AXA Life Invest (ALI) – Feedback on CBI Risk Appetite discussion paper

The following comments relate to the CBI discussion paper on risk appetite published on the 20th June 2014. The comments reflect the input of a number of members of senior management of ALI but have not to date been discussed by the Boards of the constituent entities of ALI (AXA Life Europe (ALE) / AXA Life Invest Reinsurance (ALIR) / AXA Life Invest Services). The intention to publish a series of papers on this topic is a welcome proposition; however, ALI feels that this paper would have been of much greater value if it had been published at the time when Risk Appetite Statements (RAS) were first made mandatory (i.e. on the publication of the first version of the Corporate Governance Code for Credit Institutions and Insurance Undertakings ("the CGC") in 2010.

Section 2 Background

ALI agrees that no detailed checklist can be applicable to the industry as a whole. Further to this, requiring all companies to address *all* aspects of a detailed checklist would result in statements which are neither actionable nor measurable as some companies by their nature will have very different risk exposures and risk drivers compared to others. It is still useful to have some minimal guidance to offer a benchmark and ALI welcomes the outline in section 5.

Given the definition of risk capacity vs risk appetite, the requirement to report deviations to risk appetite to the Central Bank with 5 days of the Board being informed is questionable. For example, it may be more appropriate to require immediate reporting of deviation to risk capacity, which is perhaps of more major concern of Regulators; deviations to risk appetite could be included, perhaps, as part of the routine quarterly reporting process.

A CBI led forum to develop best practices would be most welcome.

Section 3

The discussion around strategy and risk appetite is not entirely clear. ALI agrees that they evolve in parallel in practice and are of course interlinked. ALI would welcome additional discussion on how to drive the strategy using risk appetite and vice versa.

ALI agrees with the view that the phrases (risk..) appetite / tolerance / limit are used interchangeably in industry and sometimes even in the context of the RAS's of ALE and ALIR, however there are two elements to note in this regard:

1. RAS's have now been mandatory under the CGC for three years and the language is likely to be bedded down in an organisation, making it difficult to change without creating unnecessary confusion.
2. If part of a Group, any company may find it difficult to use one definition of a term over another where there is a differing view of its meaning between the CBI and the ultimate shareholder.

ALI understands that figure 2 is a simplified representation of the risk/return dynamic; however ALI believes that this 2-dimensional view is not an adequate picture, particularly in the way that it represents Risk Capacity in relation to the other measures and the axes of the graphic. ALI does not propose a way to show the multi-dimensional interactions that exist, however the graphic itself seems to be misleading as it stands.

Section 4

ALI agrees that it would be poor practice to continually adapt the RAS merely to stay within appetite. On the other hand it can be hard (or represent an inappropriate use of limited resources) to create limits which are flexible enough in their definition to reflect automatically every change in conditions. It is also just as important that a deviation to a limit which is outdated or that was poorly defined in the first instance should not lead to any unnecessary escalation like regulatory reporting. In this instance an update to the RAS is the best course of action and any regulatory requirements in relation to the RAS should be flexible enough to allow this, subject to an appropriate RAS review process being put in place by companies, including proper oversight of any proposed changes by the Risk Committee.

Additional comments

One area of the CGC which seems to cause confusion in the industry is the requirement under section 15.2 of the revised code requiring the RAS to “address separately the short, medium and long term horizons”. ALI would welcome further discussion around this requirement in future papers.

In an insurance context, it seems evident that the ORSA / FLAOR should tie into the RAS. This would also be a welcome topic of future debate & guidance.

In practice ALI understands that the RAS outlines a framework for companies to manage their risk but also for the Central Bank to engage with companies. ALI encourages the Central Bank to outline how it envisages that this engagement process should ideally work. In order for the RAS to work effectively and be treated merely as an exercise in compliance, companies need to be comfortable that the right balance is achieved with regard to regulatory engagement. In an extreme, a company could set limits and tolerances at levels that imply that engagement with the regulator is extremely unlikely. This is not efficient in terms of risk management. The regulatory engagement process around the RAS should foster a culture of risk management without a fear of additional regulatory oversight, scrutiny or sanction.