risks in the Risk Appetite Framework

For which risks have you defined the Risk Appetite and do you have a measure in place?

Insurance Risk



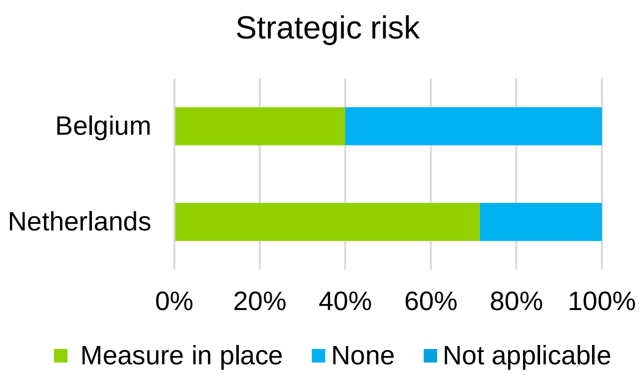
Almost all the insurance companies that have defined a risk appetite at the level of their non-life insurance risk mostly defined risk appetite measures at sub-risk level for catastrophe risk. Less than half of them also do so for premium, reserve or lapse risk.

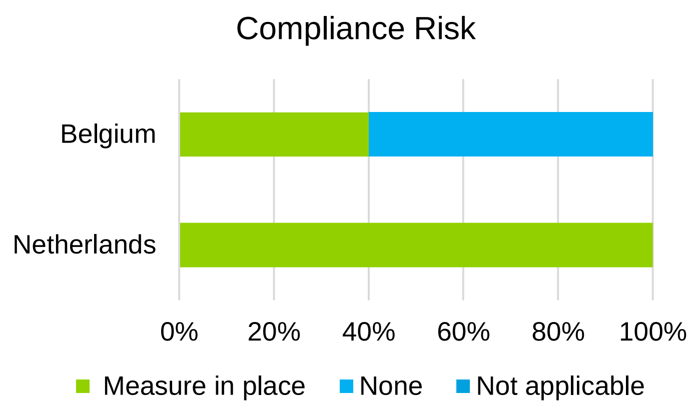


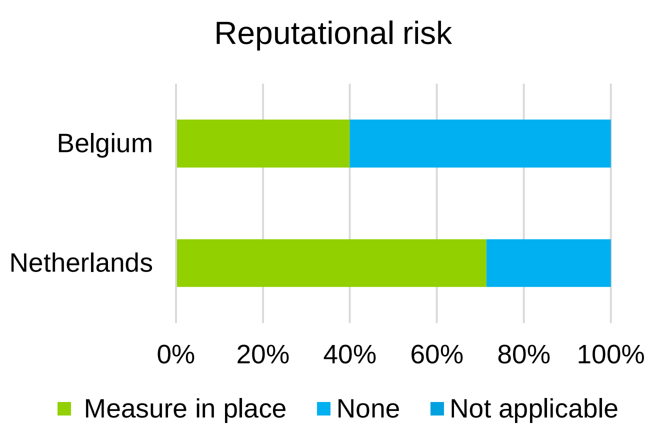
Although most companies that have defined their risk appetite on the level of life risk also have measures in place for lapse and expense risk, this is less the case for longevity and other (mortality, catastrophe and revision) life risks.
Given the relative importance of lapse and expense risk compared to longevity or mortality risk this is a reasonable outcome.

Granularity of the risks in the Risk Appetite Framework

For which risks have you defined the Risk Appetite and do you have a measure in place?







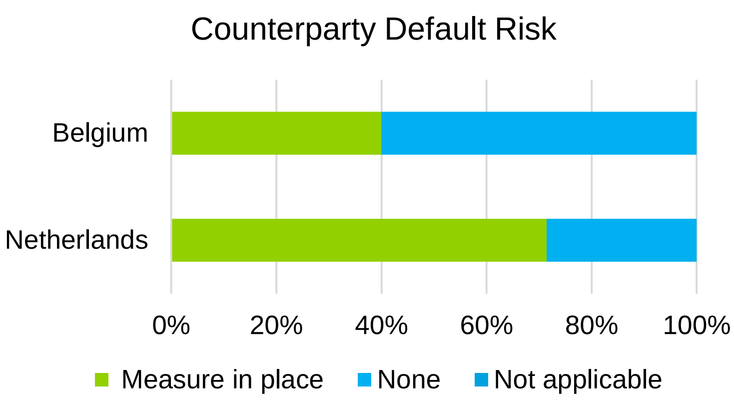
For the “less common” risk types we notice that the feedback amongst respondents is quite different and no trend could be identified between small and large companies.

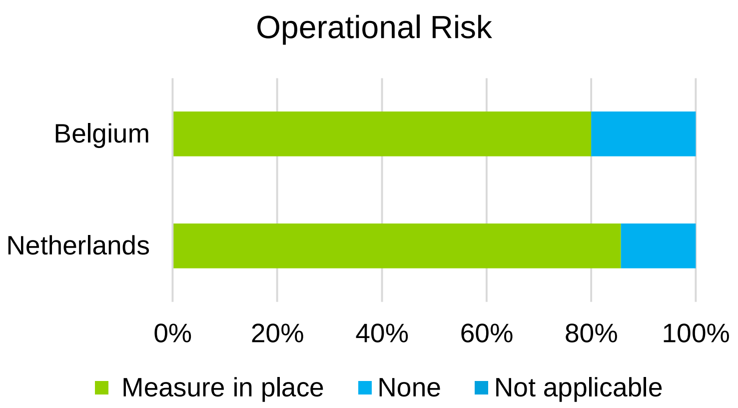
However, we see that a higher number of Dutch companies indicated that for these “non Solvency 2 pillar 1” risk types a measure has been defined. This could be related to the ORSA dry runs the Dutch companies had to perform for the DNB.

Even though these risk types are not treated as such under Solvency II (pillar 1) framework, the second pillar requires insurance companies to assess all risks to which they are subjected.

Granularity of the risks in the Risk Appetite Framework

For which risks have you defined the Risk Appetite and do you have a measure in place?





Most insurance companies have defined the operational and counterparty default measures. Only 40% of the Belgian insurance respondents state to have included measures for counterparty default risk. There are no explicit differences between large and small institutions.

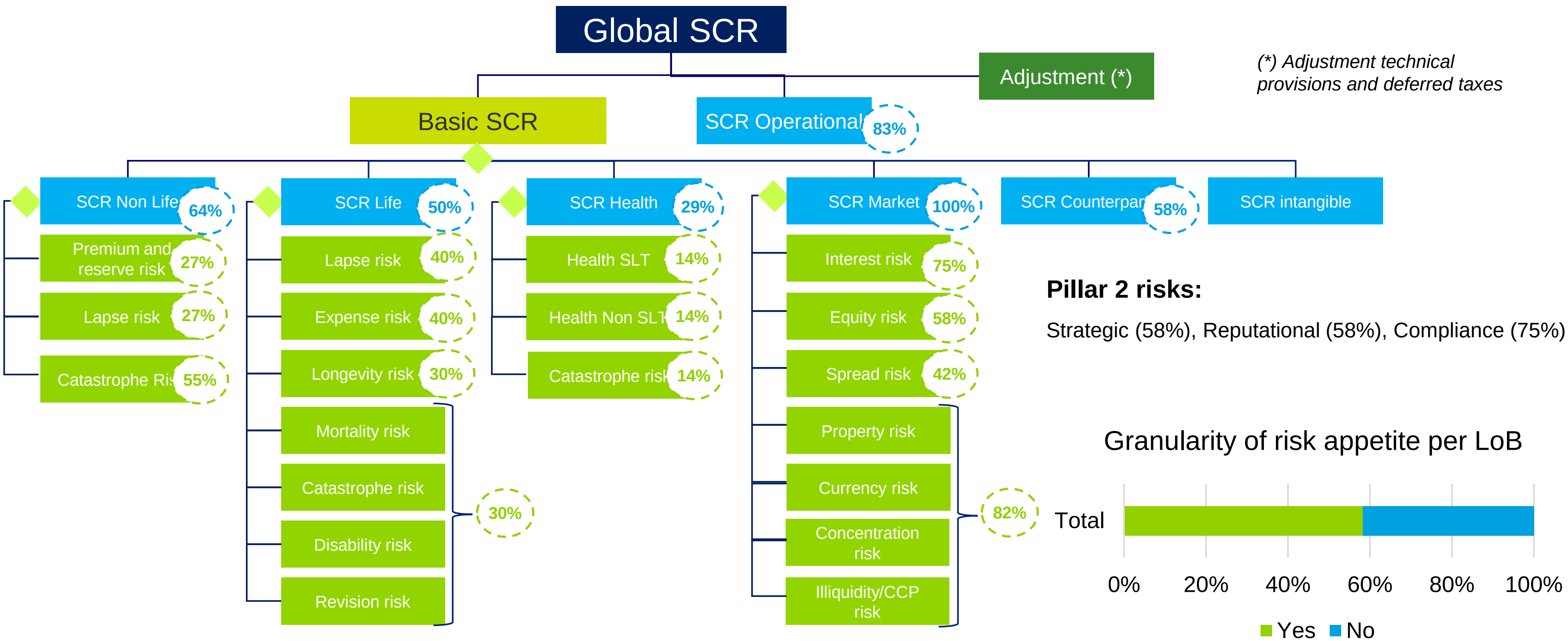
On top of the risks mentioned before, some insurance companies also indicated to have measures in place for:

- Liquidity risk
- Financial reporting risks and/or profitability
- Reinsurance risk
- Regulatory risks (legal, taxation on top of compliance) and/or customer/competitor//product and/or product pricing

Granularity of the risks in the Risk Appetite Framework

For which risks have you defined the Risk Appetite and do you have a measure in place?

Summary of risk appetite granularity presented in risk modules of SCR

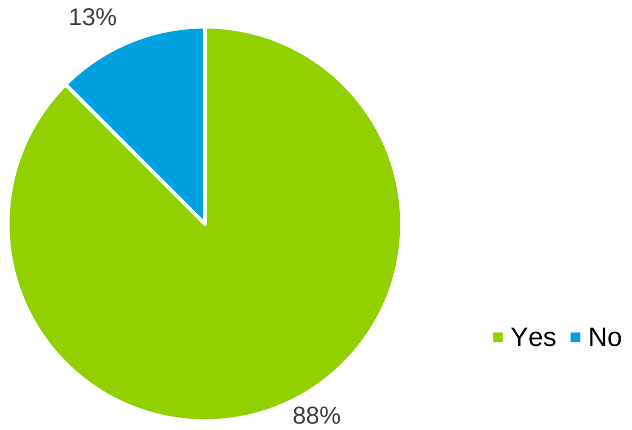


The percentages stated above represent the % of respondents that have defined their risk appetite at that level (excluding insurance companies not active in that segment). 58% of respondents also indicated to further specify their risk appetite per line of business. There is no significant difference between Belgian and Dutch insurance companies.

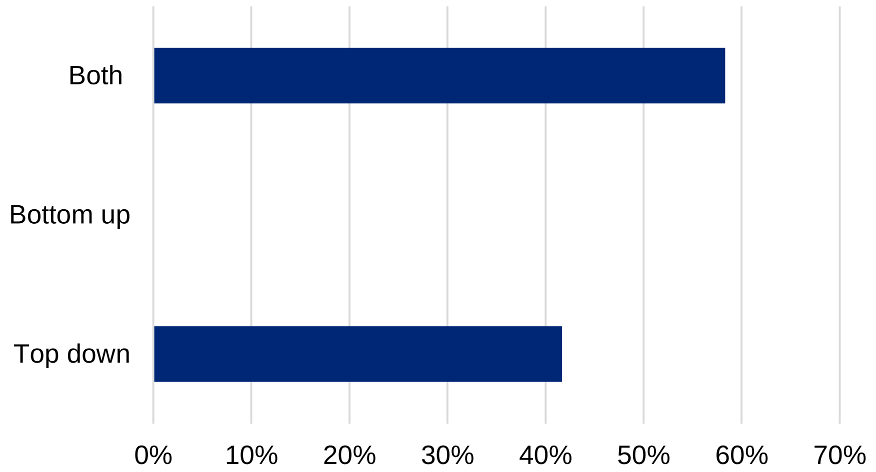
Cascade risk appetite into operational levels

There are different ways of translating a firm's high-level risk appetite into a limit and reporting system cascaded down to the business lines. Proper management attention is needed at both ends of the range for potential over-but also undershooting of the objectives.

Is the Risk Appetite translated to a tactical and operational level within the organisation?



How was the translation done: bottom-up, top-down, or a combined approach?



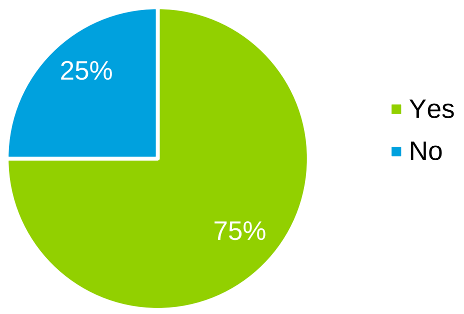
Most of the insurance companies have translated the Risk Appetite to a tactical / operational level. Most of the respondents indicated that the translation was done top-down. As would be expected, none did only a bottom-up exercise.

The institutions that indicated that a combination of a top-down and bottom-up approach was used were mostly large companies.

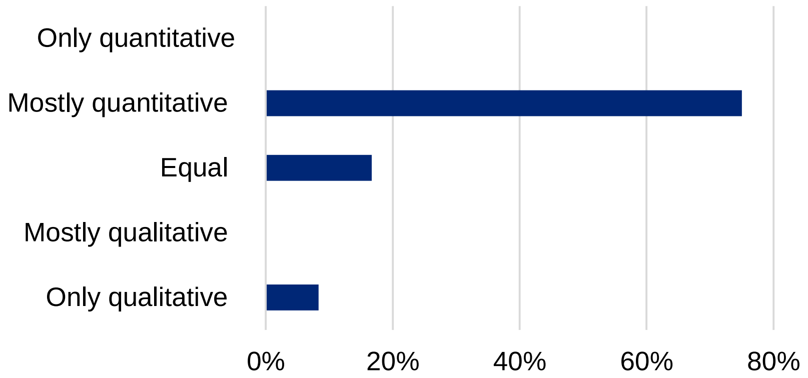
The establishment of tolerance limits per risk category

The objective of tolerance limits is to constrain risk-taking within the risk appetite, taking into account the interests of all stakeholders. Limits should be measurable even through qualitative assessments.

Have tolerance limits been defined per risk category?



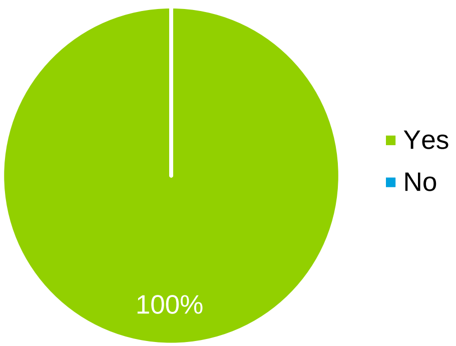
How are tolerance limits defined?



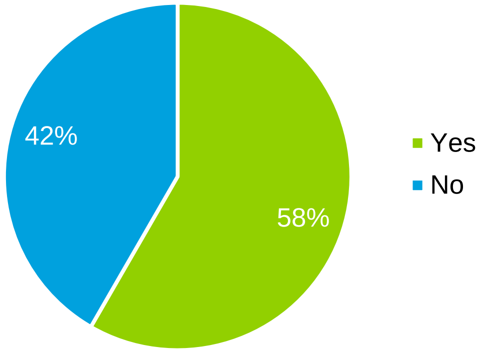
Three quarters of the insurance companies indicate that they have formulated tolerance limits per risk category. Most institutions indicate that within their organisation, the tolerance limits per risk category are of quantitative nature.

The establishment of tolerance limits per risk category

Has a clear link been established / modelled between the tolerances and the Risk Appetite?

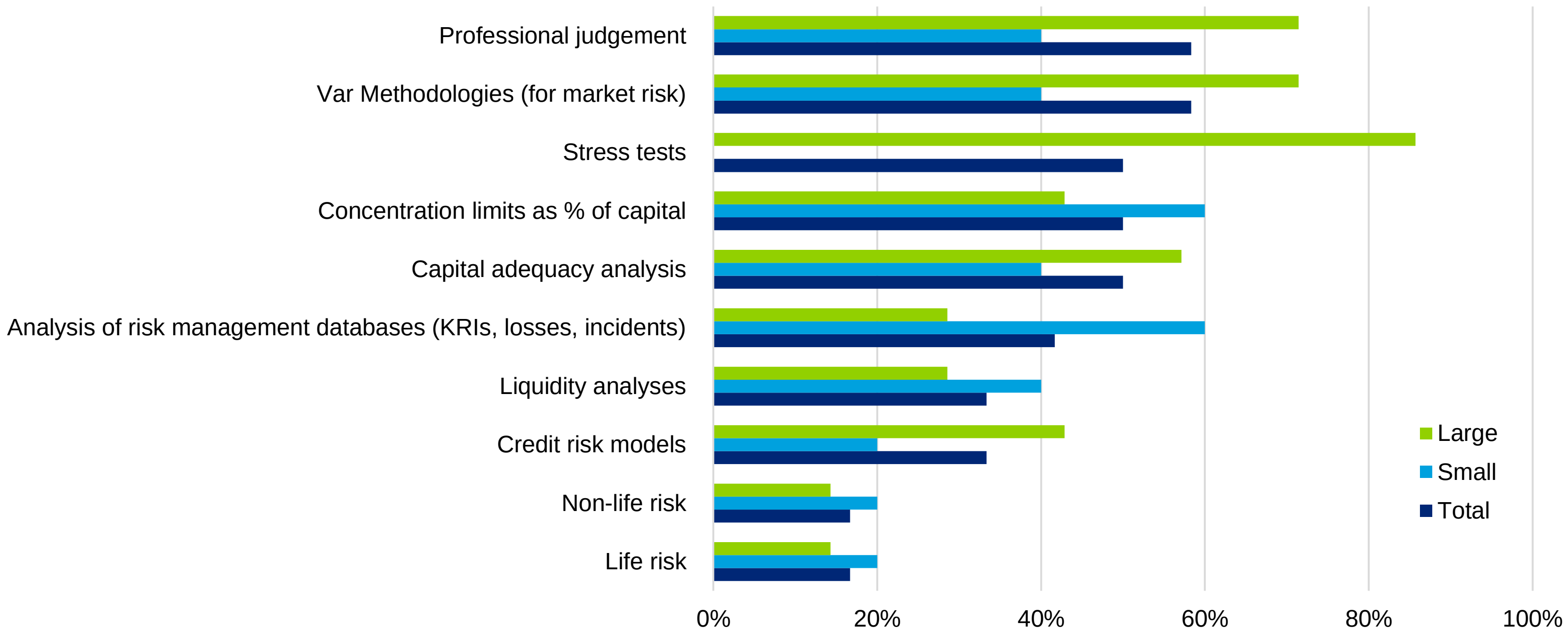


Have tolerances also been formulated on sub-risk categories?



The articulation of the risk appetite in operational limits

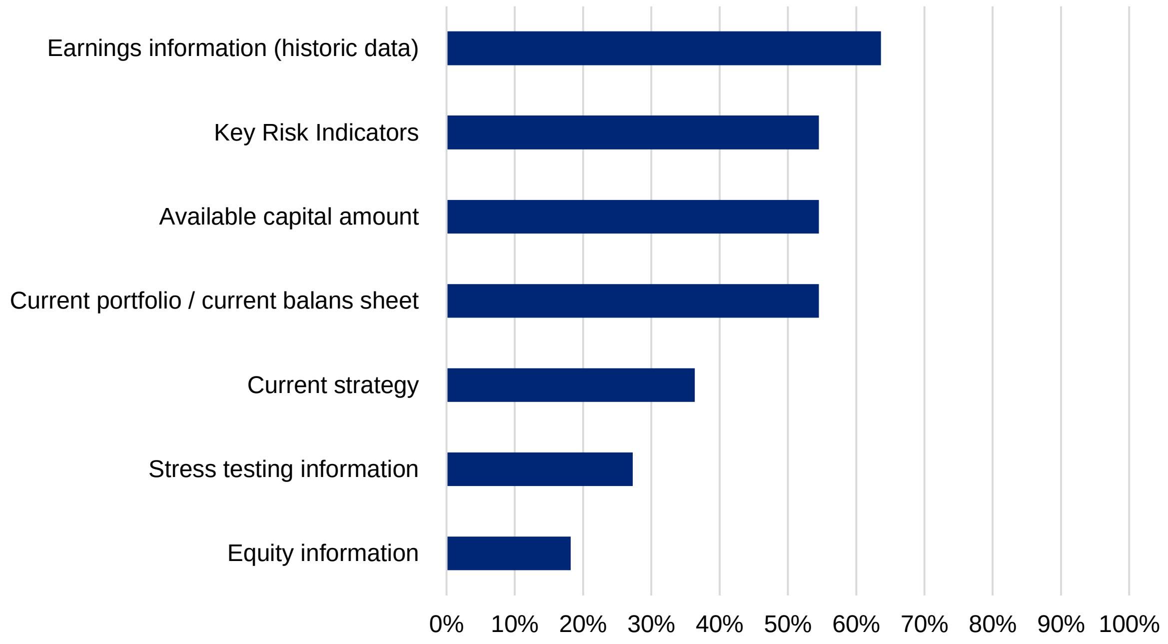
What methods and/or techniques have been used to articulate the risk appetite in operational limits?



There is a clear distinction between large and small companies. The top 3 for large companies are stress tests (86%), professional judgement (71%) and Var methodologies for market risk (71%). Stress tests have not been mentioned by small companies.

The articulation of the risk appetite in operational limits

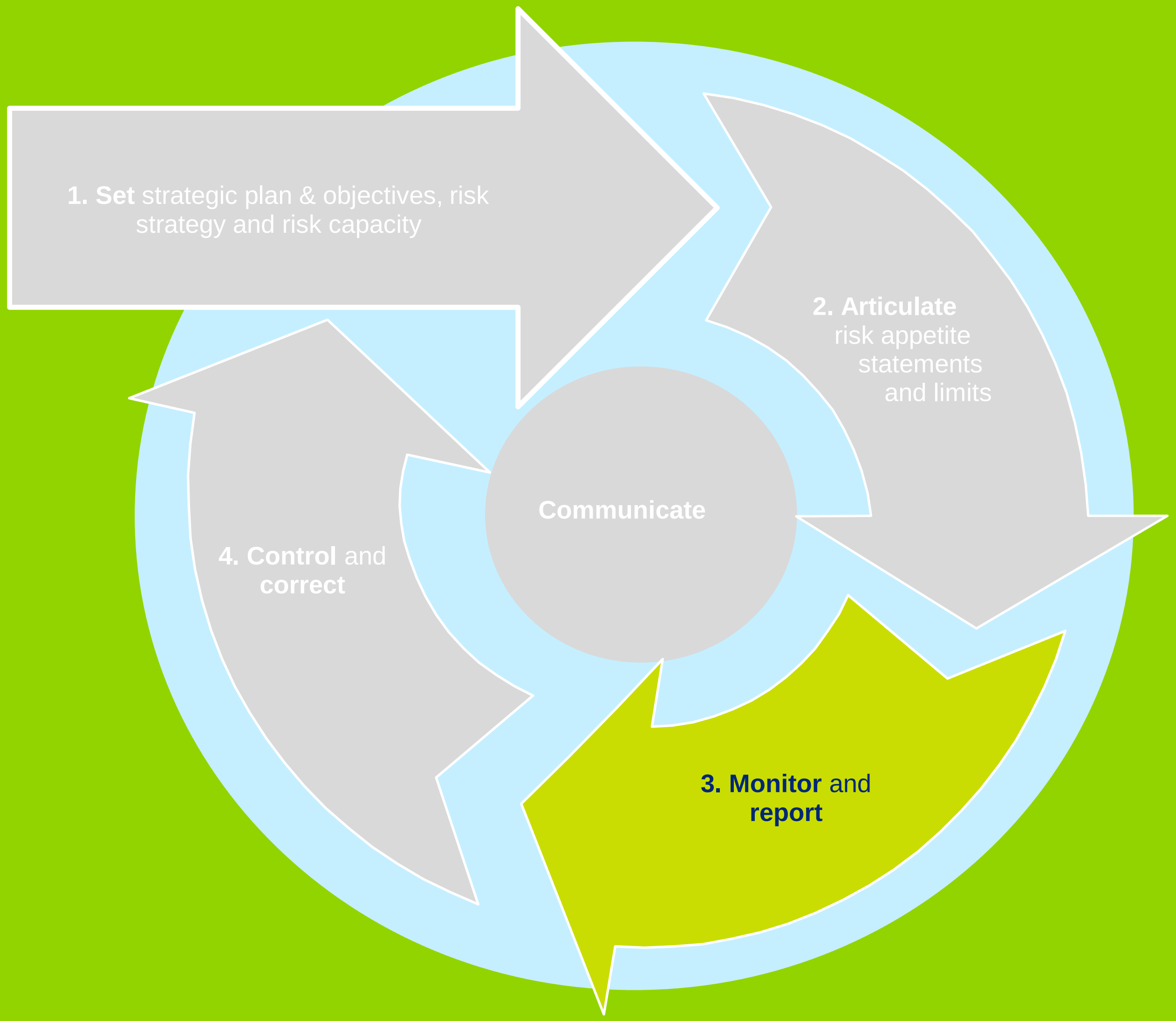
What have you used as a starting point / basis for establishing the detailed risk appetite measures and limits?



Most insurance company participants indicated that the starting point used to establish the detailed risk appetite limits were:

1. Earnings information (64%)
2. KRI, Available capital and current portfolio/balance sheet (55%)

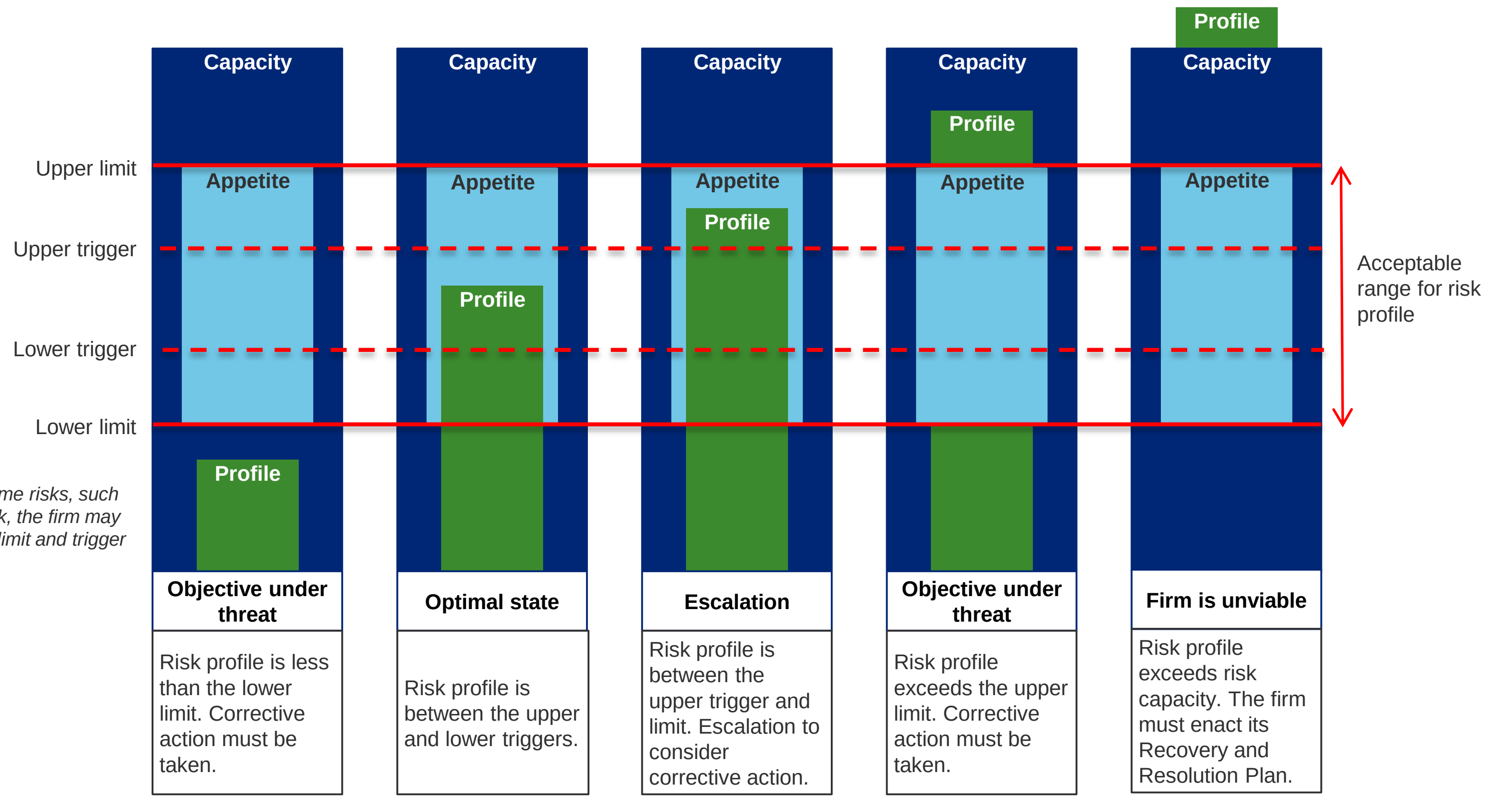
4



1. Set strategic plan & objectives, risk strategy and risk capacity
2. Articulate risk appetite statements and limits
Communicate
3. Monitor and report
4. Control and correct

Content of this section

Risk appetite limits, if breached by the firm's risk profile, necessitate immediate escalation and corrective action. A risk appetite framework allows the firm to identify and determine the relative positions of its risk capacity, risk profile and risk appetite when evaluating and pursuing its strategy and to take corrective action where necessary. In each of the five states illustrated, the firm's risk profile has changed relative to its risk capacity and risk appetite.



Note:

In practice, for some risks, such as operational risk, the firm may not have a lower limit and trigger

Content of this section

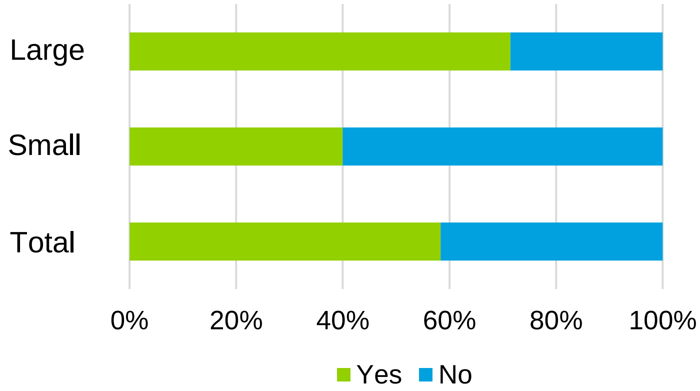
In this section we first look into the **governance, oversight and accountability** defined within risk appetite frameworks. A firm's risk governance is essential in clarifying lines of accountability and describing how staff should adhere to the firm's risk appetite framework. Having the involvement of the key stakeholders is important in the roll-out of a risk appetite framework.

Quantitative or qualitative detailed risk appetite measures and limits are articulated to allow risk appetite to be monitored and controlled in day-to-day risk management processes. Secondly we surveyed the current practices for **monitoring the risk profile**, and how the risk appetite limits, if breached by the firm's risk profile, would trigger escalation to consider corrective action.

In this context we also looked in to the definition of the **risk bearing capacity**, i.e. the maximum level of risk at which a firm can operate, while remaining within constraints implied by its capital and funding needs and its obligations to stakeholders.

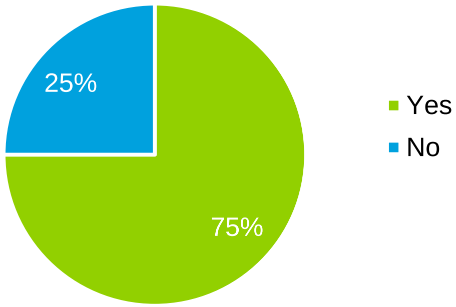
Risk Governance, oversight and accountability

Do you have a Risk Appetite Policy which ensures uniformity of the risk appetite process and which establishes roles and responsibilities?



The majority of the insurance sector respondents indicated that within their organisation a mature Risk Appetite Policy is in place. This is more the case for large companies (71%) than for small entities (40%).

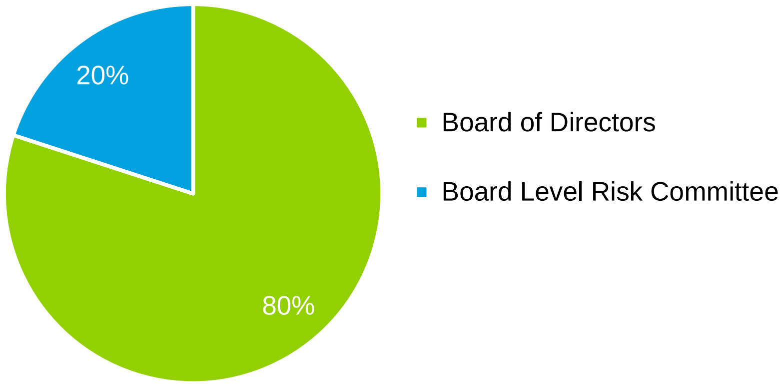
Has the Risk Appetite led to adjustments in your Risk Framework?



75% of the Insurance institutions indicated that the development of the Risk Appetite led to changes in their risk framework (including risk governance).

Risk Governance, oversight and accountability

Which departments and/or people (positions) are ultimately accountable to approve the definition of the Risk Appetite statements?

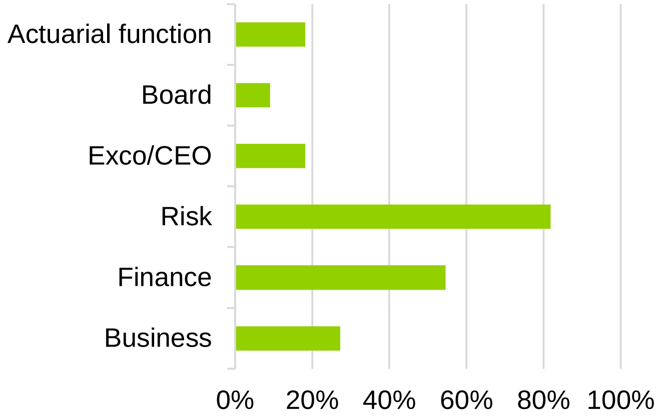


Executive Management, Line Management, Risk Manager, Internal Audit, ALCO and Controller are never granted accountability to approve the risk appetite statement.

The Board of Directors (1) and the Board Level Risk Committee (2) are considered as ultimate accountable bodies for approving the Risk Appetite Statements.

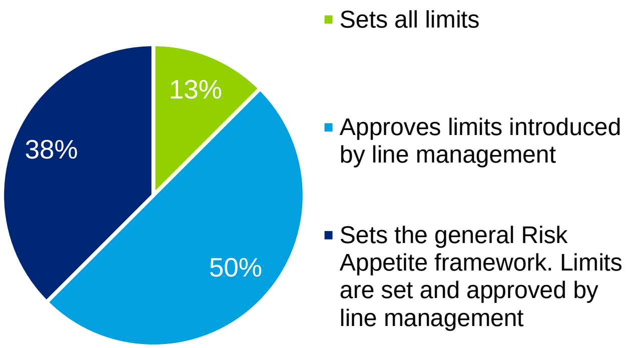
Risk Governance, oversight and accountability

Which departments and/or functions have assisted (were consulted, provided support,…) in establishing the Risk Appetite?



The Risk teams, together with Finance are the drivers for establishing the Risk Appetite.

What is the role of the Board in establishing the detailed risk appetite measures and limits?



The majority of the participants answered that within their organisation the role of the Board is limited to setting the Risk Appetite framework and limits are set by line management. Most of the other participants that answered the question indicated that the Board approves the Risk Appetite limits. Only one of the participants responded that the Board has a role in setting Risk Appetite limits. This is a small company.

Risk Governance, oversight and accountability

What is the role of First and Second Line in establishing and monitoring Tolerance limits?

	Line Management	The second line Risk Management
	In establishing tolerance limits	In establishing tolerance limits
Sets and approves all limits	38%	0%
Proposes all limits which are approved by the board	50%	100%
Has no role in establishing these limits	13%	0%
	In monitoring tolerance limits	In monitoring tolerance limits
Has full responsibility to monitor these limits	56%	50%
Has a reporting responsibility towards the board	22%	33%
Has no role in monitoring these limits	22%	0%
Other	0%	17%

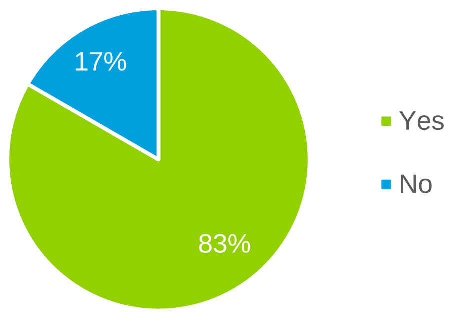
The survey respondents find that it is mainly the responsibility of the 2nd line to propose limits to the Board. Subsequently, it is up-to the Board to review and approve these limits. Monitoring these limits is a responsibility which could either reside within the 1st line (56%) or the second line (50%). One participant mentioned the 2nd line only had to be informed in case of a breach and propose remediation actions.

What is the role of Internal Audit in establishing and monitoring Tolerance limits?

Furthermore, 91% of the respondents say that Internal Audit has no role at all in setting tolerance limits; 55% of the respondents also say that Internal Audit has no role in monitoring these limits. 45% of the respondents say that Internal Audit's responsibility is to provide feedback on the process of monitoring these limits.

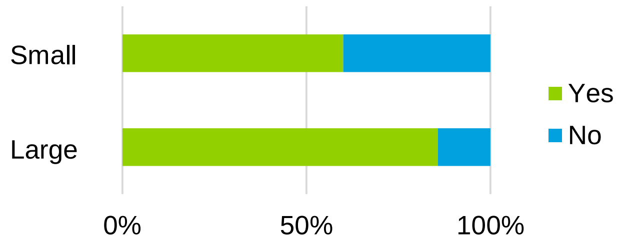
Risk Governance, oversight and accountability

Are the tolerances being monitored by specific committees?



Examples of such committees are: Assets & Liabilities Committee, (Group) Risk Committee, Risk type specific committees, Executive Committee, Audit Committee, Financial Committee (to monitor all financial aspects), Operational Risk Committee (to monitor operational activities)

Have the roles of the various functions (line management, 2nd line, internal audit, etc.) regarding Risk Appetite been formalized?

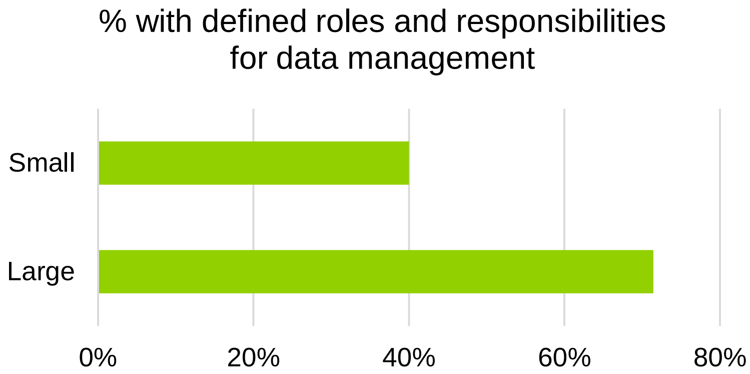


The majority of the participants indicated that the roles of the different functions regarding risk appetite have been formalised. This is even more the case for large companies (86% compared to 60% for small companies).

All respondents also express that business managers as the First Line of Defense have explicit responsibility for risks and risk management. All respondents but two, also state that business managers understand what their Risk Appetite is.

Risk Governance, oversight and accountability

Has your organisation formalized the Roles and Responsibilities with regard to the data used in the Risk Appetite Framework?



The attention to data management and data quality, including the roles and responsibilities regarding data has increased due to the introduction of Solvency 2. As larger companies usually have done more investments to date regarding data control, this is probably also the reason large companies have a more formalized approach.

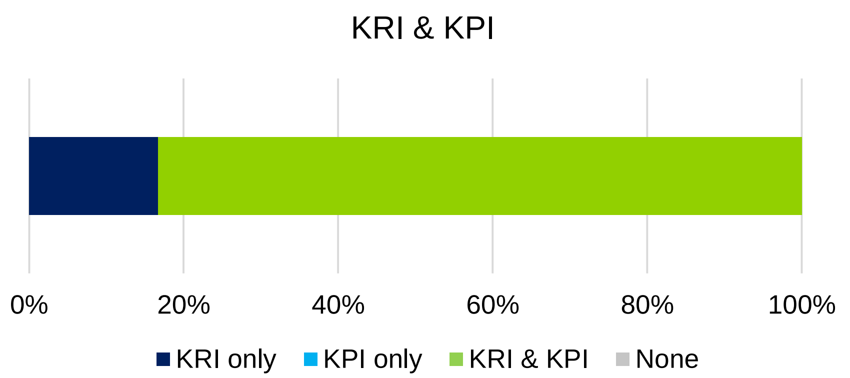
Monitoring the risk profile

Risk appetite limits, if breached by the firm's risk profile, necessitate immediate escalation and corrective action. A risk appetite framework allows the firm to identify and determine the relative positions of its risk capacity, risk profile and risk appetite when evaluating and pursuing its strategy and to take corrective action where necessary.

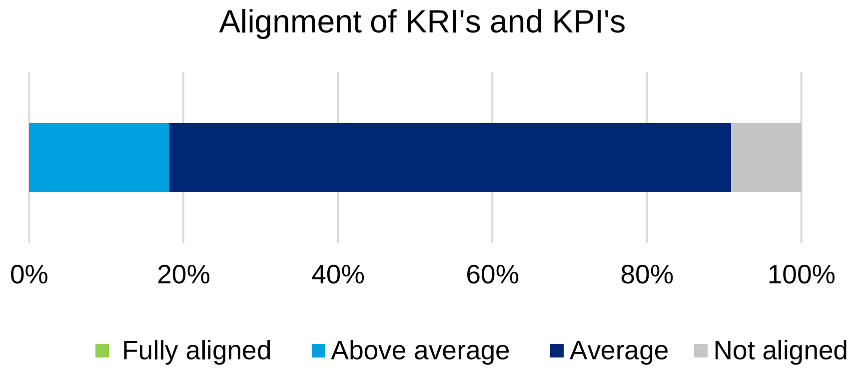
All of the surveyed insurance companies use KRI's based on the defined limits.

The majority (83%) of the respondents also state that these KRI's are and affective tool to support steering and decision making. 83% of the respondents use both KRI's and KPI's. The effectiveness of those KPI/KRI are typically (80%) reported directly to the Board or management committees.

Have Key Risk Indicators (KRI's) and/or Key Performance Indicators (KPI'S) been formulated?

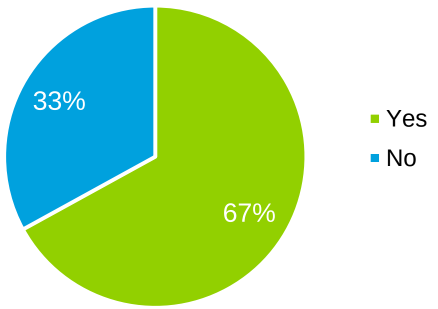


To what extent are KPI's (steering) and KRI's (control) aligned?



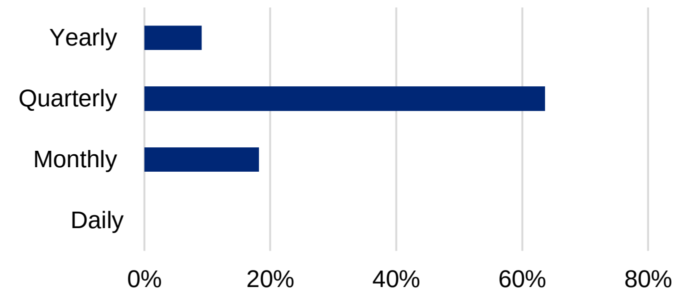
Monitoring the risk profile

Is there an escalation procedure for crossing a limit or tolerance?



67% of the participants indicated that within their organization an escalation procedure is foreseen when crossing a limit or tolerance.

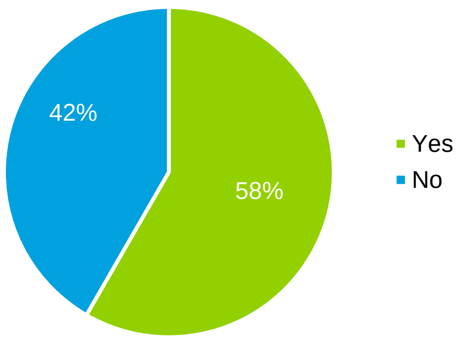
With what frequency does the board receive reports to monitor compliance to the tolerance limits?



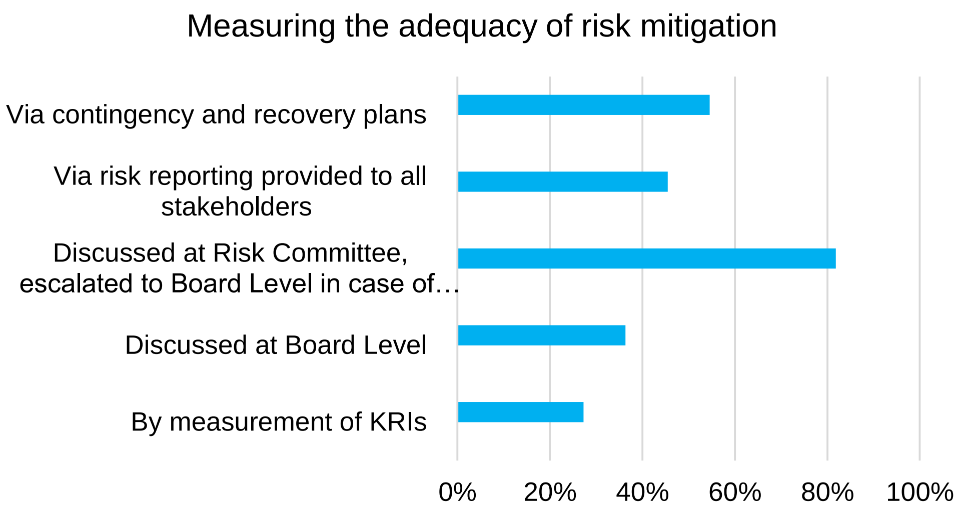
In addition, more than 80% of the participants indicated that the Board of Directors receive at minimum on a quarterly base reports with an overview if tolerance limits were respected or not.

Monitoring the risk profile

Have (ex-ante) action plans been defined for risk mitigation if tolerances are breached?



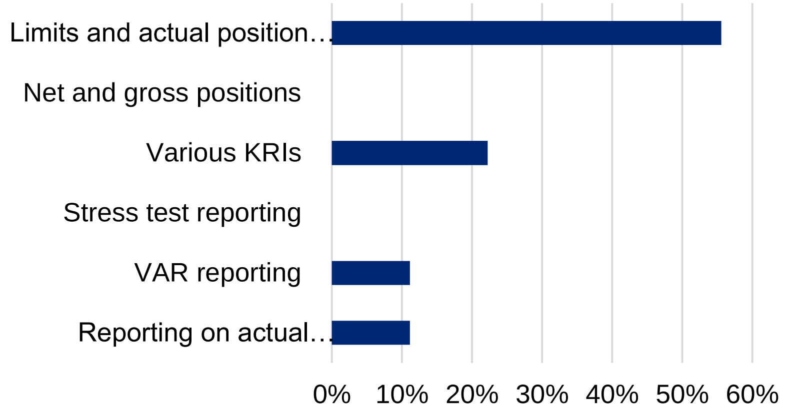
How is the (ex-post) adequacy of risk mitigation measured and assessed?



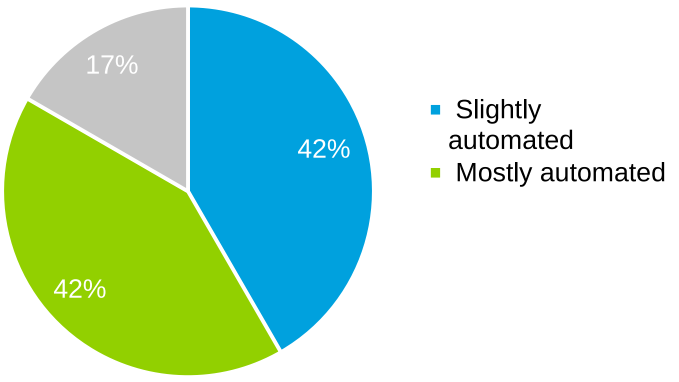
42% of the respondents indicated that no predefined action plan is in place when the risk profile is not in line with the defined Risk Appetite. Risk Committees assess the adequacy of the risk mitigating actions. In only 36% of the surveyed institutions, the Board is involved on a structural way.

Monitoring the risk profile

What data, methods and reports does your organization use to monitor the tolerance levels and limits?



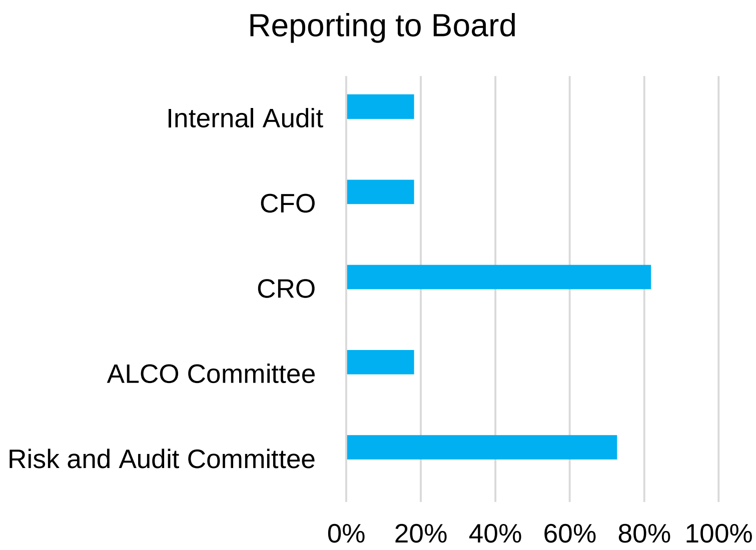
To what extent is monitoring of the tolerances and limits automated?



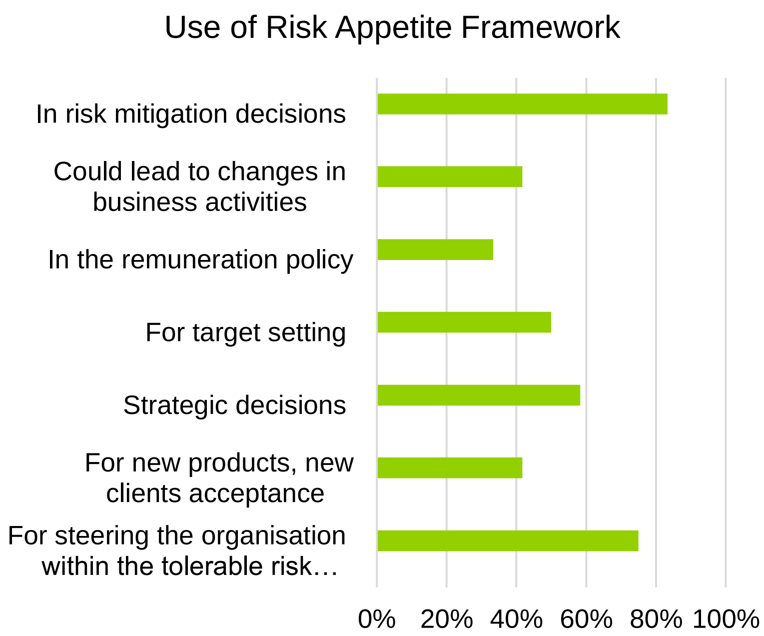
An effective and efficient risk appetite framework should be strongly supported by a sound management information systems (MIS).

Monitoring the risk profile

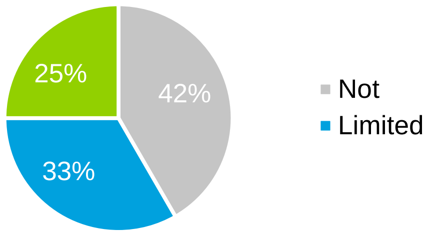
Through which channels does the Board receive reports on the Risk Appetite within the organization?



How is the information on Risk Appetite used for steering the organization?



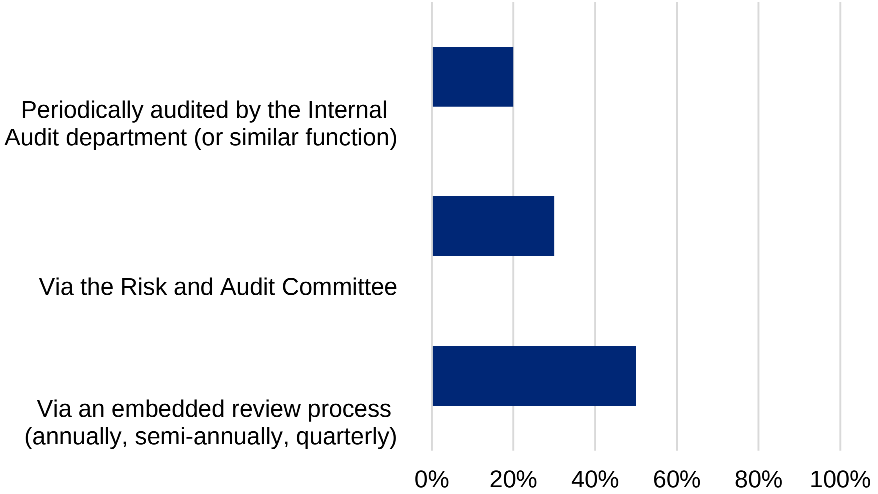
To what extent does Risk Appetite influence your pricing strategy?



Most participants indicate that their risk appetite did influence their pricing strategy at least to some extent. Only one fourth mentions the risk appetite has a significant impact on pricing.

Monitoring the risk profile

How does your organisation verify if the various functions (line management, 2nd line, etc.) fulfil their responsibilities accurately and completely?



A Board needs to satisfy itself that the limits in the risk appetite statement are reflected appropriately in business plans and specific risk limits per risk type, and that the business act according to the limits.

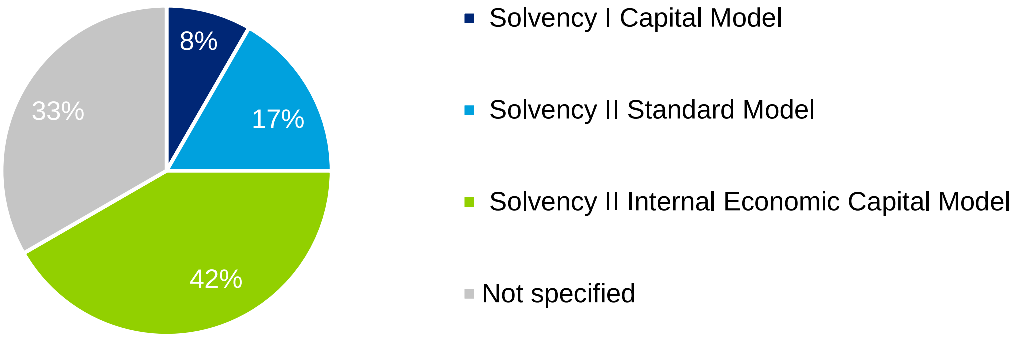
In half of the institutions there is an embedded review process to verify if the various functions fulfil their responsibilities.

Supervisors may also seek verification or demonstration of the board's role in approving the risk appetite statement, for instance by reviewing board minutes or through discussions with directors and management, to ensure that the board did not simply 'rubber stamp' the risk appetite.

The participants of the survey indicate that the role of the auditor and the regulator is very limited to non-existing in verifying the performance of the different functions within the process.

Risk Bearing Capacity

How does your organization determine its internal capital need?

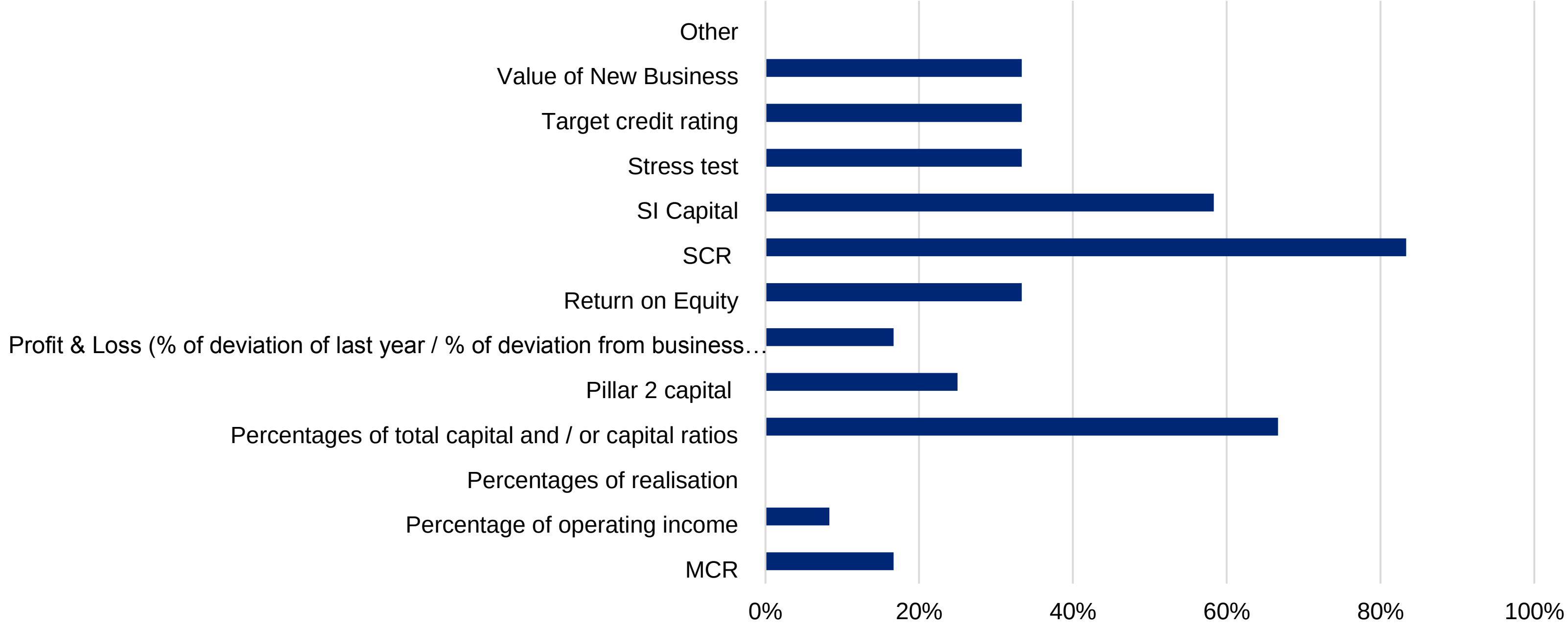


Most insurance clients indicate that their Solvency II Internal Economic Capital Models are the basis to determine their internal capital needs.

None of the respondents indicated that Rating Agency Specific Models are used for this purpose.

Risk Bearing Capacity

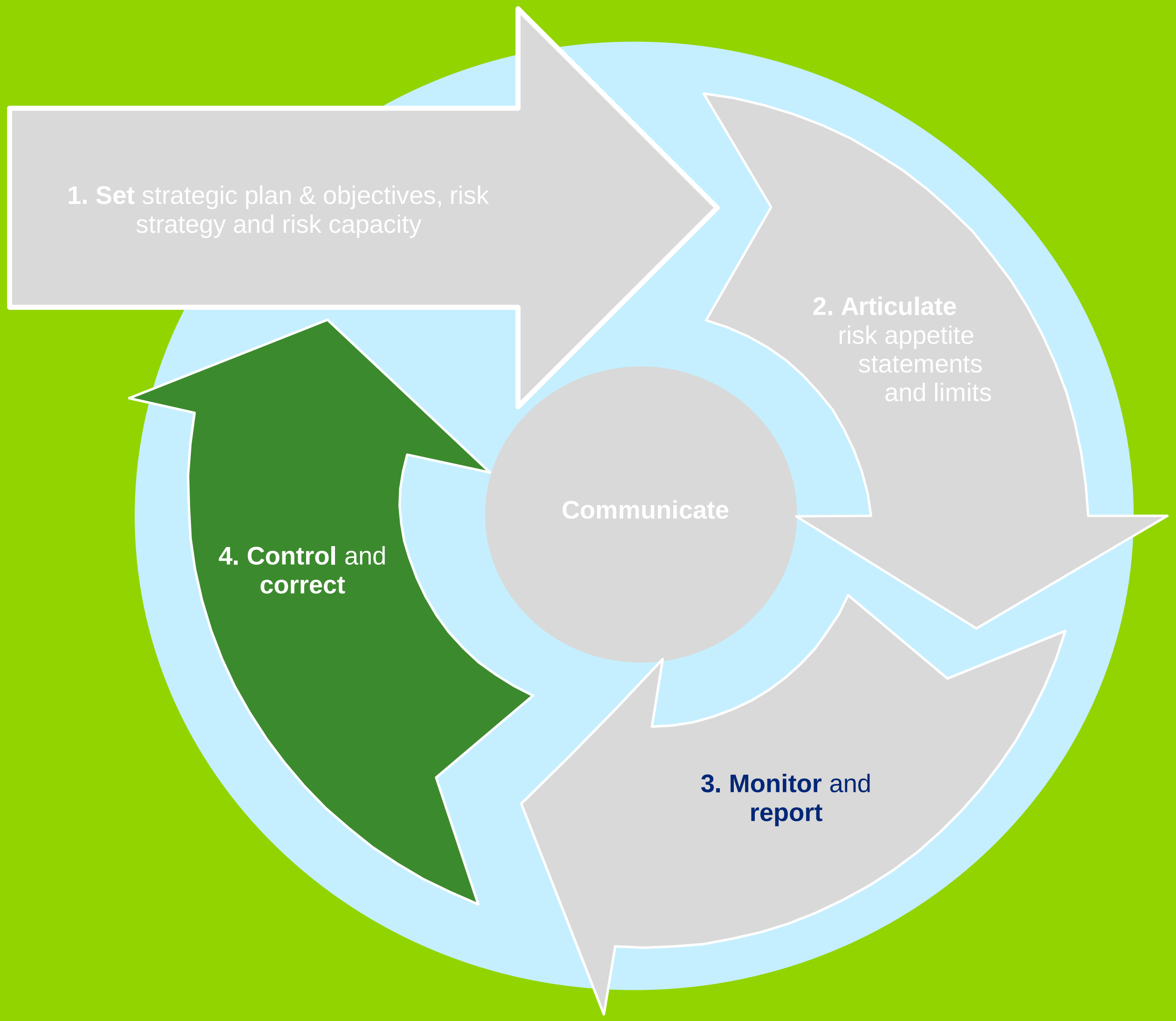
Which measure(s) does your organization use to measure the amount of risk the organization is able to bear?



Within the insurance sector, the measures most often used are:

- SCR
- Percentages of total capital and/or capital ratios
- Solvency 1 Capital

5



1. Set strategic plan & objectives, risk strategy and risk capacity
2. Articulate risk appetite statements and limits
Communicate
3. Monitor and **report**
4. Control and **correct**

Content of this section

A risk appetite framework is not a one-off process and needs to be embedded within the financial institution. The insurer should not only monitor the risk profile within the boundaries of the risk appetite, but should also timely review and adjust its risk appetite (statement).

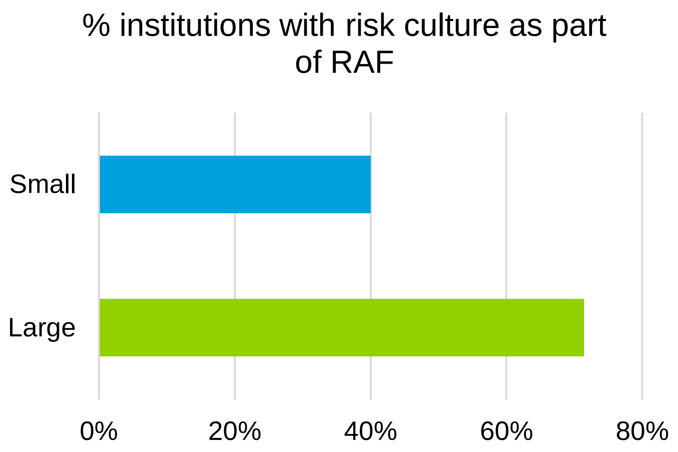
In this section we look into **risk culture** as part of the risk appetite framework. A sound risk culture will create an environment to facilitate emerging risks having a material impact on an institution, and any risk-taking activities beyond the risk appetite, to be identified and addressed in a timely manner.

Next, we analysed whether the adequacy of risk mitigation is formally reviewed and leading to potential corrective action regarding the risk appetite statement, and how the Board assesses the accuracy of the risk appetite.

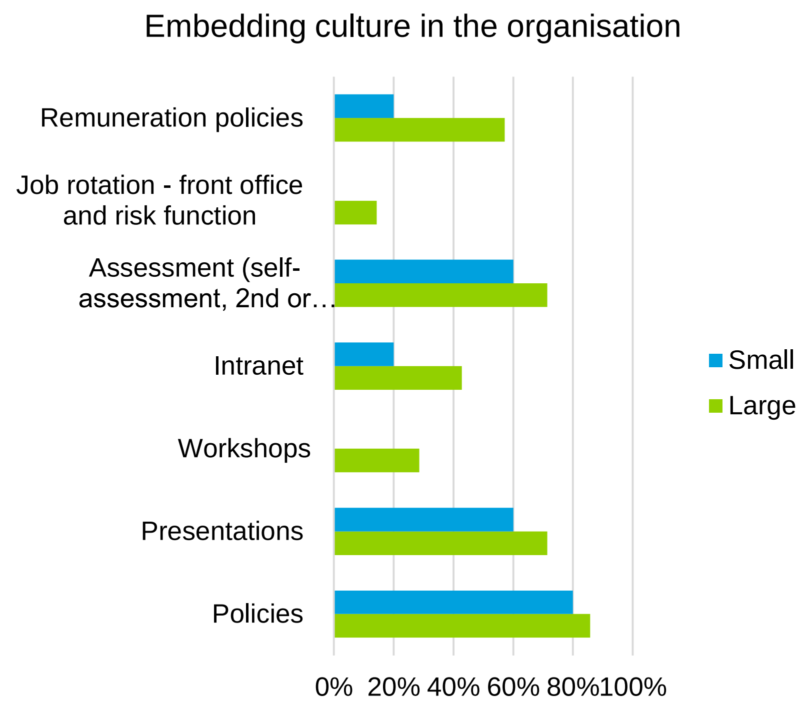
Culture and Awareness

A relative high number of large companies has “risk culture” as an integral part of their Risk Appetite Framework. The embedding of risk culture in the Risk Appetite Framework is mainly organized through policies, presentations and workshops, and the remuneration policy.

Is Risk Culture an explicit part of your Risk Appetite Framework?

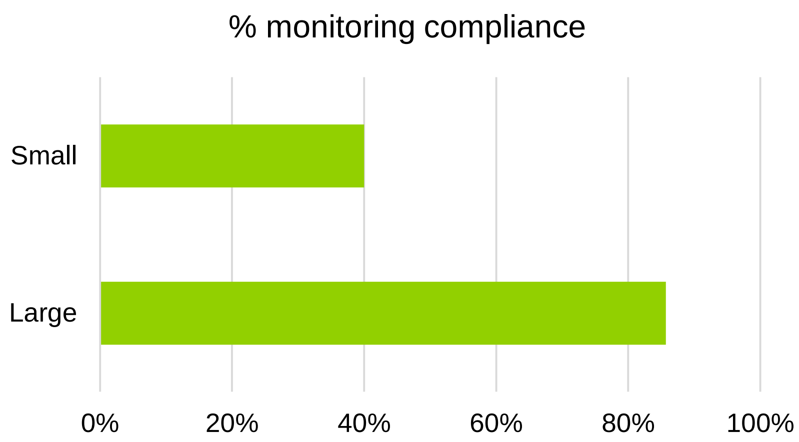


How have you translated and secured the desired risk culture in your organisation?

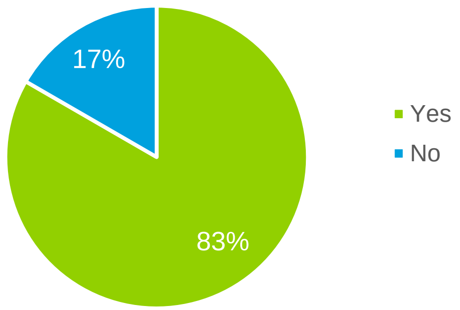


Culture and Awareness

Is compliance with Risk Appetite procedures and processes monitored?

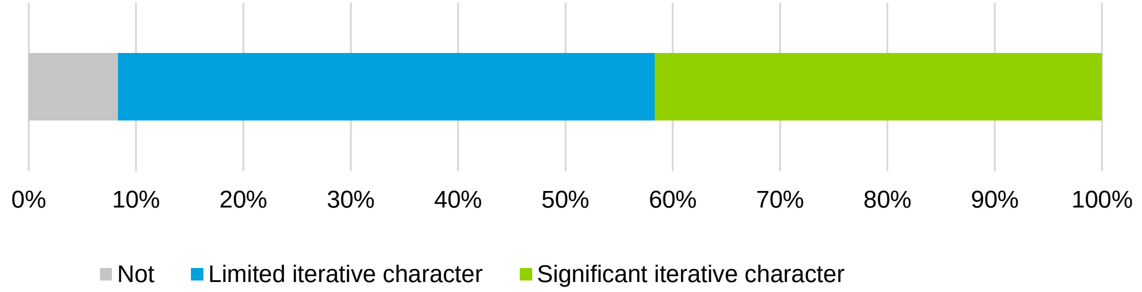


Is the measurement of risks compared to their limits and tolerances recorded and stored?



Effectiveness of the Risk Appetite Framework

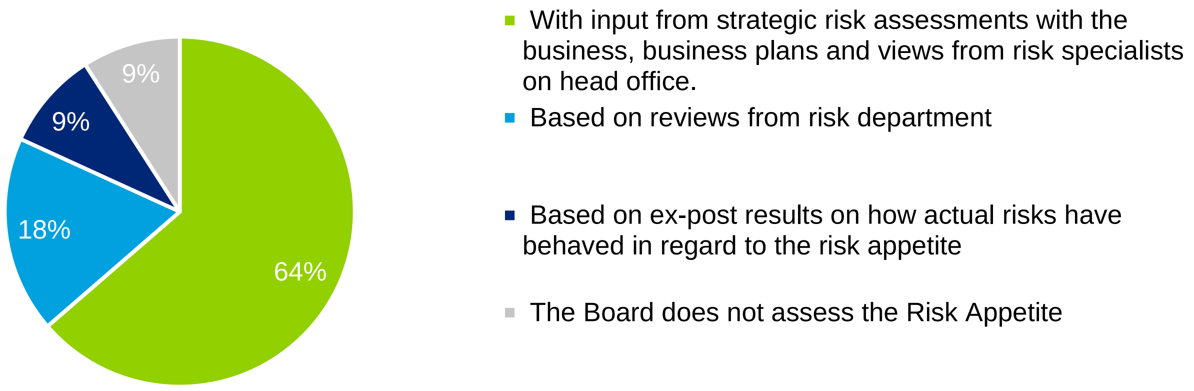
To what extent does the Risk Appetite process have an iterative character so that the process provides analysis and correction over multiple iterations?



Most participants indicated that the Risk Appetite has a limited iterative character. When comparing large to smaller insurance institutions and Belgian against Dutch companies, no real distinction could be observed.

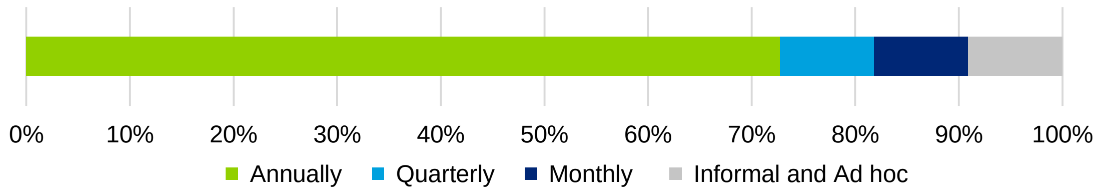
Effectiveness of the Risk Appetite Framework

How does the Board assess the accuracy of the Risk Appetite …?



Most of the insurance companies indicated that the board mainly relies on (1) Input from strategic risk assessments with the business, business plans and views from risk specialists on head office and on (2) Reviews from risk management. Supervisors may also look for evidence in board minutes, the risk appetite statement documents, metrics, reporting, and other activities, that the board understands how management interprets and applies the risk appetite and risk limits.

… and at what frequency?



Effectiveness of the Risk Appetite Framework

The participants of our survey provided additional feedback on potential improvements on their risk appetite framework. An overview of some feedback collected, is provided in the table below:

On what points would you like to improve your Risk Appetite framework? (grouped by similar statements)	
Link with business strategy	• A more country driven risk appetite statement. • To raise the awareness of the risk appetite in the first line of business. • Improve the link with strategy and work more with risk ladders (appetite versus tolerance versus targets).
Dependencies between performance and risk	• Higher level of maturity could still be realized for some parts of the group with respect to the development, alignment and effective use of KRIs. • More insight into the dependencies (KRI's and KPI's). • Alignment KPI's (steering) and KRI's (control). Making RA more fully implemented (cascading). Reporting.
Effectiveness and compliance	• More effective. • Reporting on compliance with risk appetite statements.
Type of risks covered in the RAF	• Non-financial risks. • Better inclusion of insurance risk indicators.

Where are you?

Sophistication of risk appetite frameworks in the industry

Increased sophistication of a firm's risk appetite framework can increase stakeholder value. The sophistication of risk appetite frameworks vary widely across the industry. The status of most firms' risk appetite frameworks are either at 'basic' or 'emerging standard'.

Rudimentary: Compliance focus

The firm has developed a high-level qualitative risk appetite for capital but it is not widely used or understood.

The firm's risk management framework remains largely unaffected and there is no link to performance.

Basic: Controlling risk

The firm has developed risk appetite statements using its risk register. Quantitative measures might reflect only existing limit statements and are not tailored to top down risk appetite statements.

The development of risk appetite statements is not linked to strategy.

The links between risk and performance are not clearly articulated.

Emerging standard: Linking risk and performance, decision support

The firm has developed high-level and directional risk appetite statements, measures and limits, refining existing limits to the stated risk appetite.

The high-level risk appetite statements are linked to strategy. The links between KPI and KRI are clearly understood.

The risk appetite framework is operational. The firm has embedded risk appetite within many of its risk management tools.

The firm's risk appetite language is spoken and understood by both risk management teams and to a large extent the wider firm.

Leading: Optimising performance versus risk

The firm has developed a comprehensive set of risk appetite statements, measures and limits, cascaded from high-level down to the detailed level.

The risk appetite statements and limits are directly linked to the firm's strategy and risk management framework.

The links between KPI and KRI are clear and the company uses a comprehensive set of risk return optimisation techniques.

The firm's risk appetite framework is fully operational and is reviewed and updated on a regular basis. The firm has embedded risk appetite across all elements of its risk management framework.

The firm's risk appetite language is spoken and understood across the entire firm.

Increasing stakeholder value

Contacts

Arno De Groote
Partner, Financial Services Industry (FSI)

Enterprise Risk Services

Mobile + 32 475 90 44 11

adegroote@deloitte.com

Christophe Vandeweghe
Director, FSI - Actuarial & Insurance Solutions

Enterprise Risk Services

Mobile +32 477 88 01 26

cvandeweghe@deloitte.com

Deloitte.