

**Risk Appetite Survey**  
**Current state of the Belgian**  
**Financial Services Industry**



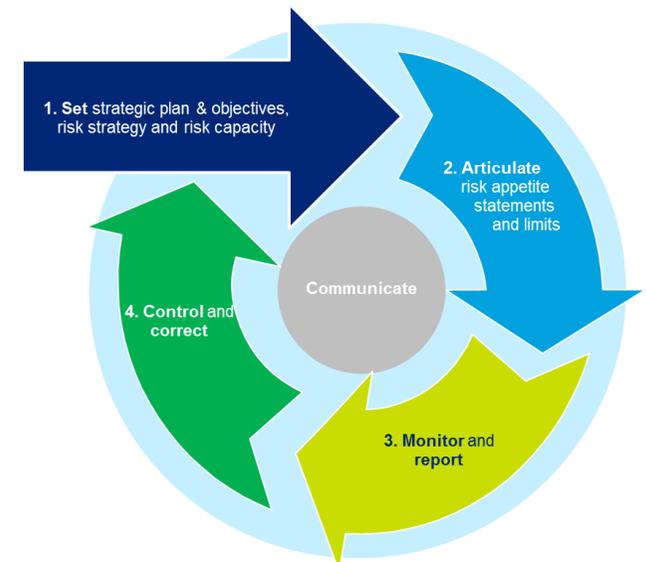
# Introduction

The regulatory landscape for banking and 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 financial institutions active on the Belgian market and investigate if there is an emerging consensus on the core concepts of a risk appetite framework amongst financial institutions.

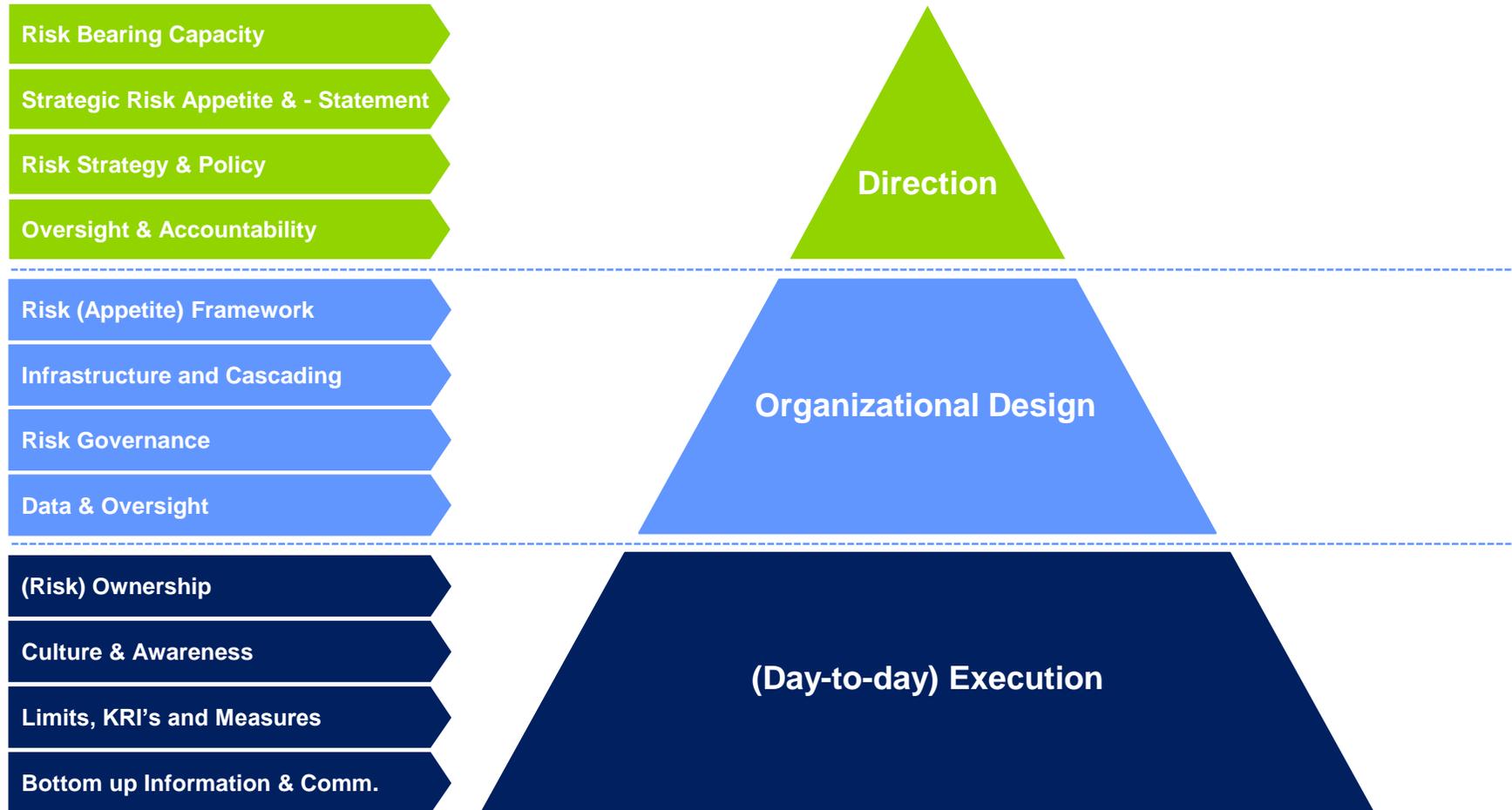
We surveyed 15 firms' current practices and views on key stages in implementing and running a risk appetite framework and are very grateful to all survey correspondents for their contribution to this research.

We hope you find this study helpful to reflect on your company risk framework to ensure that risk appetite is the way its people talk, think and do risk.



# 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.

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: (1) the strategic business plan is the most common source for defining the risk appetite, followed by (2) the solvency measures, and (3) stress scenarios. The results are very similar for the banking and insurance sector.

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. More than one third of the participants indicated that the risk appetite process is not or only limited part of the Finance Planning and Control cycle.

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. Looking to the banking sector we see that the external environment plays a less prominent role in the development of the risk appetite.

67%<sup>(\*)</sup> have a risk appetite to improve Boardroom understanding of the risks

90% directly link the risk appetite to strategic objectives

36% have no or little alignment with planning & budgeting.

33% banks 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 three quarter of the surveyed institutions believe the definition of risk appetite used within the organization is commonly known and recognised in the organization.

73% believe to have a clear and understood risk appetite statement

As also expressed by the Financial Stability Board (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 almost all institutions the risk appetite is of a quantitative nature; the institutions which include also a qualitative aspect in their risk appetite, are those institutions that also have risk appetite measures for compliance & legal risk, reputational risk, strategic & business risk.

47% have a balanced statement with quantitative and qualitative elements

Most of the financial institutions have further translated the risk appetite to a more tactical / operational level. Most of the Financial Institutions indicated that the translation was done top-down.

42% define appetite top-down and bottom-up

## Risk Bearing Capacity

### Defining the Risk Bearing Capacity

Whereas more than 70% of the respondents indicated that they believe the definition of the risk appetite statement is commonly known within the organisation, only 40% have a clear and commonly known definition of 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. Most respondents indicated that they only looked into the Risk Bearing Capacity of the bank after having defined the company's risk appetite.

40% believe to have a clear and understood risk 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 most institutions as ultimate accountable bodies for approving the Risk Appetite Statements. Line Management, Risk Manager or Internal Audit are never granted accountability to approve the risk appetite statement. The Board never 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 receive 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).

87% of Boards approve the limits.

92% of Risk,  
50% of Finance,

33% of CEO/Exco involved in establishing the risk appetite

40%-60% defined a risk appetite and a measure for strategic and business risk

80% banks, and

40% insurers formalized the responsibilities for data

## Risk Appetite Framework

### Granularity of the risks in the Risk Appetite Framework

Most banks have defined the most common risk types in their risk appetite definition and have translated these into risk measures for market, credit and operational risk. The same applies to insurance companies with regard to market and operational risk; only 40% of the insurance respondents state to have included measures for counterparty default risk.

## Data & Oversight

In some institutions, the risk management function is considered to be responsible for, even has to certify, the data used in the RAF, whether or not with the contribution of Finance. Others recognize that the risk function primarily uses business data to articulate risk appetite statements and limits.

# 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.

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.

67% have tolerance limits per risk type

## 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.

Several methods and techniques are used to articulate the risk appetite into operational limits: bankers primarily use capital adequacy analysis, concentration limits as % of capital, liquidity analysis and analysis of risk management databases (losses, incidents); insurers use Var Methodologies, professional judgement and analysis of risk management databases.

85% have a clear link between the limits and the risk appetite

# 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.

80% of the banking and insurance companies use KRI's to monitor limits and almost all institutions have an escalation procedure when crossing a limit or tolerance. .

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 financial services industry regarding the level of automation for monitoring tolerances and limits. Whereas all insurance companies have at least some automation (40% even mostly automated) of the monitoring of the tolerances and limits, more than half of the bankers have no automated monitoring.

92% has an escalation procedure when crossing a limit or tolerance.

80% use KRI's to monitor limits

80% of Boards are involved in evaluating the adequacy of risk mitigation.

## 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 bank or 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). Most participants however indicated that the risk appetite has a limited iterative character.

73% 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 October 2013.

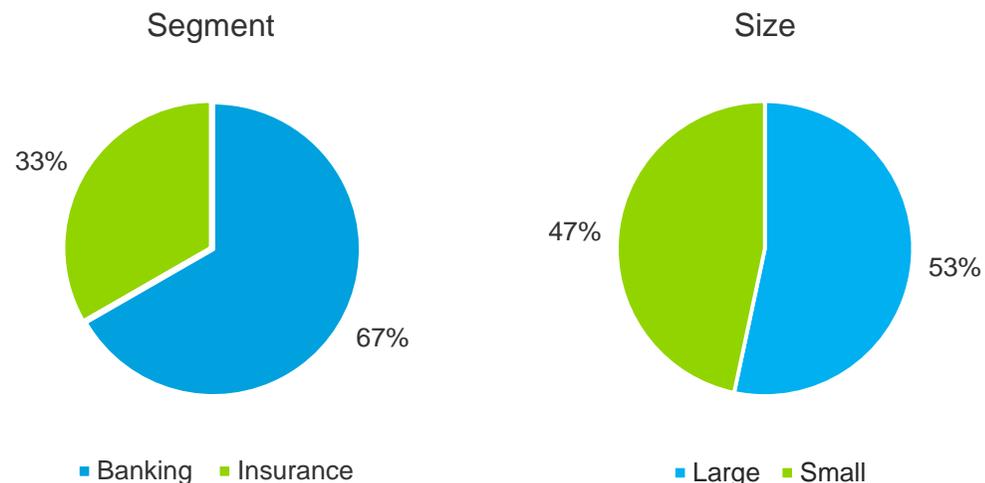
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Survey respondents

# Respondents

## Belgian bank and insurance companies:

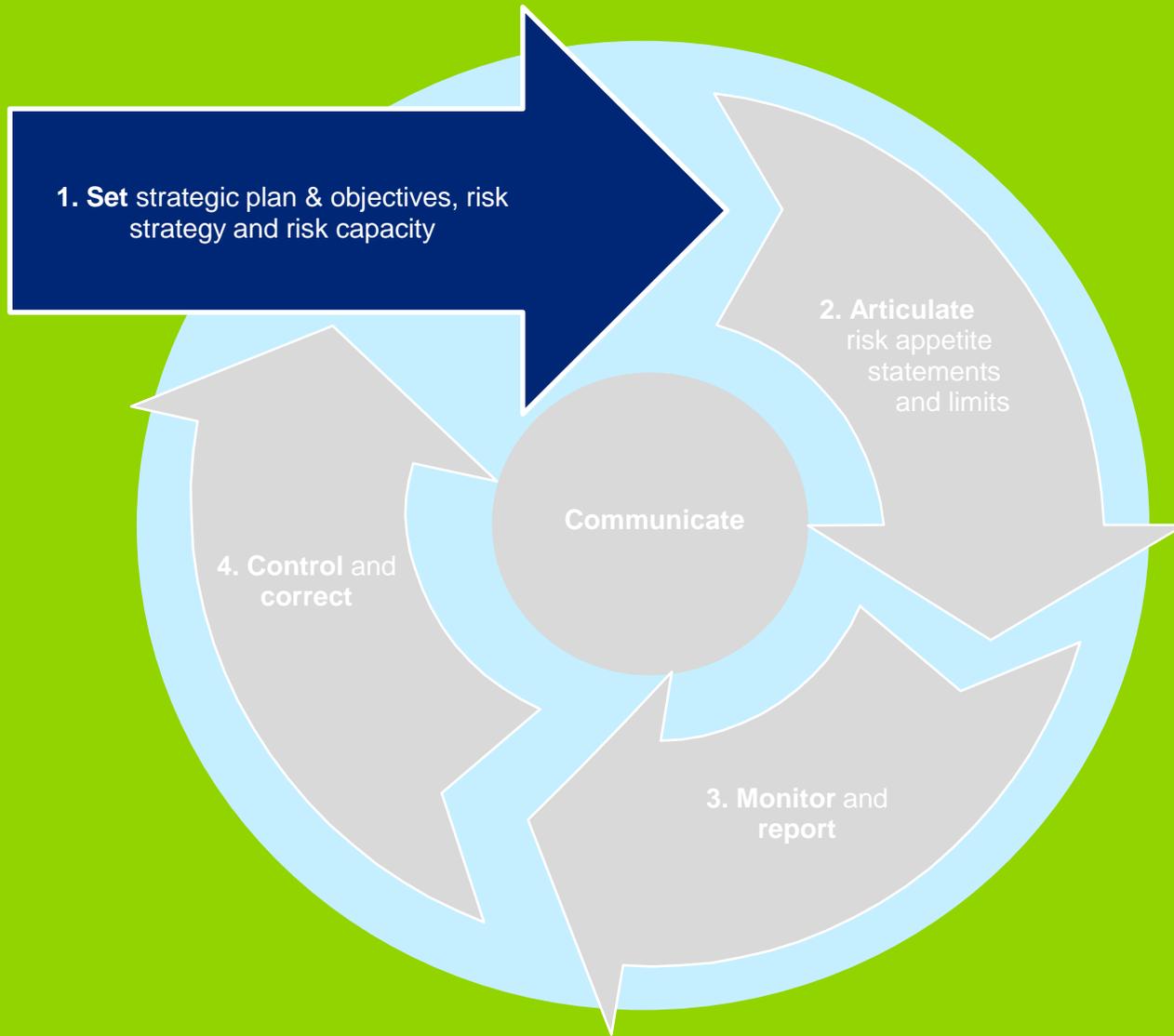
- groups headquartered in Belgium,
- stand-alone Belgian entities, and
- Belgian subsidiaries of international groups.



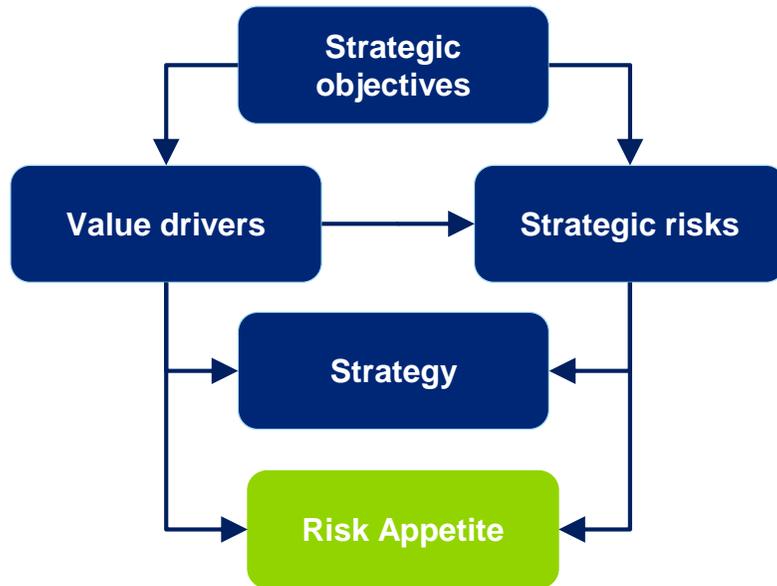
## Responsibilities of the respondents:

Involvement matrix	Must be consulted	Accountable to approve	Responsible to execute the task	Responsible for the coordination	Not involved
Setting strategic plan & objectives	53%	27%	20%	0%	20%
Setting the risk strategy and risk bearing capacity	53%	33%	40%	27%	7%
Articulating the risk appetite statement	27%	47%	47%	33%	0%
Articulating the risk appetite statement in operational limits	20%	27%	40%	33%	7%
Monitoring risk appetite levels and reporting on risk appetite	20%	33%	40%	33%	0%
Controlling and correcting the risk appetite	27%	33%	33%	20%	7%

# 2



# 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 banks and 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.**

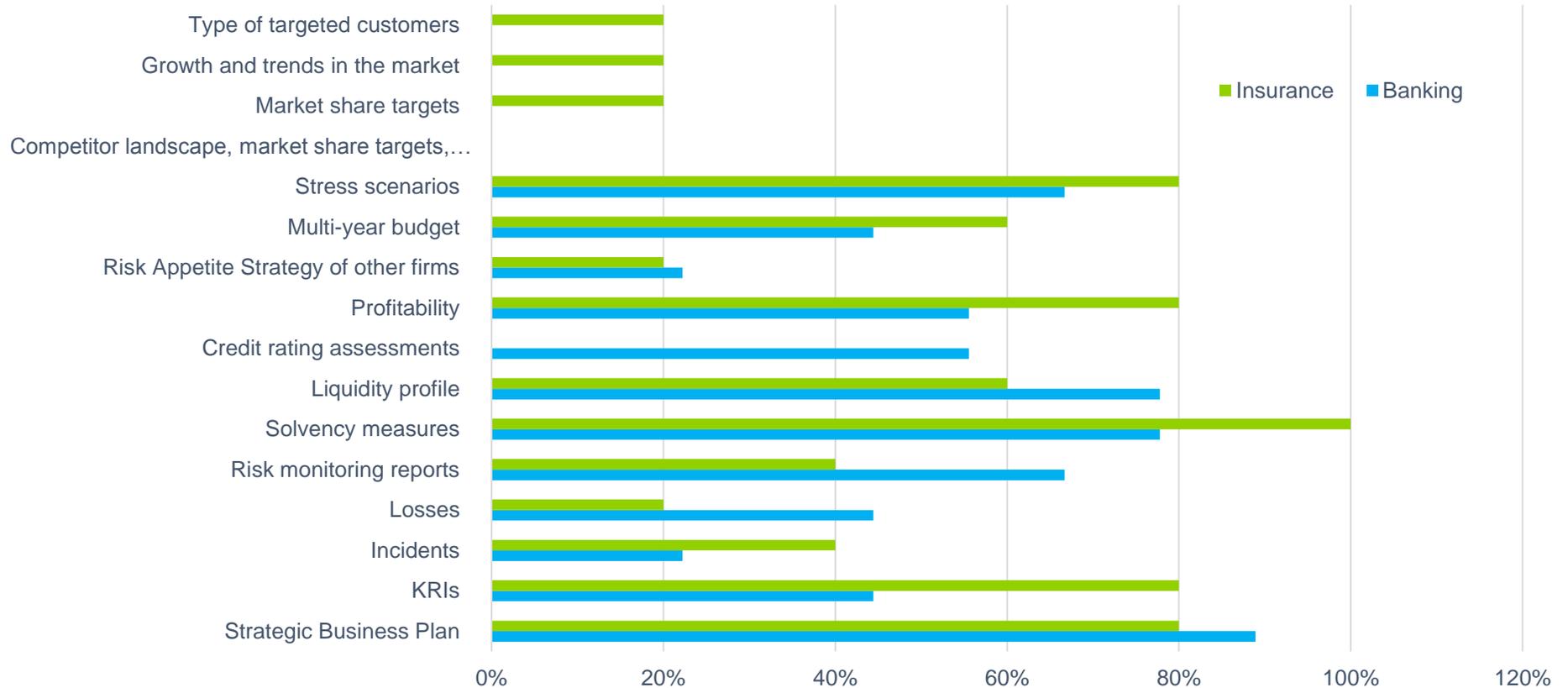
# Risk Appetite

## Why has your organization formulated a Risk Appetite?



# Strategic plan & objective as root for Risk Appetite

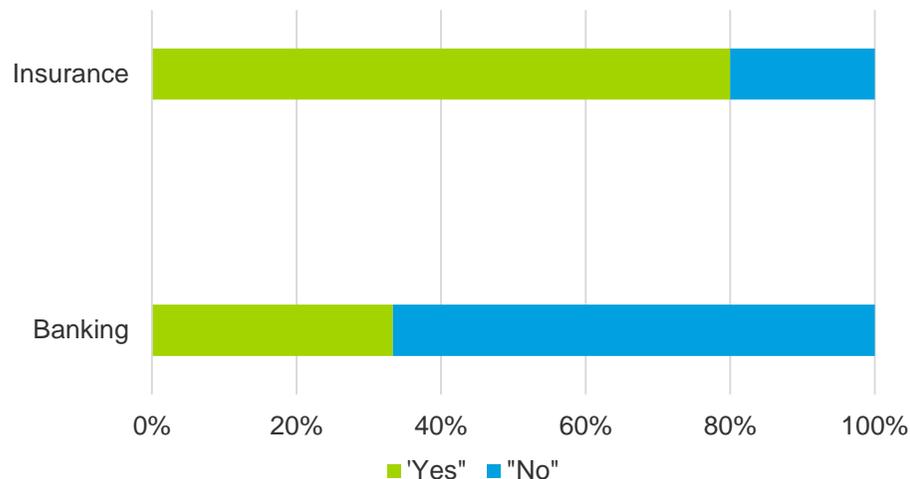
Which information (sources) are used in establishing the Risk Appetite?



The information sources most commonly used within the financial sector are (1) the strategic business plan, (2) the solvency measures, (3) stress scenarios and the financial institutions liquidity profile. The results are very similar between the banking and insurance sector. However, when only focusing on the insurance sector, we find that also profitability and KRIs are information sources often used within that sector.

# Strategic plan & objective as root for Risk Appetite

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



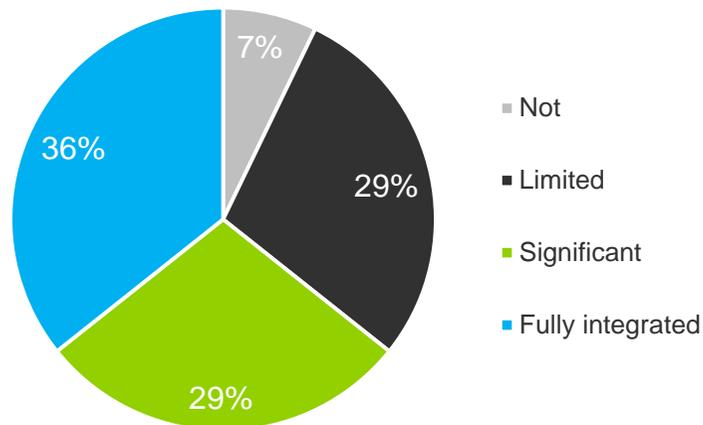
A good risk appetite framework enables financial institutions to adapt to the changing economic and regulatory environment in order to manage new types of risk. Most insurance companies take developments in the external environment into account when establishing their Risk Appetite. Looking to the banking sector we see that the external environment plays a less prominent role in the development of the Risk Appetite.

One explanation for a presumed higher focus on external (regulatory) developments at insurance companies could be because insurance companies are currently in the process of implementing Solvency II, and more specifically the Pillar 2 requirement on the System of Governance which includes an important link with the risk appetite framework.

# Finance Planning & Control cycle

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

Financial Planning and Control Process

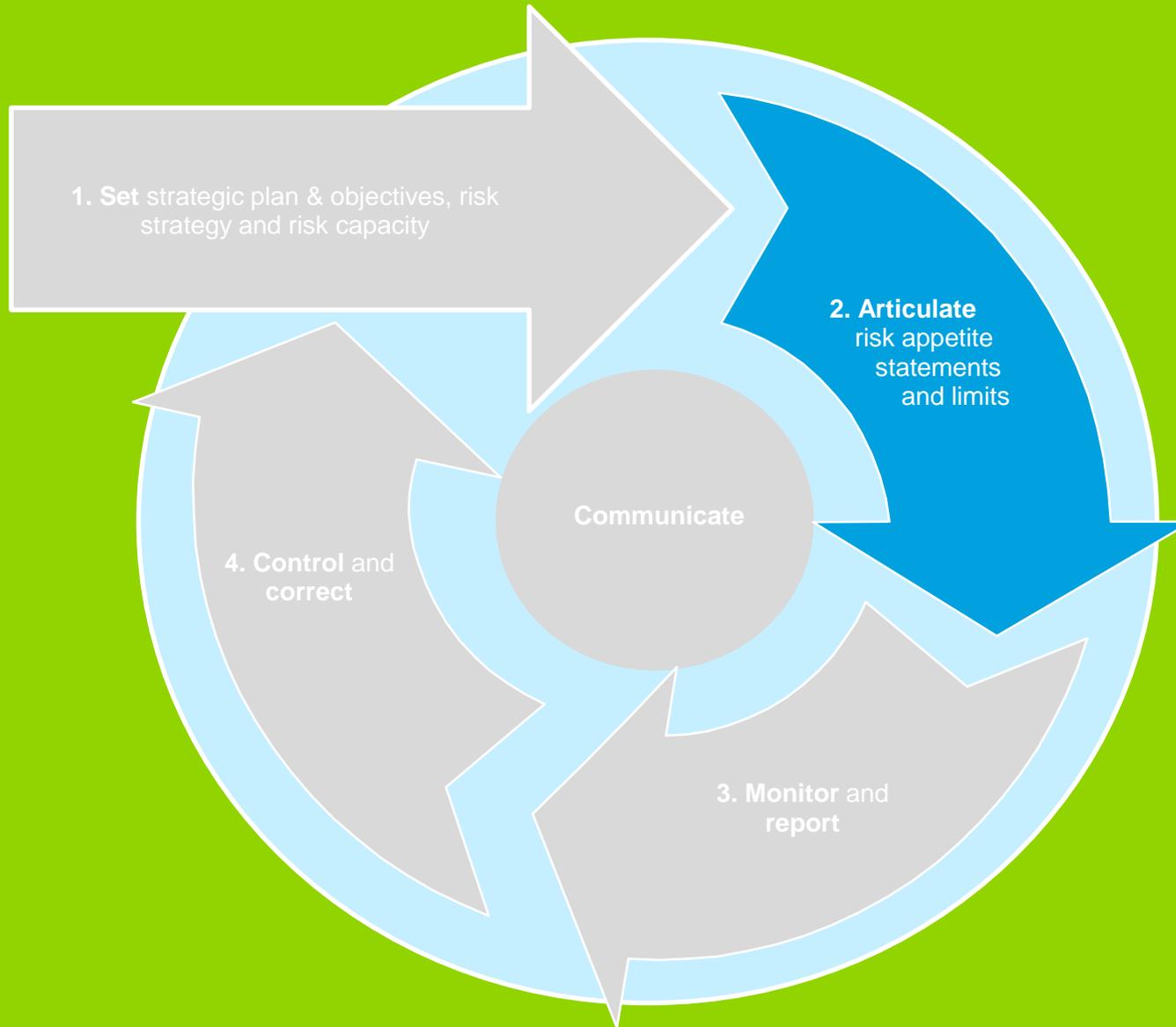


The existence of an integrated risk appetite in the planning & budgeting process can be an indicator of the level of awareness and the whether the risk appetite is effectively used within an organisation.

More than one third of the participants indicated that the Risk Appetite process is little to not part of the Finance Planning and Control cycle.

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

# 3



# 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 bank and insurance companies.

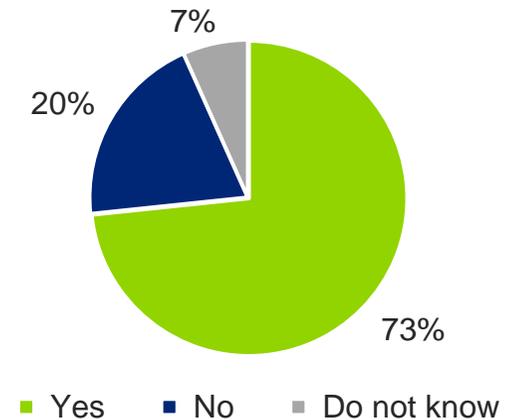
The risk appetite statement is a quantitative and qualitative articulation of risk appetite in written form, generally expressed as the acceptable range for the firm's risk profile between upper and lower risk appetite limits. We survey **for which risks** the respondents defined the risk appetite and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

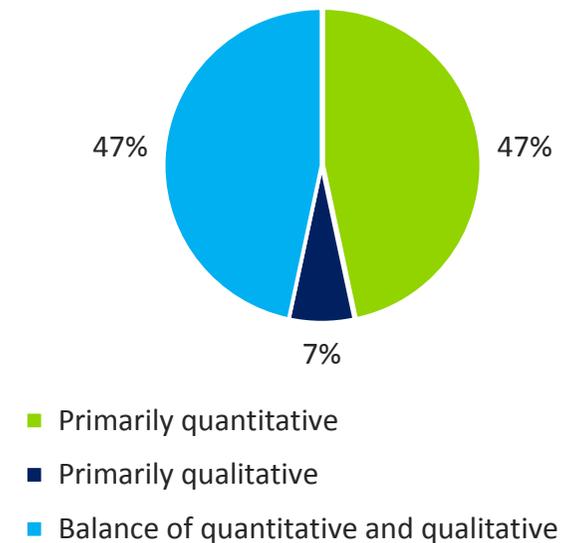


## Are the statements in the risk appetite primarily of a qualitative or of a quantitative nature?

50% of the correspondents from the banking sector and 40% of the insurance sector indicate that their risk appetite is mainly a balance between quantitative and qualitative elements.

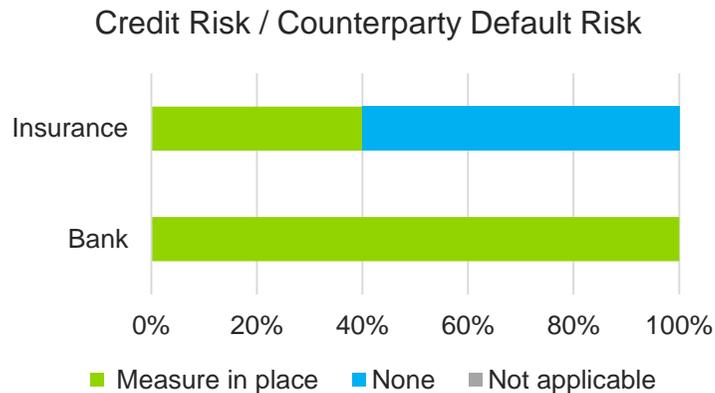
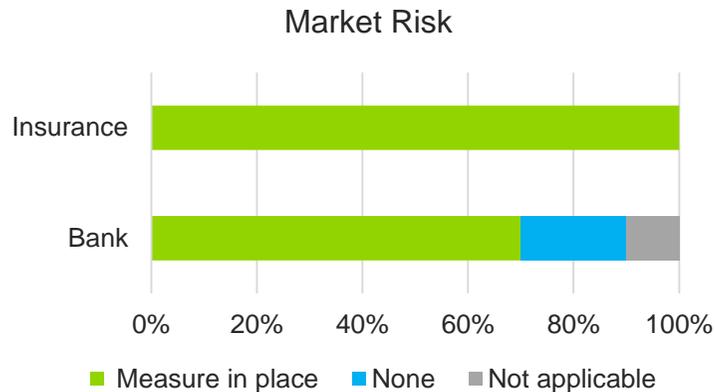
For the other half of the companies, the risk appetite statement is mainly of a quantitative nature.

The institutions which include also a qualitative aspect in their risk appetite, are those institutions that also have risk appetite measures for compliance & legal risk, reputational risk, strategic & business risk.



# 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?

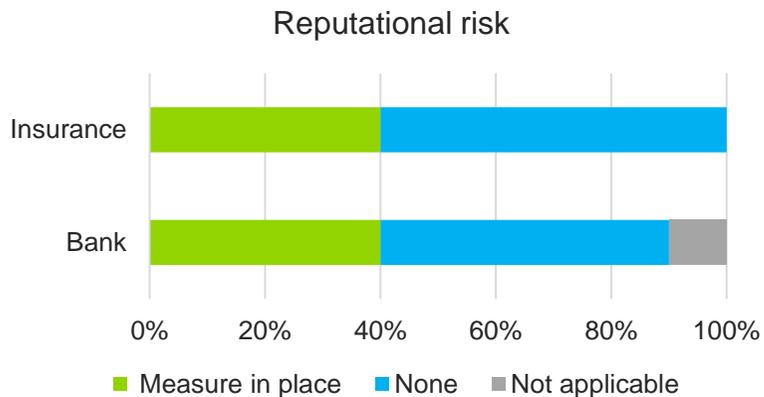
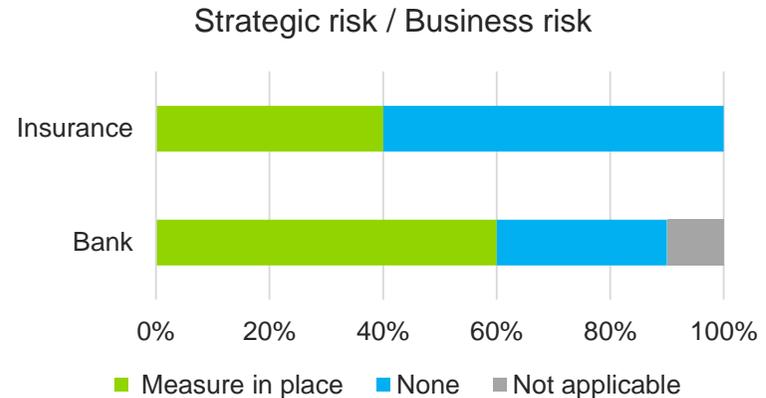
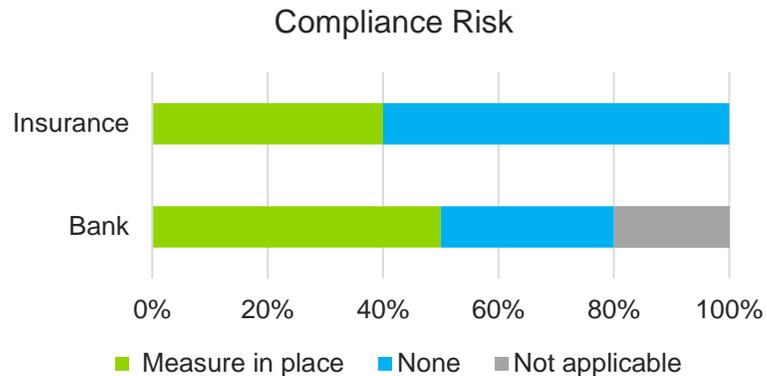


Most banks have defined the most common risk types in their Risk Appetite definition and have translated these into risk measures (market risk, credit risk, operational risk). The same applies to insurance companies with regard to market and operational risk; only 40% of the insurance respondents state to have included measures for counterparty default risk.

The banks that stated that market risk was not included in the risk appetite, or was not applicable, are 'small' institutions.

# 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.

However, we see that a slightly higher number of banking clients indicated that for these “non Basel” risk types a measure has been defined. One of the reasons could be that the Basel II framework has been implemented for a number of years compared to the Solvency II framework which is still under development.

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

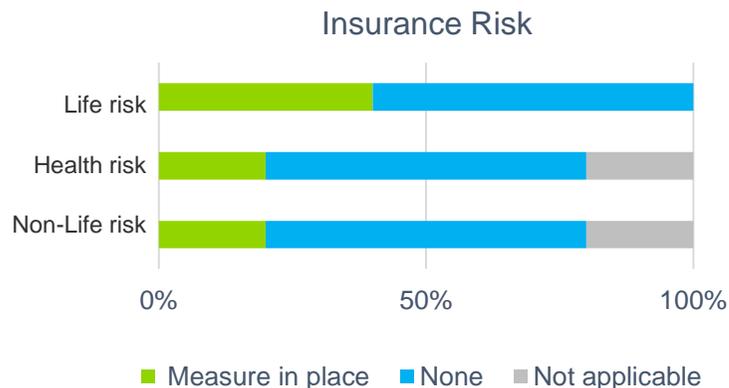
# Granularity of the risks in the Risk Appetite Framework

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

## Insurance only



A number of the insurance correspondents that have measures for Market Risk, also have risk appetite measures in higher granularity to follow-up market risk exposure.



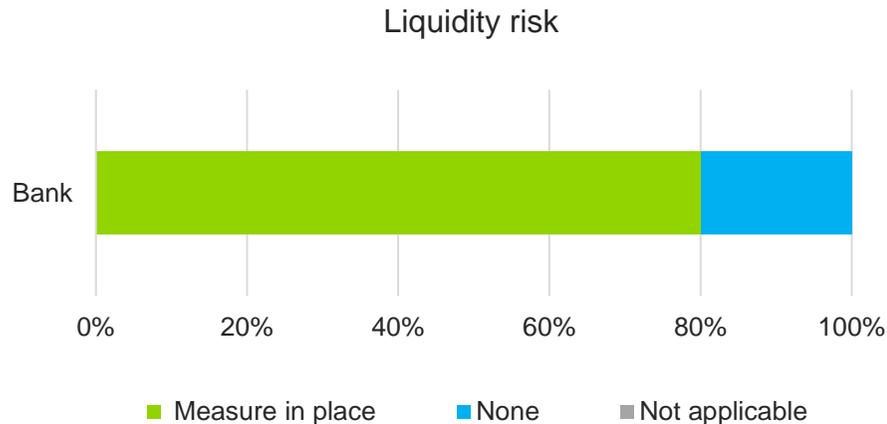
The correspondents that have measures for Insurance Risk, also have risk appetite measures in higher granularity:

- Non-Life Risk includes risk appetite measures for Lapse risk, Catastrophy risk, Premium risk and Reserve Risk
- Health includes risk appetite measures SLT Risk, Non-SLT and Catastrophy risk
- Life Risk includes risk appetite measures for Lapse risk, Longevity risk, Expense risk and other life risks (mortality, catastrophe, revision).

# 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?

Banking only



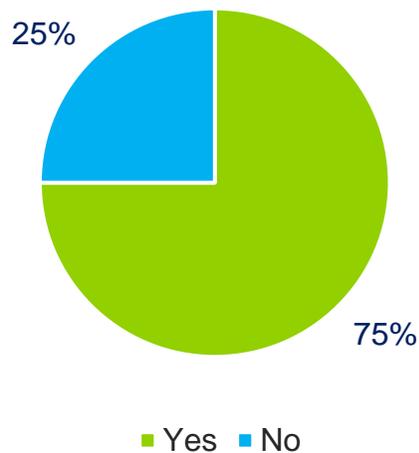
Liquidity risk is one of the measures where almost all banking correspondents indicated that a Risk Appetite is defined and a measure is in place. This is not surprising as the recent financial crisis showed the impact of a liquidity shock on the industry. The regulator and the sector have (are) developed (developing) sound practices for liquidity risk management and are defining short term and long term liquidity ratios.

On the question whether there was an impact of the addition of liquidity risk under Basel III on the total Risk Appetite, some stated that new measures were included whereas others declare that the impact was little to none given the comfortable liquidity position or because liquidity was already included in the Risk Appetite Framework before Basel III regulation.

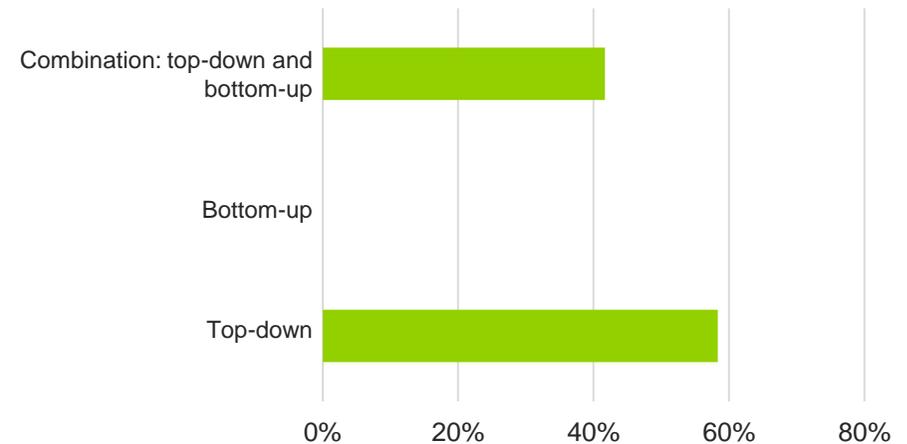
# Cascade risk appetite into operational levels

There are different ways of translating a firm's high-level risk appetite into a limit and reporting system cascaded down to the bank's 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?**

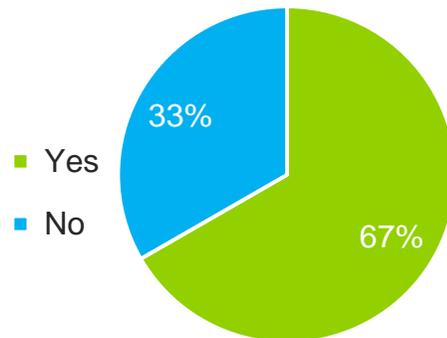


Most of the financial institutions have translated the Risk Appetite to a tactical / operational level. Most of the Financial Institutions indicated that the translation was done top-down. As would be expected, none did only a bottom-up exercise. The institutions that indicated that a combination of a top-down and bottom-up approach was used were all large Financial Institutions

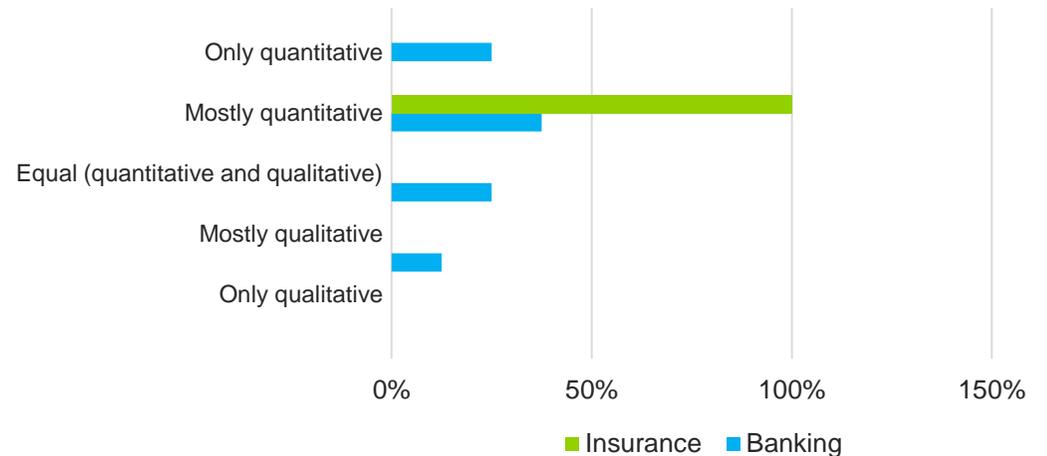
# The establishment of tolerance limits per risk category

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?



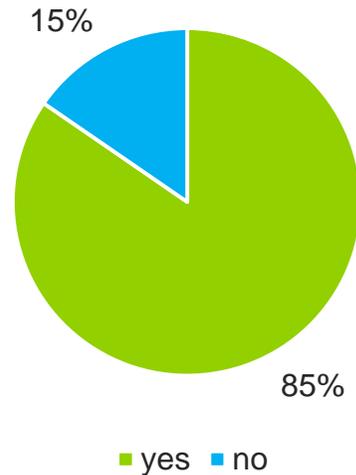
## How are tolerance limits defined?



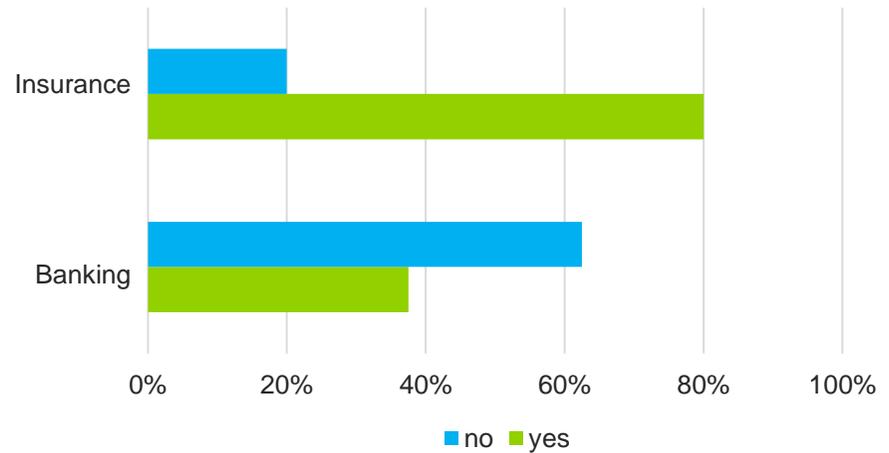
Two third of the financial institutions indicate that they have formulated tolerance limits per risk category. Most institutions indicate that within their organisation, the tolerance limits per risk category are of quantitative nature.

# The establishment of tolerance limits per risk category

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

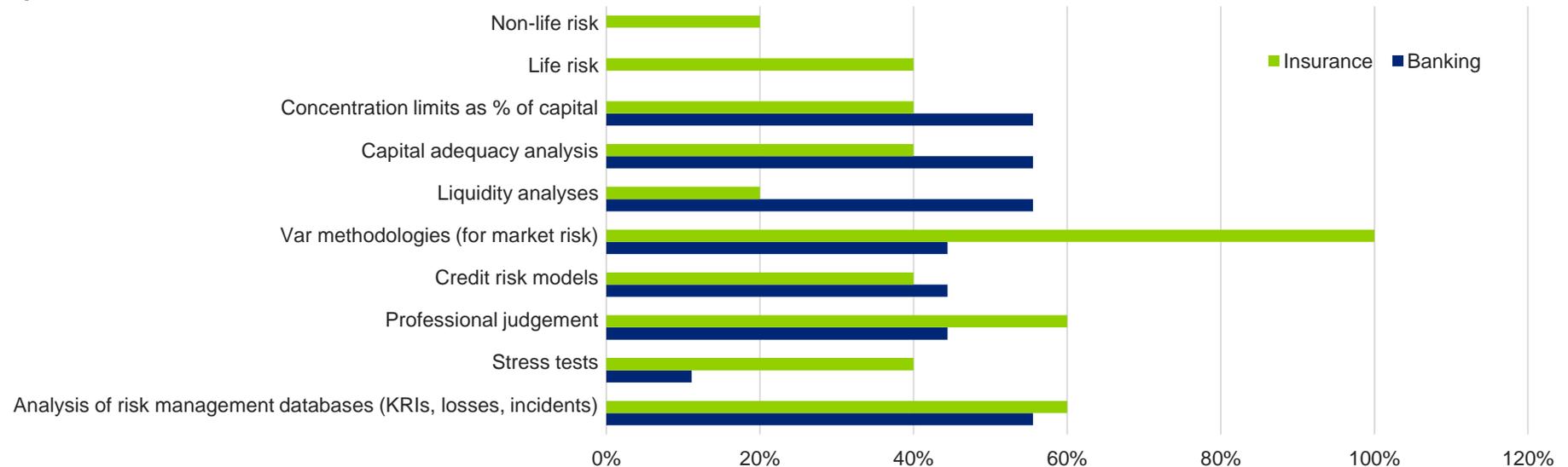


Have tolerances also been formulated on sub-risk categories?



# 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 the insurance and banking sector when analysing the methods and techniques to articulate the risk appetite in operational limits:

## The banking top 3 :

1. Capital adequacy (56%)
2. Concentration limits as % of capital (56%)
3. Liquidity analysis (56%) and analysis of risk management databases (56%)

## The insurance top 3 :

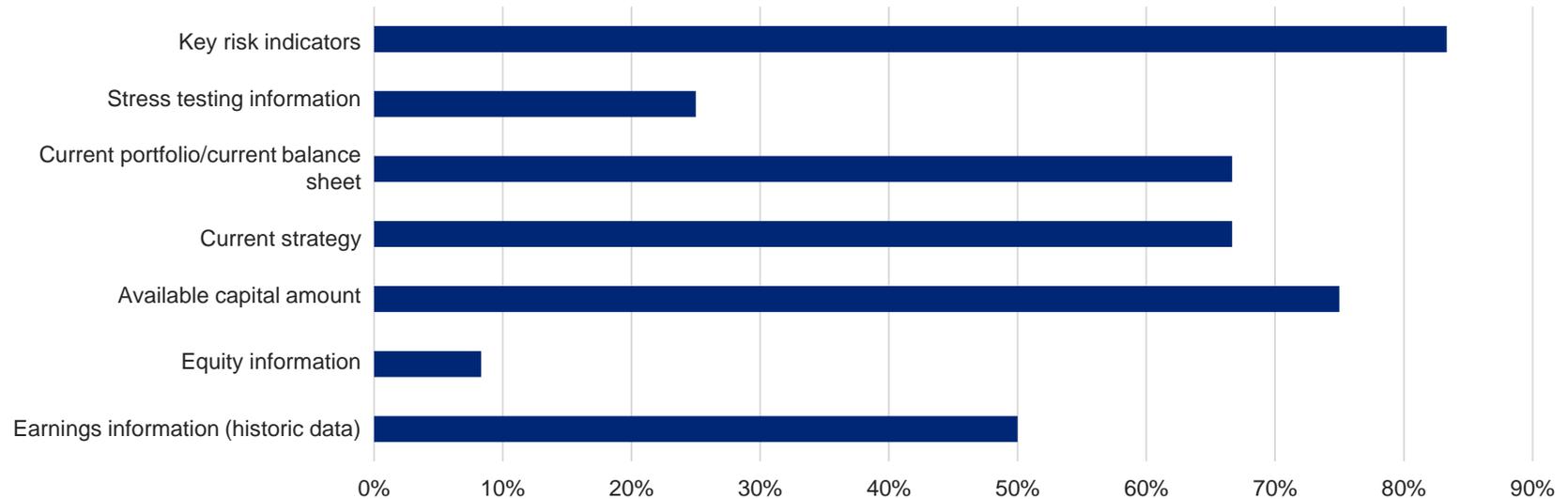
1. Var Methodologies (100%)
2. Professional judgement (60%)
3. Analysis of risk management databases (60%)

### Note:

The banking sector respondents indicated that stress tests were often used to define their risk appetite. However, for translating the defined risk appetite into operational limits, we see that, contrary to the development of the risk appetite, the banking sector relies much less than the insurance sector on this technique.

# 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?

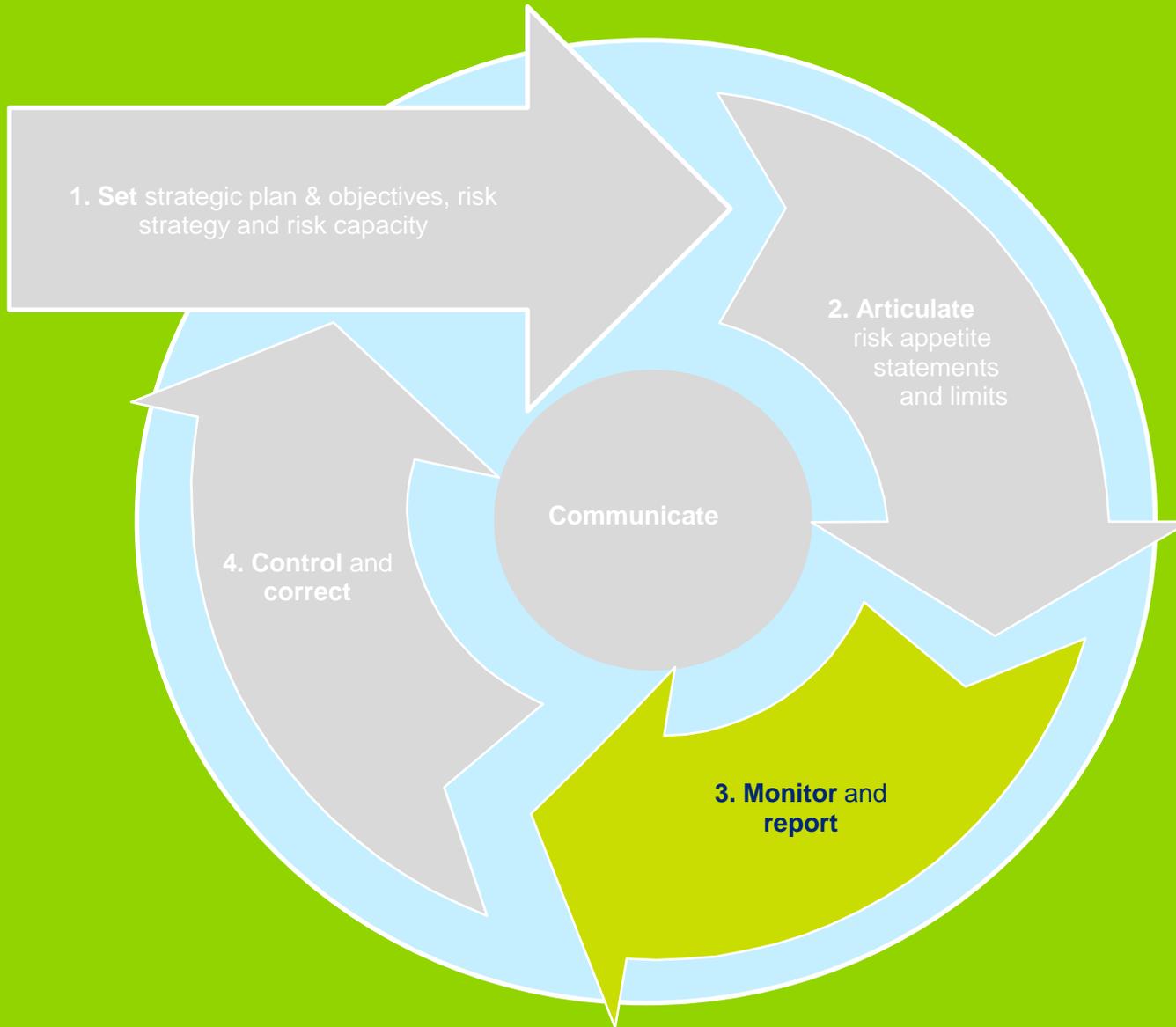


Most Financial Sector participants indicated that the starting point used to establish the detailed risk appetite limits were:

1. Key risk indicators
2. Available capital amount
3. Current Balance sheet and Current Strategy

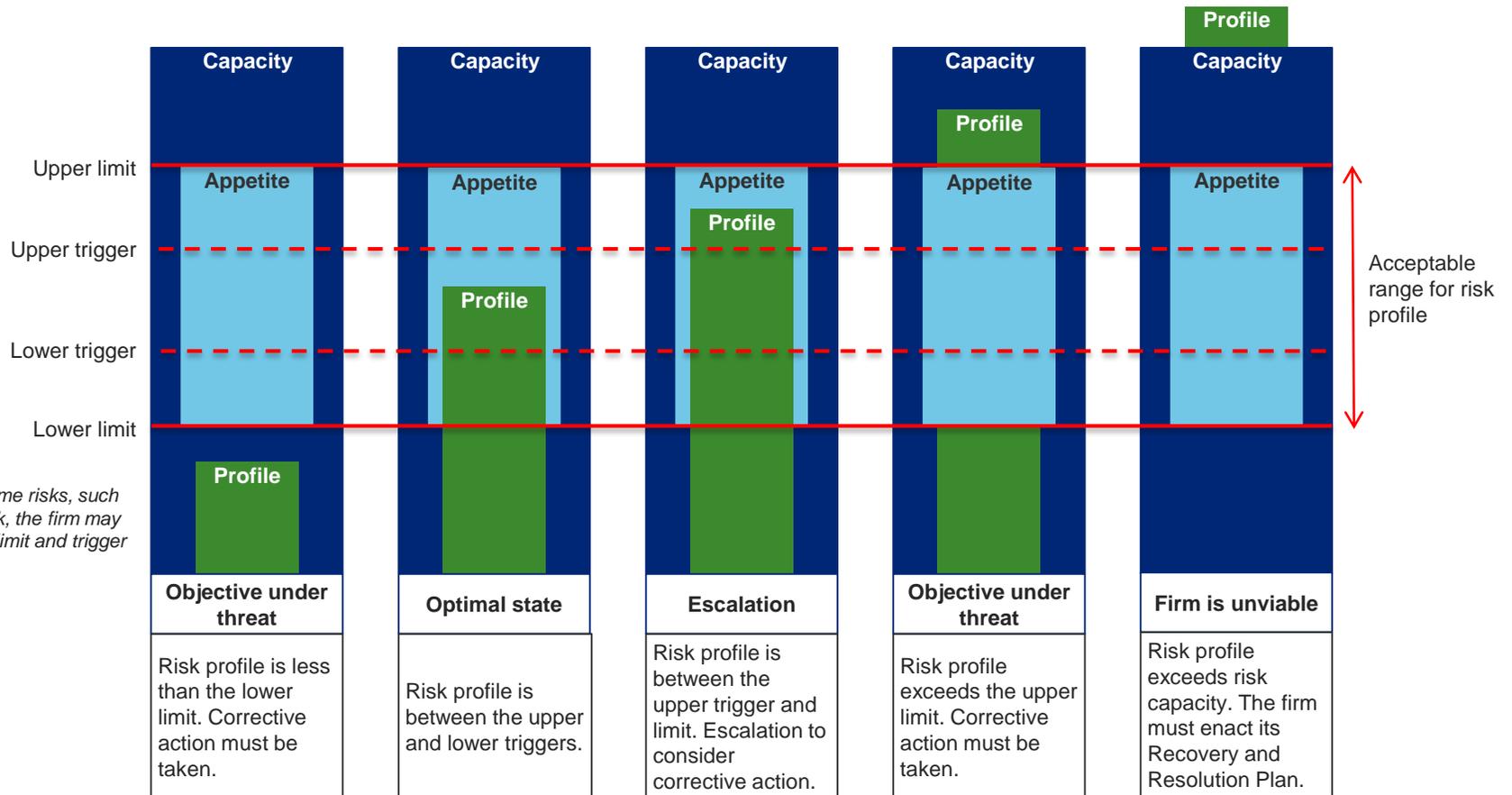
When isolating the insurance sector, we find that earnings information is one of the main starting points used within the sector (2<sup>nd</sup> place).

# 4



# 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

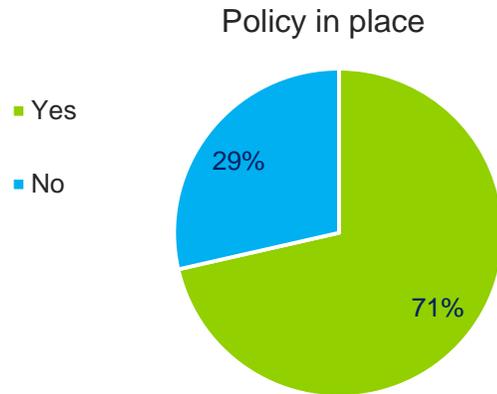
In this section we first look into the **governance, oversight and accountability** defined within risk appetite frameworks. A firm's risk governance is essential in clarifying lines of accountability and describing how staff should adhere to the firm's risk appetite framework. Having the involvement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

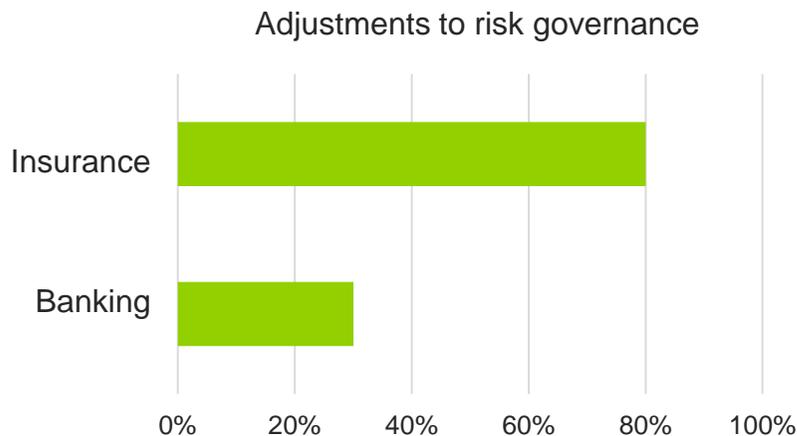
# Risk Governance, oversight and accountability

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 Financial Sector respondents indicated that within their organisation a mature Risk Appetite Policy is in place. No real distinction between the banking sector and insurance sector respondents was observed.

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

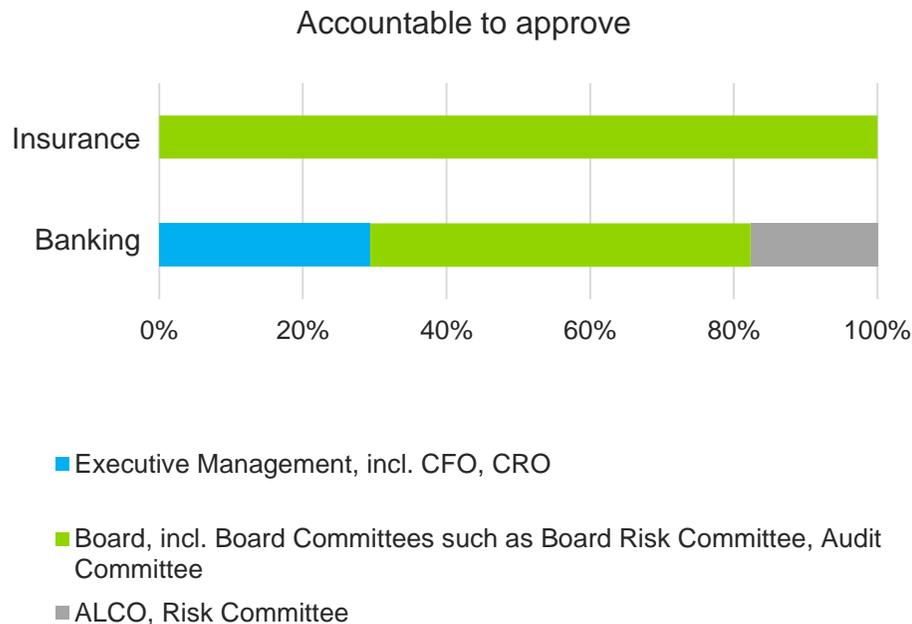


80% of the Insurance institutions and 30% of the Banks indicated that the development of the Risk Appetite led to changes in their risk governance.

Similar results were obtained when gauging for the impact the Risk Appetite had on an institution's Risk Framework

# Risk Governance, oversight and accountability

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



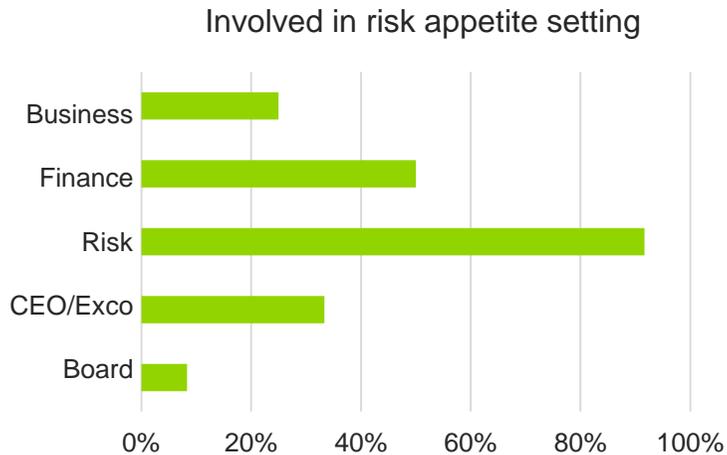
Line Management, Risk Manager, Internal Audit, Controller are never granted accountability to approve the risk appetite statement.

The Board of Directors (1), the Board Level Risk Committee (2) and the Executive Management (3) are considered by most institutions as ultimate accountable bodies for approving the Risk Appetite Statements. For the smaller Banks, some institutions attribute this role to the CRO, CFO, Audit Committee, ALCO and non-board Risk Committee.

Whereas in banking, several answers were provided, all insurance companies give one uniform answer, i.e. Board members are ultimately accountable. It should be noted that banks that indicated that Executive Management is accountable, also indicated the Board or a Board committee as accountable.

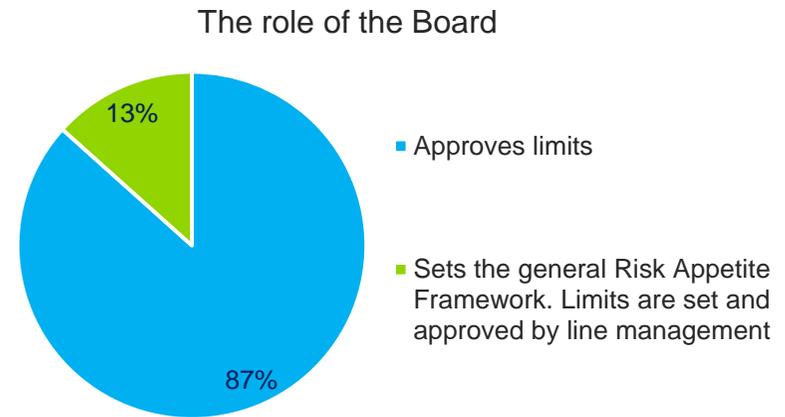
# Risk Governance, oversight and accountability

**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 participants indicated that the Board approves the Risk Appetite limits. A minority 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. No one of the participants responded that the Board has a role in setting Risk Appetite limits

# 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	20%	0%
Proposes all limits which are approved by the board	40%	80%
Has no role in establishing these limits	27%	0%
Other	13%	20%
	In monitoring tolerance limits	In monitoring tolerance limits
Has full responsibility to monitor these limits	53%	40%
Has a reporting responsibility towards the board	27%	50%
Has no role in monitoring these limits	13%	0%
Other	7%	10%

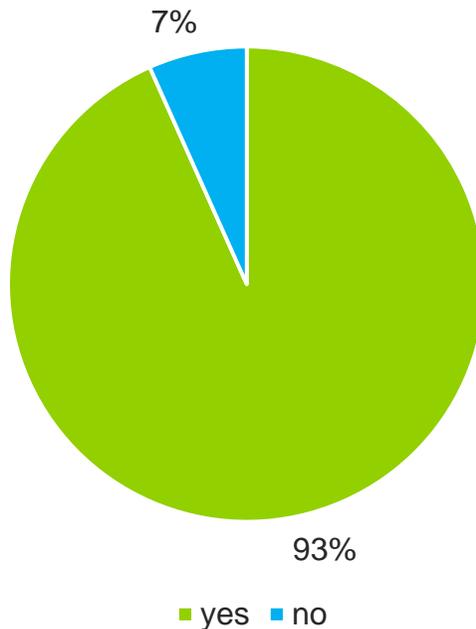
The survey respondents find that it is mainly the responsibility of the 2<sup>nd</sup> line to propose limits to the Board. Subsequently, it is up-to the Board to review and approve these limits. Monitoring these limits is a responsibility which mainly resides within the 1<sup>st</sup> line (53%). However, the interaction with the Board mainly lies with the 2<sup>nd</sup> line (50%).

Furthermore, 80% of the respondents say that Internal Audit has no role at all in setting tolerance limits; half of the respondents also say that Internal Audit has no role in monitoring these limits. Half 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?

## Monitoring of tolerances



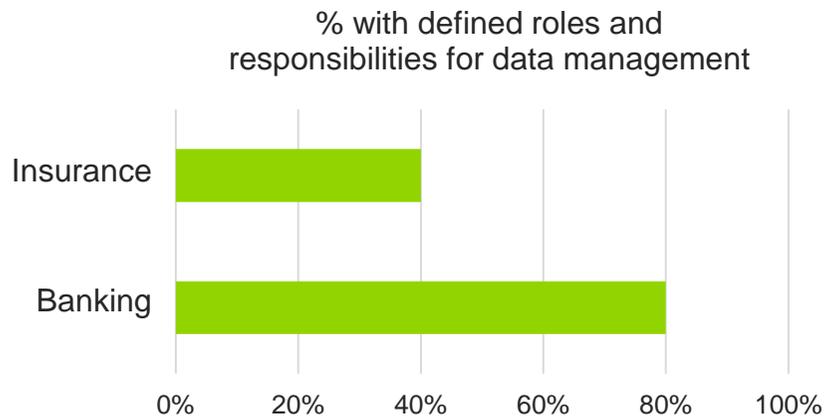
Examples of such committees are:

- 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)

# Risk Governance, oversight and accountability

All respondents but one, express that business managers as the First Line of Defense have explicit responsibility for risks and risk management. Examples are: monitoring of risk / return, defaults may affect the bonus, product managers do risk assessment for new products, operations managers are doing self control assessment and “own” operational risks related to their business processes. All respondents but one, also state that business managers understand what their Risk Appetite is, e.g. through the communication of risk limits, risk reports, closer cooperation between business and risk management, participation of risk management in decision processes (co-decision, advice), formal documents and signature of acknowledgement,...

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



In some institutions, the risk management function is considered to be responsible for, even has to certify, the data used on the Risk Appetite Framework, whether or not with the contribution of Finance.

Other recognize that the risk function primarily uses business data to articulate risk appetite statements and limits.

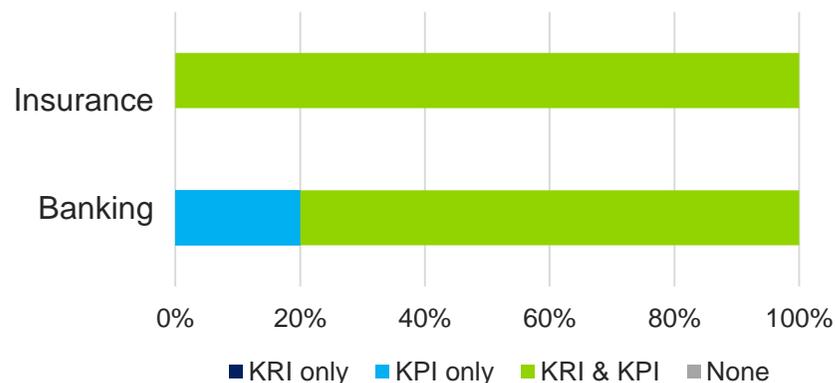
# Monitoring the risk profile

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.

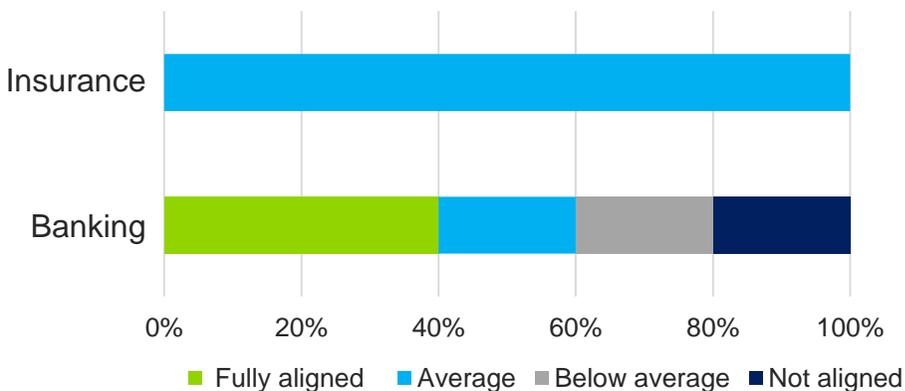
80% of the banking and insurance companies use KRI's based on the defined limits.

The majority of the respondents also state that these KRI's are an effective tool to support steering and decision making. All insurance respondents, and 80% of the banks use both KRI's and KPI's.

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

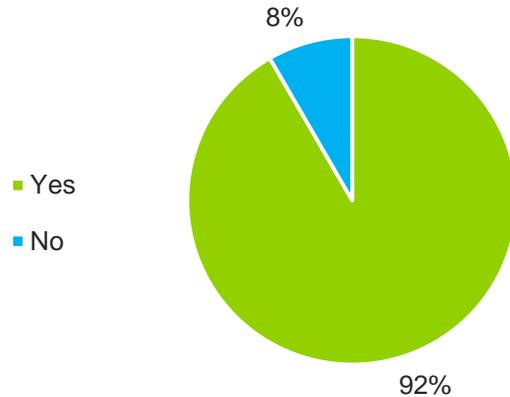


## To what extent are KPI's (steering) and KRI's (control) aligned?

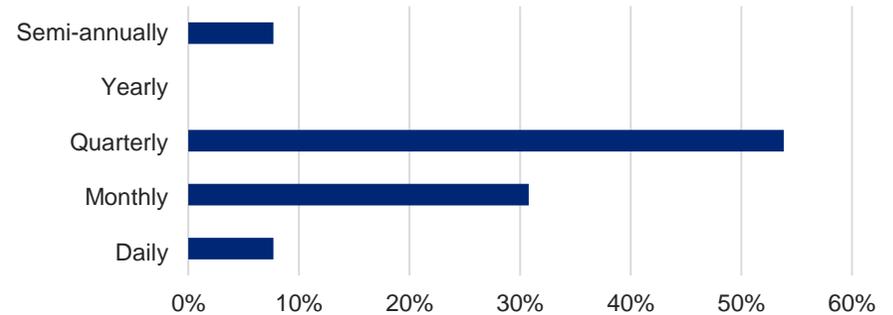


# Monitoring the risk profile

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



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

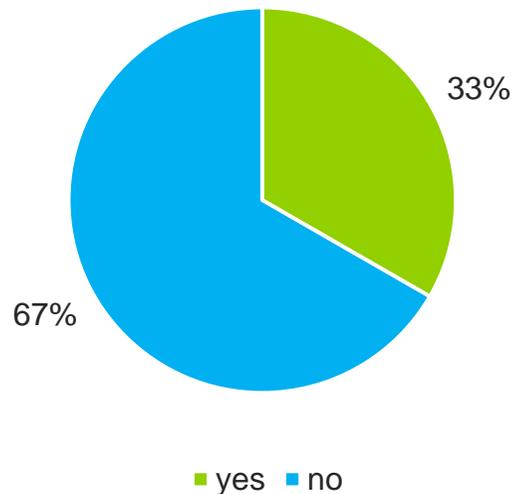


Almost all participants indicated that within their organization an escalation procedure is foreseen when crossing a limit or tolerance.

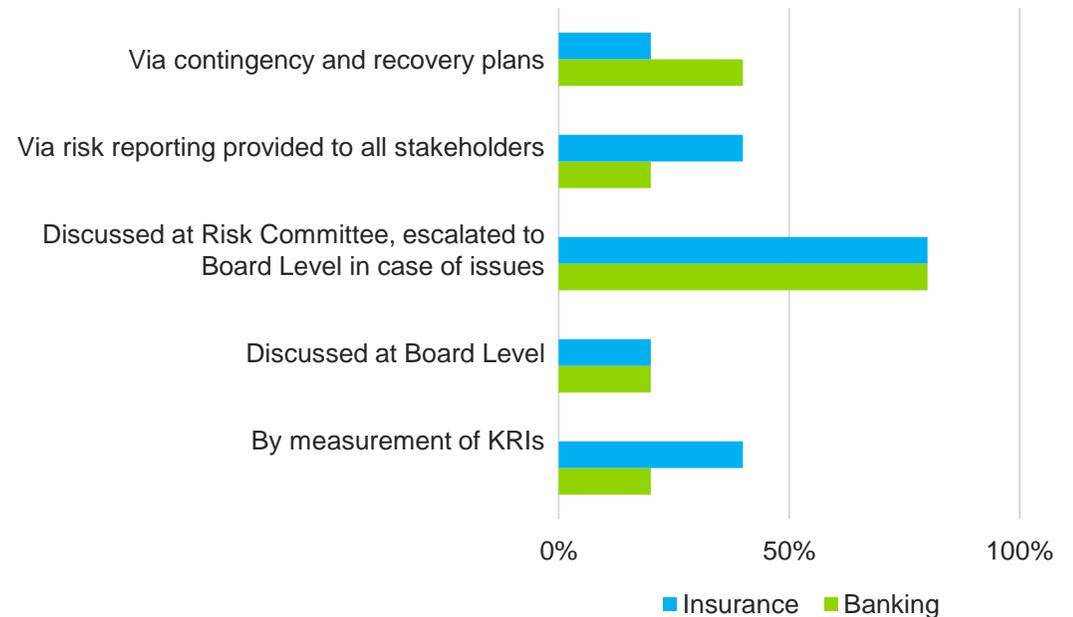
In addition, more than 80% of the participants indicated that the Board of Directors receive at minimum on a quarterly base reports with an overview if tolerance limits were respected or not.

# Monitoring the risk profile

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



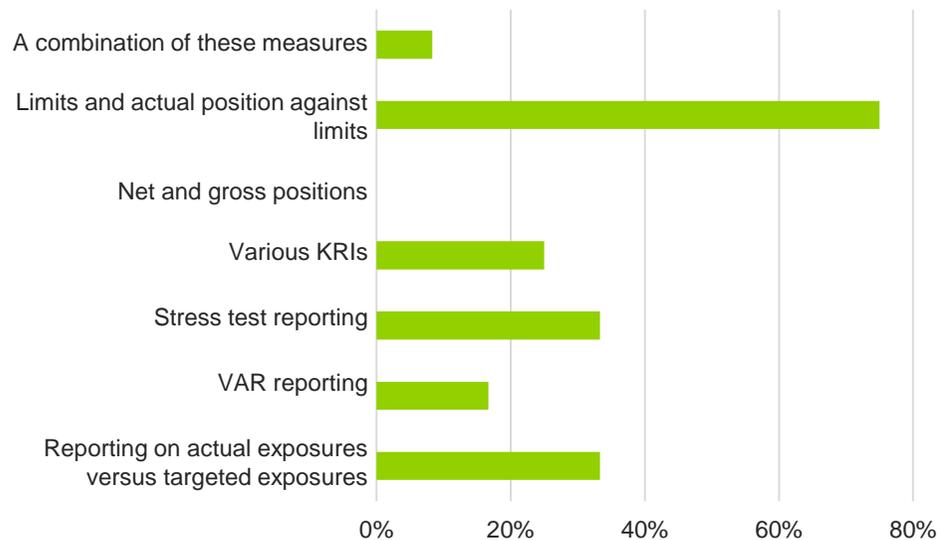
How is the (ex-post) adequacy of risk mitigation measured and assessed?



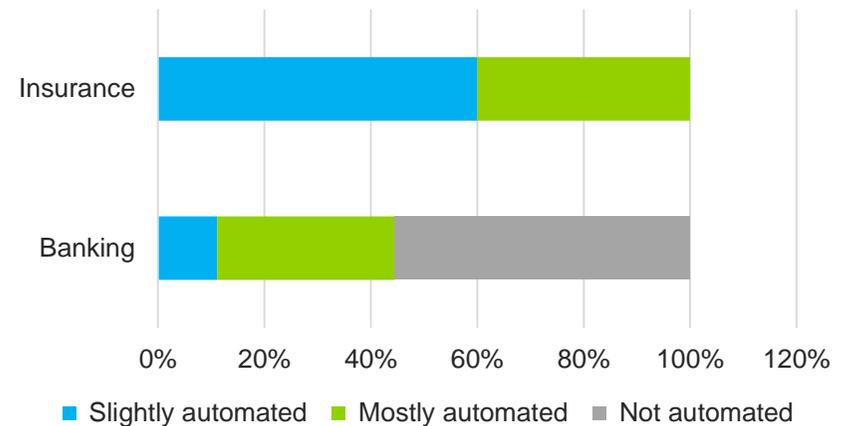
Two third of the respondents indicated that no predefined action plan is in place when the risk profile is not in line with the defined Risk Appetite. Risk Committees assess the adequacy of the risk mitigating actions. In only 20% of the financial institutions, the Board is involved on a structural way.

# 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?**

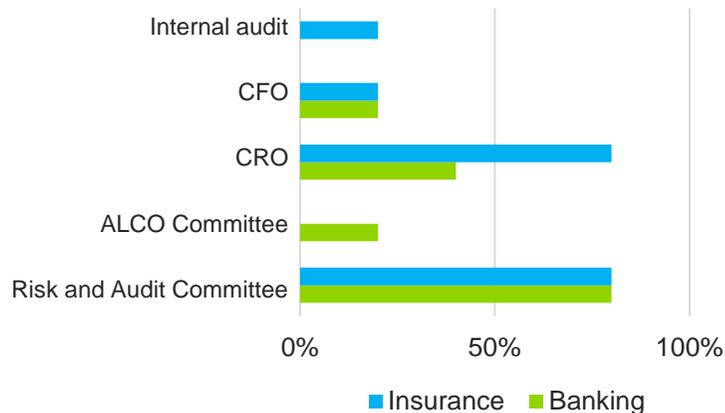


An effective and efficient risk appetite framework should be strongly supported by a sound management information systems (MIS). Implementation of the *BCBS Principles for Effective Risk Data Aggregation and Risk Reporting* will facilitate institutions' ability to identify, measure, aggregate and report on risks at the institution-wide, business line, legal entity and risk category levels.

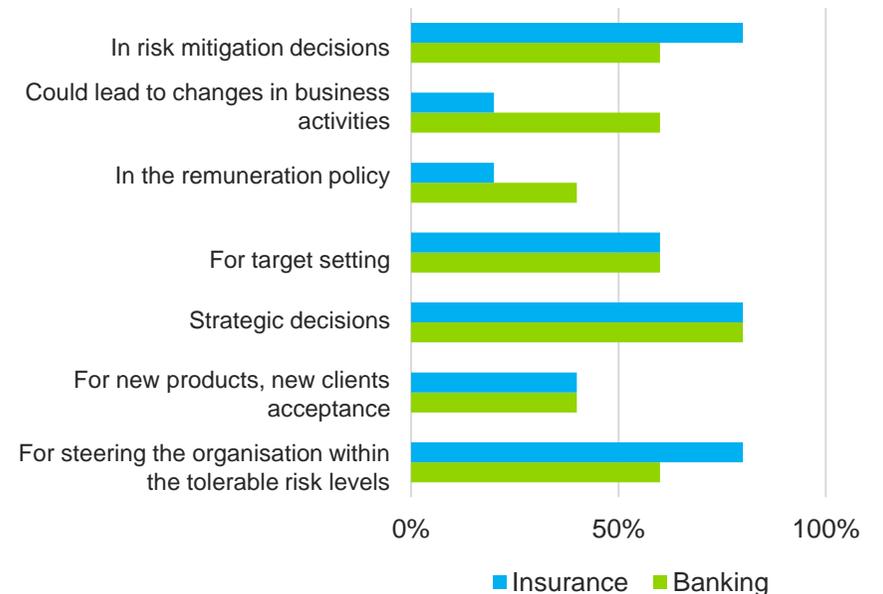
# Monitoring the risk profile

Risk appetite reports exist in different forms and frequencies. Most common reporting frequency is quarterly to Board members, including Audit & Risk committee, and monthly reporting to executive committee, though some also reporting on monthly basis to Board. Content of the reports are primarily risk indicators, accompanied with analysis (e.g. stress test and back testing results) and comments from the risk manager.

**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?**



# 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.

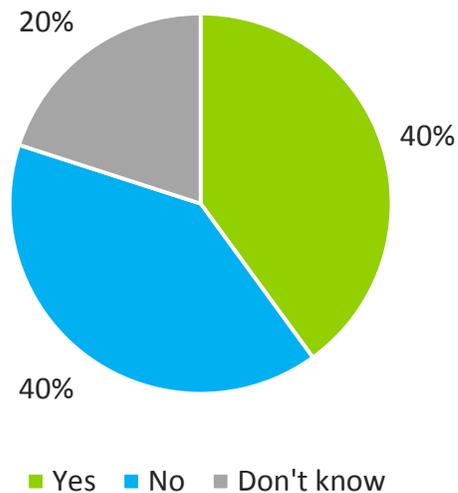
In almost 60% of the institutions the Risk and Audit Committee verify compliance with the risk limits.

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

**Do you believe the definition of your Risk Bearing Capacity is commonly known and recognised in the organisation?**

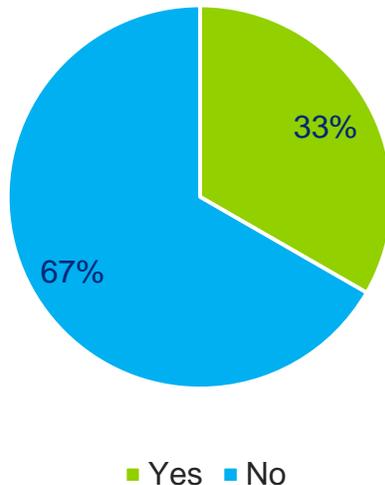


Banking respondents only

Whereas more than 70% of the respondents indicated that they believe the definition of the risk appetite statement is commonly known within the organisation, this is much less for the definition of the risk bearing capacity

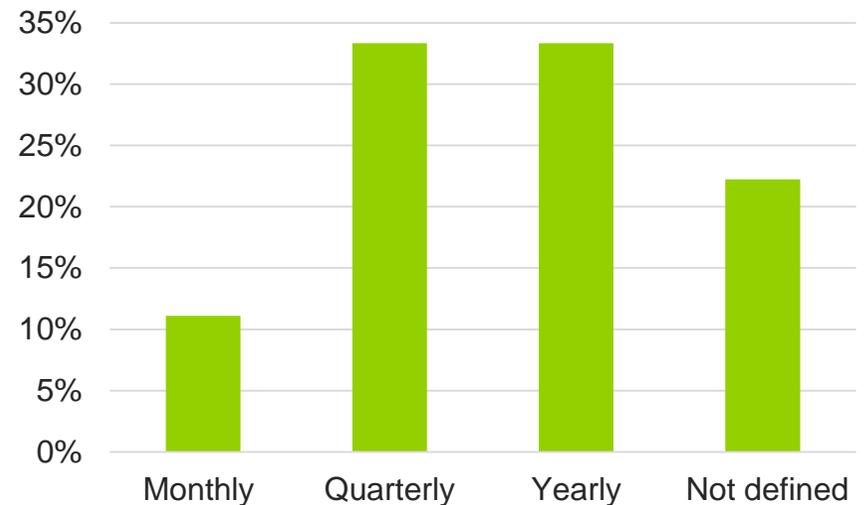
# Risk Bearing Capacity

Did you determine the Risk Bearing capacity of your organisation prior to establishing the Risk Appetite?



Banking respondents only

With what frequency do you calculate the Risk Bearing Capacity?



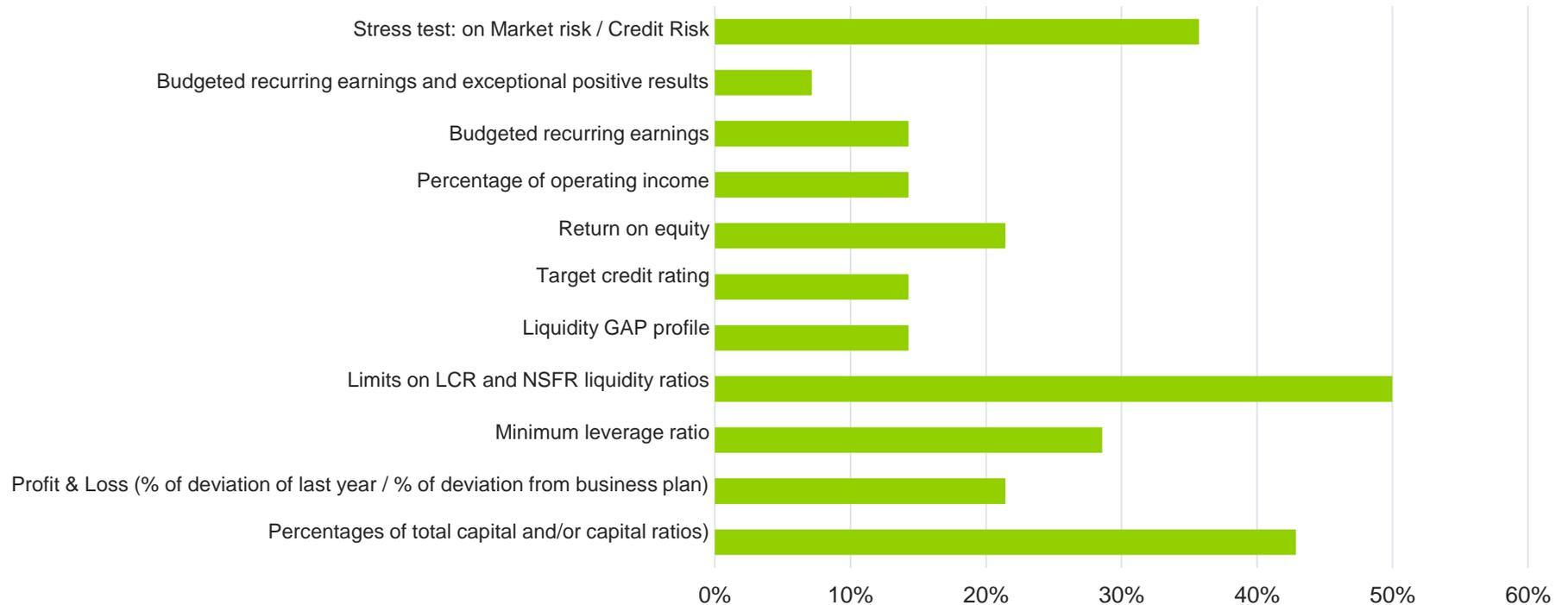
Banking respondents only

Most respondents indicated that they did not determine the Risk Bearing Capacity of the bank before determining the company's Risk Appetite.

In addition, most banking clients responded that their Risk Bearing Capacity is re-assessed on an annual or quarterly basis.

# Risk Bearing Capacity

**Banking:** which measure does your organisation use for expressing the Risk Bearing Capacity?



The measures most commonly used in the banking sector are Basel III measures such as the liquidity ratios (LCR and NSFR) and the capital ratios. These measures are often complemented with (internal) stress tests where several severe market and credit risk scenarios are taken into account.

# Risk Bearing Capacity

**Insurance:** How does your organization determine its internal capital need?

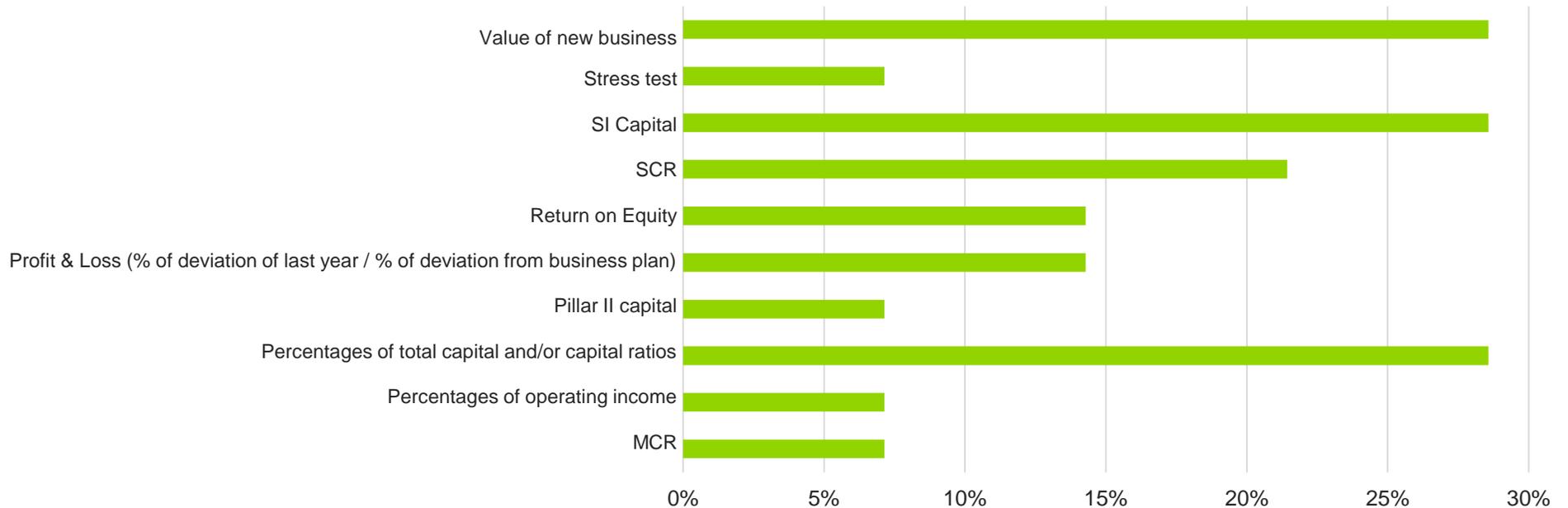


Most insurance clients indicate that their Solvency II Internal Economic Capital Models are the basis to determine their internal capital needs.

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

# Risk Bearing Capacity

**Insurance:** Which measure does your organisation use for expressing the Risk Bearing Capacity?

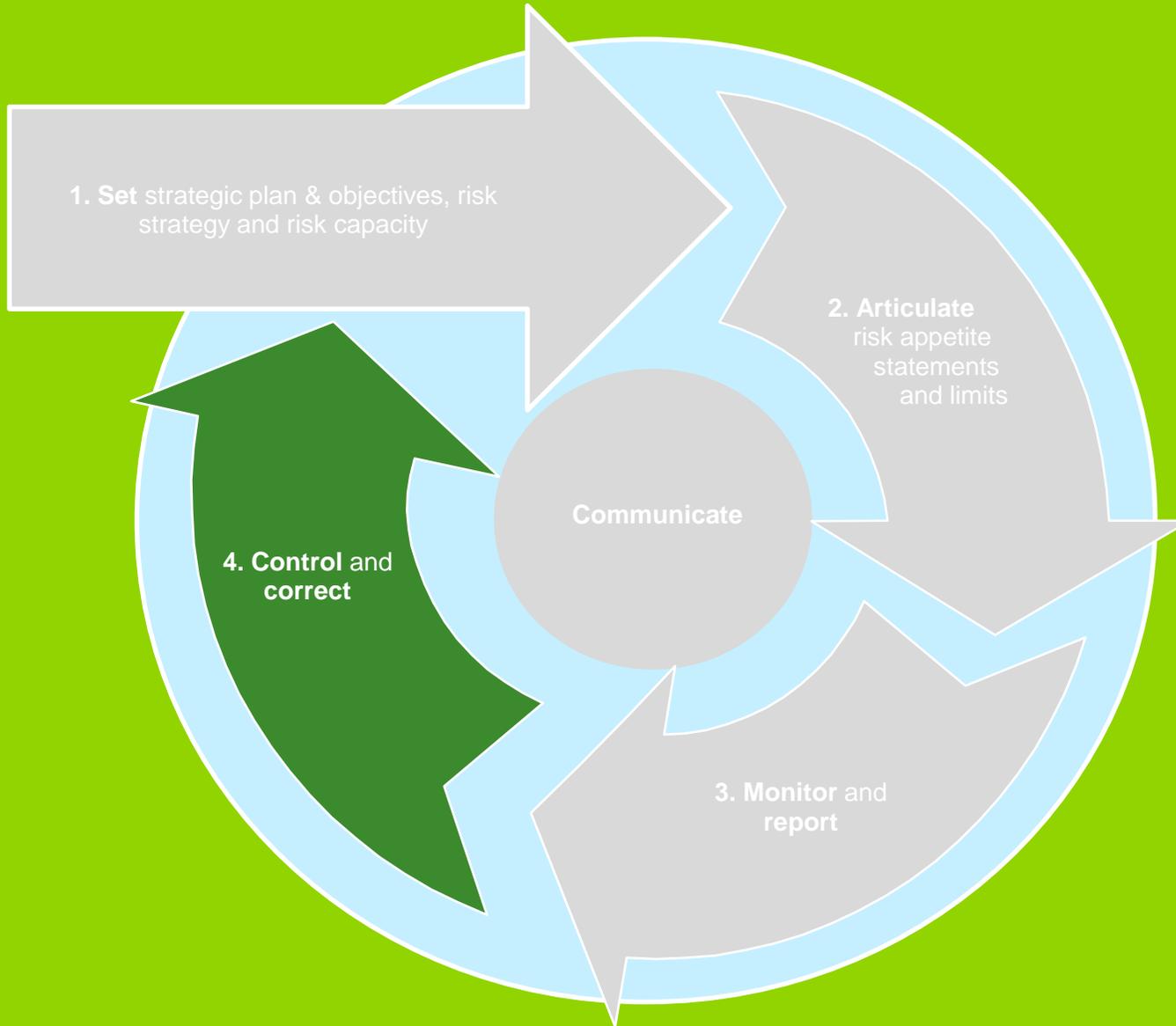


Within the insurance sector, the measures most often used are:

- % of total capital and/or capital ratios (which is also the case within the banking sector)
- Solvency I Capital
- Value of new business

A striking observation is that within the insurance sector, stress tests scenarios are less frequently used for expressing the Risk Bearing Capacity than within the banking sector.

# 5



# Content of this section

A risk appetite framework is not a one-off process and needs to be embedded within the financial institution. The bank or 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).

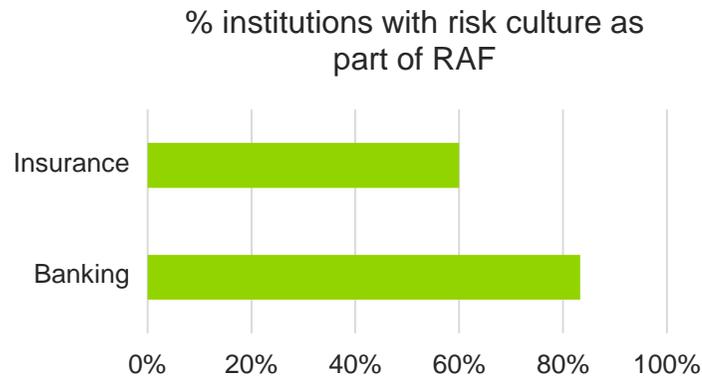
In this section we look into **risk culture** as part of the risk appetite framework. A sound risk culture will create an environment to facilitate emerging risks having a material impact on an institution, and any risk-taking activities beyond the risk appetite, to be identified and addressed in a timely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

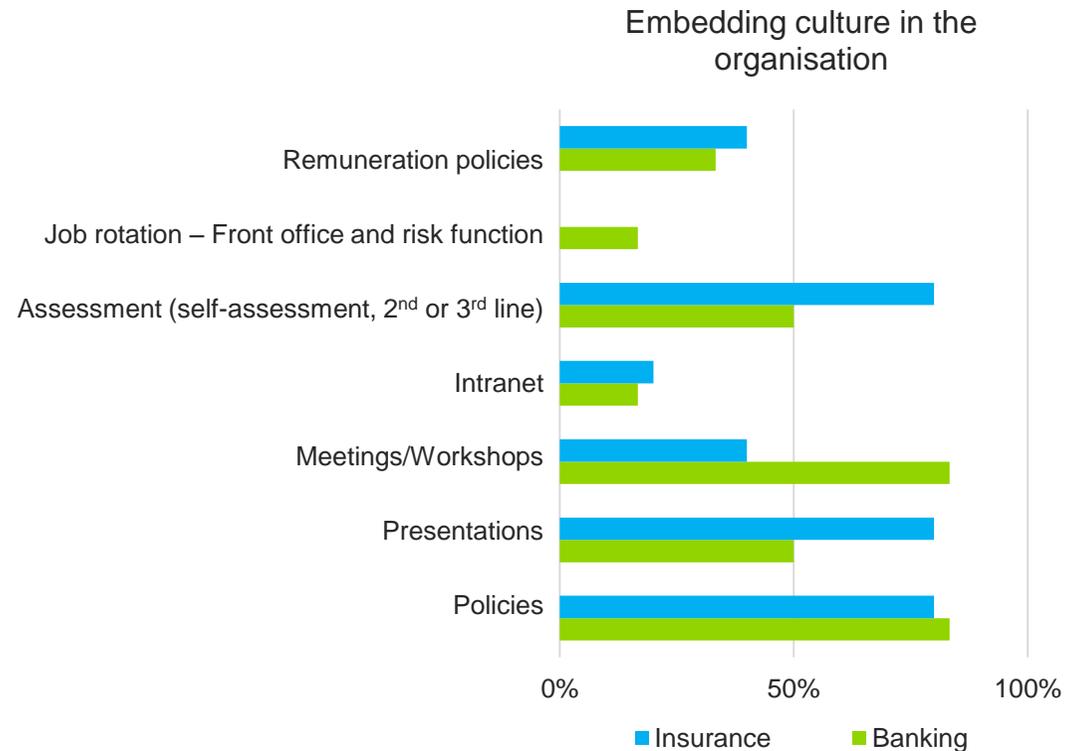
# Culture and Awareness

A relative high number of respondents has “risk culture” as an integral part of their Risk Appetite Framework. The embedding of risk culture in the Risk Appetite Framework is organized through qualitative statements, by recognizing risk culture as a key objective of risk appetite or e.g. by monitoring the completion of mitigation actions on time.

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

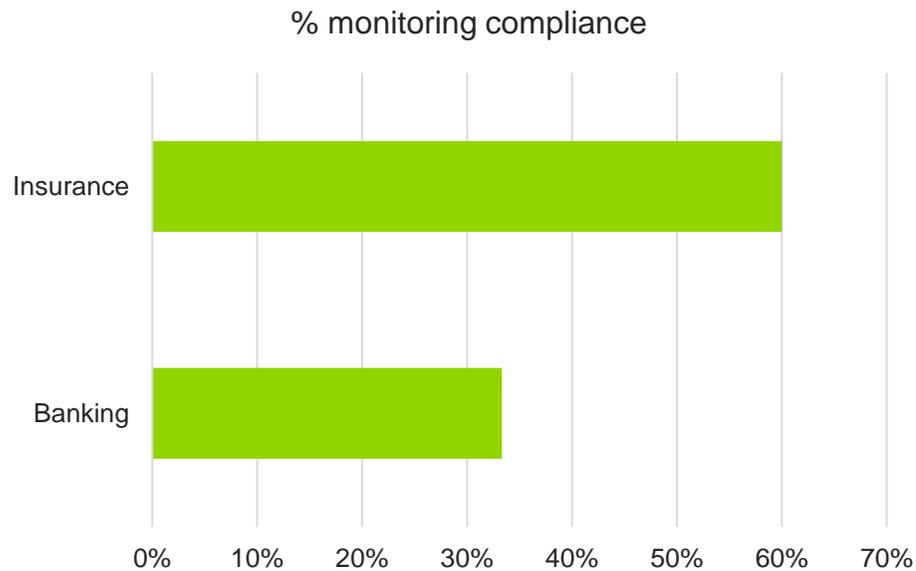


## How have you translated and secured the desired risk culture in your organisation?

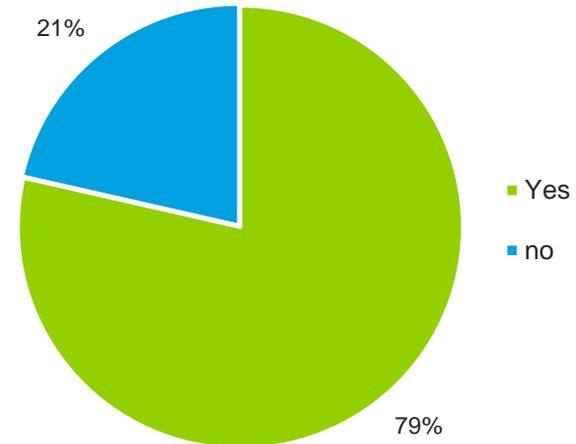


# Culture and Awareness

**Is compliance with Risk Appetite procedures and processes monitored?**

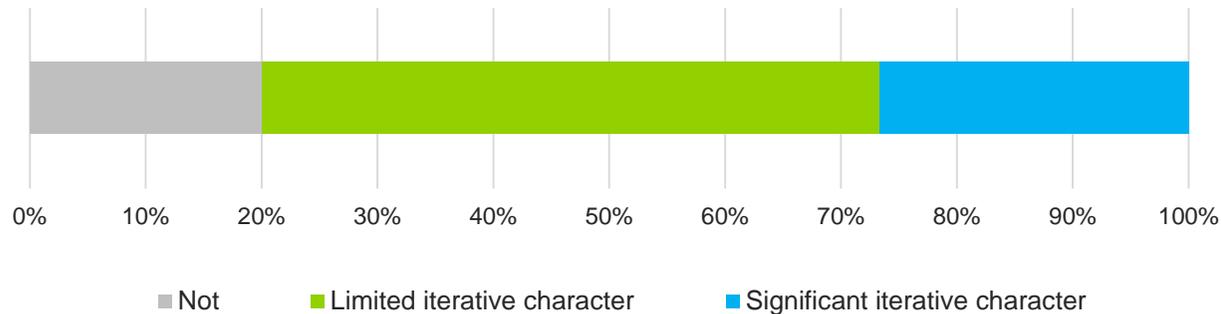


**Is the measurement of risks compared to their limits and tolerances recorded and stored?**



# 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 financial institutions and insurance against banking companies, no real distinction could be observed. Some additional explanation on the process followed is provided below:

Significant iterative:

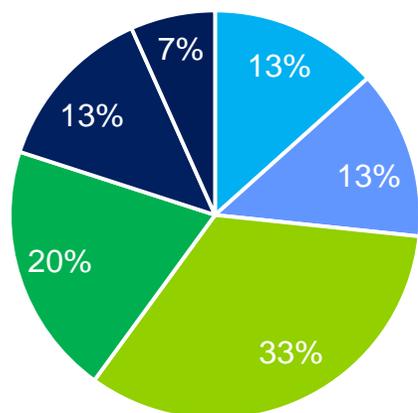
- Different iterations within Risk function, different iterations with business managers and executive committee, iteration with Board
- Evaluation by risk management of new procedures (yearly)

Limited iterative:

- Iterations between daughter and mother (response of subs.)
- Through voluntaristic RAF process, included in the business plan process

# Effectiveness of the Risk Appetite Framework

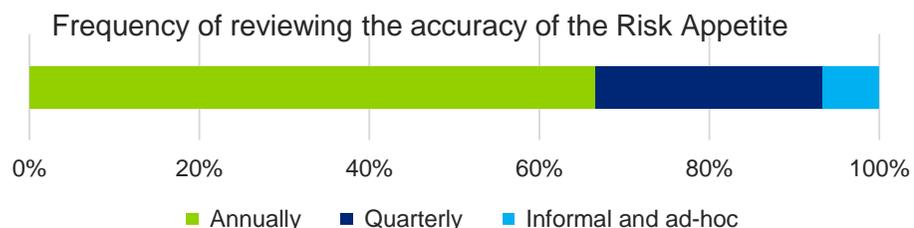
## How does the Board assess the accuracy of the Risk Appetite ...?



- Via strategic risk assessments with the business, via business plans and via views from risk specialists.
- Based on business plans and business plan reviews
- Based on reviews from risk department
- Based on ex-post results on how actual risks have behaved in regard to the risk appetite
- The Board does not assess the Risk Appetite
- Other

Most of the bank and insurance companies indicated that the board mainly relies on (1) reviews from the risk department and on (2) ex-post results which show how actual risks have behaved in regard to the risk appetite. Some respondents indicated that their organization is missing a structured process (7%) to assess the accuracy of the Risk Appetite. 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.

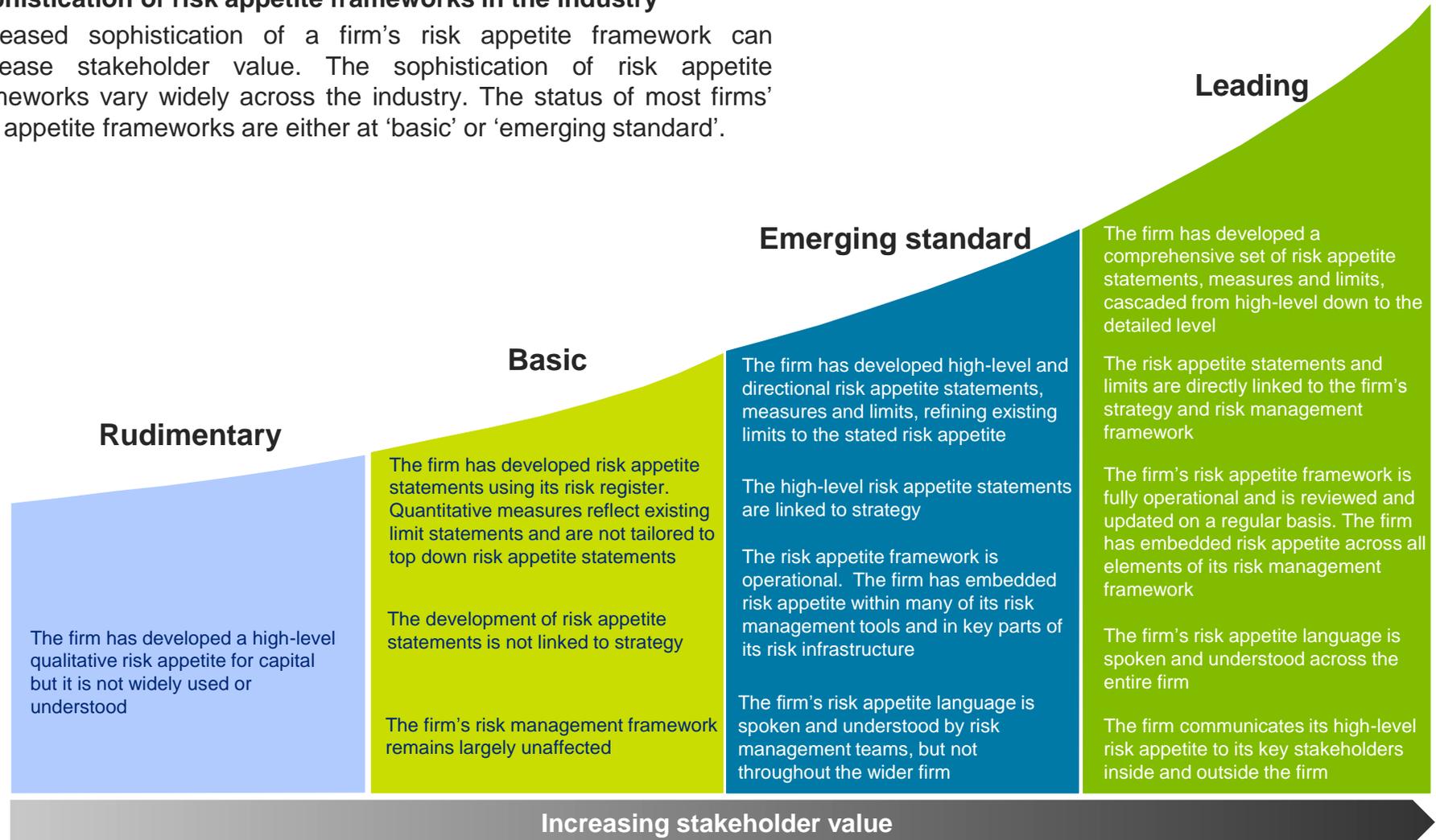
## ... and at what frequency?



# 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'.



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