



BNY MELLON

Risk Appetite Discussion Paper

Central Bank of Ireland

By Email: riskappetite@centralbank.ie

1 September 2014

Re: Risk Appetite Discussion Paper

Dear Sirs,

This response is on behalf of BNY Mellon Fund Services (Ireland) Limited, BNY Mellon Investment Servicing (International) Limited, BNY Mellon Trust Company (Ireland) Limited and Pershing Securities International Limited, collectively "BNY Mellon".

BNY Mellon welcomes the opportunity to comment on the Discussion Paper ("DP") issued by the Central Bank of Ireland ("CBI") concerning Risk Appetite.

We recognise that the intention of the CBI in issuing this DP is to engage industry in a discussion on the elements of risk appetite, and in particular to increase understanding of what effective risk appetite incorporates and we support the non-prescriptive approach that the CBI is proposing in this regard.

Please note we have not provided responses to each question posed, instead choosing to limit our submission to the particular areas where we were keen to express a view.

General

One general observation we have concerns the following statement contained within the DP: "*what differentiates a successful business from one that is not is the ability to take on calculated risks in order to realise strategic goals*".

We think it important not to give the impression that, at some level, sound risk management is more important than the clear definition and execution of strategy in terms of defining what helps define a successful business. Strategy and Risk are completely interconnected and both must be effectively defined and implemented in order to create an environment where success can be achieved.

Risk Appetite Statements

Should all organisations have a risk appetite framework? Please explain your answer.

Yes.

It is our experience that the process of defining a risk appetite statement and developing a risk appetite framework through which risk appetite can be considered and safeguarded enhances the overall effectiveness of the Corporate Governance arrangements that underpin the firms' activities. This effectiveness is enhanced when the process is undertaken in the context of a well-articulated business strategy.

What led to your organisation putting a formal RAF in place?

We have invested in our Risk Management Framework in recent times. This has included the building out of our Governance Committee structures and the definition of comprehensive risk information for each of our legal entities. The development of a Risk Appetite Framework represents one of the logical steps in that development.

How are risk appetite and strategy related?

In our opinion it is necessary to have a clear articulation of Firm strategy before attempting to define risk appetite. The achievement of strategy requires the firm to accept certain risks and the process of defining risk appetite in alignment with stated strategy enables the firm better understand the nature and quantum of the risks it must be willing to accept if stated strategy is to be realisable. Changes to firm strategy over time may result in the need to redefine risk appetite. Risk appetite is not static and should be kept under ongoing review by firms.

In your opinion would it be desirable for the Central Bank to facilitate a forum, comprising participants with experience in the financial services industry to develop a range of good practices with respect to the preparation and monitoring of Risk Appetite Statements?

Yes.

Whilst considerable international focus has been applied to the topic of risk appetite in recent times, a more focussed debate and discussion in Ireland would certainly be of benefit. This forum must have clear terms of reference and objectives, particularly in the context of the diverse population of financial services firms operating from Ireland.

Risk Appetite, Risk Tolerance and Risk Limits

What definition of risk appetite does your organisation consider to be appropriate?

BNY Mellon considers the definition of risk appetite proposed by the Senior Supervisors Group (SSG)¹ to be the most appropriate.

The SSG defines risk appetite as *“the level and type of risk a company is able and willing to assume in its exposures and business activities, given its business objectives and obligations to stakeholders”*.

¹ The SSG is a forum for senior representatives of supervisory authorities to engage in dialogue on risk management practices, governance, and other issues concerning complex, globally-active financial institutions.

In your view, how are risk appetite, risk tolerance and risk limits related to one another?

BNY Mellon chooses not use the term 'risk tolerance' within its Risk Appetite Framework. Rather, the term 'risk appetite' refers not only the aggregate level of risk the organisation is willing to assume to achieve its strategic and business objectives, but also the specific maximum risk that the organisation is willing to take in respect of each category of risk. Risk appetite is then operationalised through the use of risk limits for all relevant risks and business units. We also use the term risk capacity as part of our risk appetite framework to highlight the maximum amount of risk that the firm could potentially take. The use of the term risk capacity allows us to underpin the key message that risk appetite should always be lower than risk capacity.

Risk Culture and Responsibility

What are the challenges that organisations face in terms of communicating risk culture to stakeholders?

There are a variety of stakeholders who are concerned with an organisation's Risk Culture, both internal and external. External stakeholders include regulators, stockholders, rating agencies, auditors and clients. The principle challenge that an organisation faces in communicating with external stakeholders, is ensuring that it does so effectively and consistently so that each derives the level of assurance they desire.

Internal stakeholders include the Board of Directors, along with all employees, regardless of which line of defence they belong to. The challenge from an internal perspective is less of a communication one. Rather, it is ensuring that the Risk Culture is well embedded, such that individuals at all levels display the types of behaviours and actions that are consistent with it.

Expressing Risk Appetite

The Central Bank has suggested characteristics of an effective risk appetite statement. How would you improve this?

While acknowledging that the articulation of risk appetite in terms of quantification is vital, we also consider that the embedding of the related thresholds and limits into the governance structure and reporting processes are equally important in order to fully embed the risk appetite into the running of the business. The further embedding of quantification should also drive pre-defined management actions and responses to adverse trends and threshold breaches, whether through the escalation of increasing risk to more senior management and the Board or the need to identify and implement remediating actions and responses.

While certain risks maybe viewed as undesirable, it should be acknowledged that they may be unavoidable at least in the short term. Therefore, guidance should reflect that the response to these risks maybe more around resolution and mitigation than risk avoidance. Consequently management actions and thresholds should be based more on reporting against timeframes and decreasing residual risk.

The clear and concise reporting of risk thresholds and limits are considered vital to establishing a focused and unambiguous view for risk monitoring, identifying any increased risk or risk appetite breaches. Therefore, guidance should be provided to ensure that a risk prioritisation process should be considered when designing and agreeing appropriate measures for various risk types. This risk prioritisation should drive relevant matrices and measures, rather than utilise existing less indicative

measures. Therefore, the guidance should not be prescriptive in nature and should be determined based upon the firms' individual appetite for risk, rather than predefined measures and limits.

Should you have any queries in relation to our submission, or wish to discuss same further, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in blue ink that reads "Bny Mellon". The signature is written in a cursive, flowing style.

BNY MELLON