Risk Appetite discussion paper team
Central Bank of Ireland
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via email

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**DIMA observations to the Central Bank of Ireland's risk appetite discussion paper**

DIMA welcomes the opportunity to enter into a discussion with the Central Bank of Ireland about risk appetite, as invited in the CBI's recent discussion paper on risk appetite, including its linkage with organisational strategy and its importance for financial institutions. DIMA has consulted with directors and senior executives from its member companies in developing this response.

DIMA (the Dublin International Insurance & Management Association) comprises 61 member companies, which represent more than 200 separate insurance and reinsurance entities. These range from captive insurance and reinsurance companies, owned and writing the risks of non-insurance parent companies, to international re/insurance groups headquartered in Ireland. All DIMA's members are involved in international re/insurance, predominantly writing European business on a Freedom of Establishment or Freedom of Services business across the EU/EEA, as well as significant volumes of re/insurance business emanating from non-EU/EEA jurisdictions. DIMA members are typically part of international/global groups, therefore the comments in this document are brought solely from the international perspective and should be considered in this light.

## General comments

Re/insurance has risk at its core, providing products to its client base to provide risk transfer and mitigation opportunities. The re/insurance and banking sectors have fundamentally different risk profiles, risk exposures and business models.[1] Thus it continues to be important that any generic discussion around risk appetite in the context of financial services is sufficiently high level to encompass these differing sector anatomies.

The re/insurance industry is in the midst of the transformational implementation of Solvency II, which holds enterprise-wide risk management as the prime regulatory tenet with a principles-based environment. As well the industry's current programme of restructuring its processes, systems and operations as it adopts Solvency II, in recent years the Central Bank of Ireland has

[1] http://www.insuranceeurope.eu/uploads/Modules/Publications/1277383780_cea-report-insurance-a-unique-sector.pdf

implemented state-of-the-art regulatory requirements such as the Corporate Governance Code (both the original 2010 code and the 2013 update). The Code anticipates, and in certain areas augments, the requirements being implemented across Europe by Solvency II, which has been developed as a maximum harmonisation directive, i.e., all European Member States will implement to the same level. The Solvency II Directive does not specifically define or, indeed, refer to risk appetite. However, CEIOPS' (now EIOPA) advice on Level 2 implementing measures for system of governance, notes:

> "An effective risk management system covers all material risks and requires at least the following:
> a) A clearly defined and well documented risk management strategy that includes the risk management objectives, key risk management principles, **general risk appetite** and assignment of responsibilities across all the activities of the undertaking and is consistent with the undertaking's overall business strategy…"[2]

A generally-accepted definition of risk appetite has been adopted in Europe, emanating from the International Standard ISO31000 and defined in ISO Guide 73:2009 as "amount and type of risk that an organisation is willing to pursue or retain". This definition has been developed for all types and sizes of organisation, thus its use prevents misinterpretation or misunderstanding between different types of financial services business, and indeed different industries.

It remains important in the run-up to full Solvency II implementation that what are essentially dual codes – one at European level and one at domestic level – are not established, requiring regulated entities to operate two parallel (or, indeed, part parallel) regimes.

As noted previously, many of the international re/insurance entities established and regulated in Ireland are part of larger groups, and are utilised within the group risk strategy. The risk appetite discussion paper does not appear to reflect that regulated entities in Ireland may be individual elements within a wider group risk strategy and within that context do not have the discrimination to set their own strategy as if they are a discrete operation with autonomy from the group and external to the group risk management strategy.

To this end, Irish subsidiaries of international groups are no different from group subsidiaries established elsewhere and which are an important element of the group-wide risk strategy, though this aspect may not be as readily perceptible at an individual entity level. Within the international context, a group lead regulator will head up a college of regulators for these types of operations, a structure in which the CBI has extensive experience. The group lead regulator sets the criteria for aspects of group regulation such as risk appetite, and it is important that the lead regulator (particularly in a Solvency II or equivalent environment) is not supplanted in that role by local requirements above and beyond those set by internationally accepted standards.

The CBI's publication "Insurance Statistics 2012" shows that international insurers wrote almost three times the premium income levels in 2012 than domestic insurers[3]; the recent CBI analysis

[2] https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP33/CEIOPS-L2-Final-Advice-on-System-of-Governance.pdf
[3] http://www.centralbank.ie/publications/Documents/Insurance%20Statistics%202012.pdf

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“Reinsurance in Ireland: Development and Issues” further shows that reinsurers based in Ireland recorded €2.25bn in premiums-claims in 2011[4]. In the context of the size of the domestic industry compared to the international industry, the CBI has extensive experience of the issues around regulating international operations, and the approach it takes towards risk appetite should reflect that expertise.

Proportionality remains at the heart of re/insurance regulation, particularly in the Solvency II environment. The CBI’s PRISM model has displayed a jurisdictional maturity in actively embracing the principle of proportionality, and has already transformed the concept of regulated entities “living and breathing” risk (including risk appetite) into a fundamental modus operandi of the organisations.

**Specific questions:**

**Risk appetite statements**

While we agree that all organisations should have a risk appetite framework as a core element of its risk management strategy, the level of detail of the framework should reflect the nature, scale and complexity of the individual organisation. This is currently reflected in the CBI’s system of PRISM rankings, which has proven to date to be an effective structure.

The risk appetite framework in Ireland has been formalised through the Corporate Governance Code, with more regular reviews of risks and operational results against appetite. This has led to a greater focus on risk, and a deeper understanding of aspects and functions of the organisation by the senior management team. Risk strategy has been implemented through the risk appetite framework, with companies updating their risk appetite by making reference to their business plan. Risk appetite needs to be aligned with the future plans of the entity, but this remains in the context of group strategy rather than as a stand-alone entity, as discussed previously.

The financial services sector embraces a wide range of different business models and risk approaches; it is not a sector for which “one size fits all” generally has wide validity. Thus a forum aimed to produce a range of good practices with respect to the preparation and monitoring of risk appetite statements might prove overly prescriptive and not be able to reflect the diversity of structure and risk attitude, particularly in the light of proportionality. It would be more appropriate for individual regulated entities to develop their own risk appetite strategies which would be reflected in their unique risk appetite statements.

**Risk appetite, risk tolerance and risk limits**

Financial services is rife with terminology which has different definitions in difference sectors (vide “loss” in an insurance context compared with “loss” in a banking context). It is vital that the

4 http://www.centralbank.ie/publications/Documents/Reinsurance%20in%20Ireland%20Development%20and%20Issues.pdf

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lexicon be converged so that misunderstandings are minimised or, ideally, eliminated. The CBI has highlighted the multiple definitions of "risk appetite" currently in use, and we refer to our earlier comments around the ISO definition which is generally accepted across all industries.

DIMA cannot answer questions relating to individual entities' current approach to issues such as risk appetite, tolerance and limits, nor specific structures to deal with early warning reporting of potential breaches of risk appetite. However, discussions with member companies indicate that "traffic light" systems established around individual companies' interpretations, applications and escalation procedures have proven to be efficient structures within the organisation. Again, structures indicated by ISO31000 such as risk event logs are used to identify various aspects of risk.

**Risk culture and responsibility**

Discussions with DIMA member companies have indicated that risk culture is assessed in various ways including:

- Communication and self-assessment;
- Corporate governance code, framework and training;
- Risk champions reporting into the risk officers
- Board training to ensure "tone from the top" with regards to risks, particularly including the board chairman and CEO; and
- Ensuring that a risk culture is embedded throughout the organisation, identifying gaps and ensuring that they are filled.

Challenges that organisations face in terms of communicating a risk culture to stakeholders include identifying the appropriate and relevant stakeholders, and providing sufficient risk information while keeping it sufficiently succinct that it is comprehensible.

**Expressing risk appetite**

Because the risk appetite of each entity is different, there is a danger that a prescriptive risk appetite statement would overly homogenise the output and not properly reflect the risk profile of the business. From a metrics perspective, proportionality remains vitally important.

It is important that metrics are seen as dynamic in their use, which leads in turn to an ongoing virtuous circle. New metrics are introduced to reflect changes in business direction, and for the re/insurance sector specifically at this point in time, the migration to Solvency II is reflected in an ongoing iterative process.

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DIMA looks forward to a continuing discussion with the CBI around the area of risk appetite, and reiterates our view that it is important not to resort to an overly prescriptive environment which doesn't properly reflect the range of activities present in Ireland's financial services sector.

Yours faithfully

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