Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

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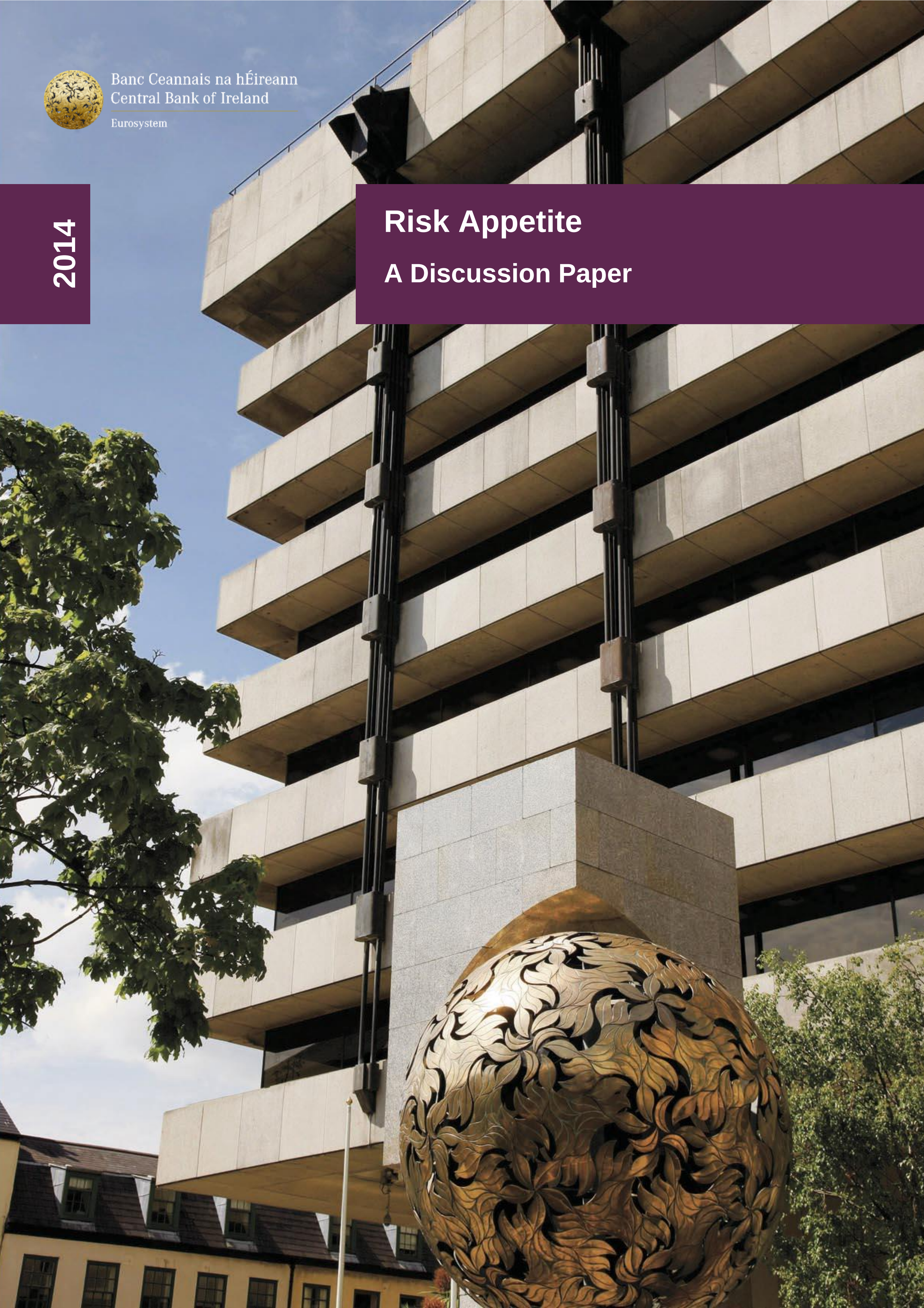
Risk Appetite

A Discussion Paper



Contents

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Policy and Risk Directorate.

1 About this paper

The purpose of this paper is to generate discussion and debate with Central Bank stakeholders on risk appetite, its linkage with organisational strategy and its importance for financial institutions. The main concepts and theories of risk appetite and its place within Risk Appetite Frameworks ("RAF") are considered. Finally, the paper provides some suggestions as to what a risk appetite statement might contain.

The paper is aimed primarily at directors and then at senior management within organisations regulated by the Central Bank. It is acknowledged that there are varying degrees of knowledge with respect to risk and the management of risk. For some individuals the concepts outlined in this discussion paper will be well understood, for others perhaps less so. However, the view of the Central Bank is that the Board is ultimately responsible for risk management and strategy. The central message of this paper is that risk appetite must be considered with strategy because they are so deeply interlinked. The board is responsible for both.

This paper is intended to be the first in a series of initiatives on elements of risk appetite.

It is the aim of this paper to advance understanding as to what an effective risk appetite encompasses and in doing so to contribute to a clearer vision of what organisations are hoping to achieve in their Risk Appetite Statements. Individuals and organisations are encouraged to respond to the paper with their own views on the subject.

Contributing to the discussion

This paper is a discussion paper. There are a number of questions included as a guide, but responses should not necessarily be limited to these. Comments from all interested parties are welcome. The Central Bank is interested in the views of financial institutions, non-financial corporates, directors, professional advisors, academics and researchers as well as those with expertise in the risk management professions. This paper will be open for comment until 1 September, 2014.

Submissions should be made to riskappetite@centralbank.ie

2 Background

Many of the crises at financial institutions in the past decade have been seen as a failure of risk management coupled with an inappropriate funding structure and/or insufficient capital. How many of the organisations that were involved in the various crises had considered whether the strategy pursued was appropriate for its risk capacity? Is it the case that the strategic and tactical planning of organisations occurred without a meaningful consideration of risk appetite?

A fundamental principle underpinning both risk management and strategy formulation is that the Board must understand the risks to which the institution is exposed and to establish a RAF for the institution.

Whilst it is easy to focus attention on a quantifiable issue such as a capital or funding deficit, it is significantly more challenging for organisations to assess what is the prevailing culture and whether this culture is consistent with the organisation's risk appetite. Evidence suggests that misalignment between risk appetite and strategic objectives persists in the absence of a strong clear risk culture.

Reviews of Risk Appetite Statements ("RAS") conducted by the Central Bank have found that these statements were of a mixed quality and raised questions over the adequacy of skills, experience and knowledge of members of Risk Committees collectively. Furthermore, the Financial Stability Board's ("FSB") progress report[1]on enhanced supervision (issued in October 2011) noted that effective Risk Appetite Frameworks that are "actionable and measureable" by both organisations and supervisors had not yet been widely adopted. The report recommended that supervisors discuss expectations of what a "good" risk appetite framework should encompass and how to supervise against these expectations.

The RAF is the "overall approach, including policies, controls and systems, through which risk appetite is established, communicated and monitored."[2] The RAF demonstrates the implicit link between risk appetite and strategy. In doing so, it defines the risk limits and tolerances around those limits. The RAF also clarifies the action required in the event of a breach of risk limits and risk tolerance. Finally, it specifies the roles and responsibilities of the officers that are responsible for the implementation of the RAF.

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[1] http://www.financialstabilityboard.org/publications/r_111104ee.pdf.

[2] http://www.financialstabilityboard.org/publications/r_131118.htm.

One way in which the perceived deficiencies within RAS may be addressed is by providing industry with a generic checklist setting out the expected content of the statement and against which the Supervisor would be able to tick off whether these requirements have been met. We do not advocate such an approach as it implies that organisations design RAF and RAS in response to regulatory requirements. The risk appetite of an organisation must express the strategy of that organisation through desirable and undesirable risk exposures. A generic list that is provided as a response to regulation is unlikely to achieve this. A further risk is that companies would create boilerplate statements without due consideration to the real risks facing their organisations.

The strategy and risk appetite of an organisation are interlinked. "Risk appetite is as much about enabling an organisation to take on calculated risks in pursuit of . . . long term strategy as it is about placing constraints on activities."[3] In that sense the RAS allows an institution to demonstrate to stakeholders that achievement of results stem from deliberate strategy and risk allocation as opposed to happenstance. It is the view of the CBI that organisations should view a risk appetite statement as a positive and dynamic document.

Following a peer review on risk governance launched by the FSB and published in February 2013, a consultative document entitled "Principles for An Effective Risk Appetite Framework"[4] was published in July 2013. This was followed by a paper of the same name in November 2013.[5] The approach taken by the FSB in relation to risk appetite has influenced the direction taken in this discussion paper.

[3] Milliman, (January 2011), Formalising Risk Appetite – a key element of enterprise risk management.

[4] http://www.financialstabilityboard.org/publications/r_130717.pdf

[5] http://www.financialstabilityboard.org/publications/r_131118.htm

Questions on Risk Appetite Statements

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

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

3. **How are risk appetite and strategy related?**

4. **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?**

3 Risk appetite

3.1 Why establish risk appetite?

Exposure to risk is an inevitable part of doing business. What differentiates a successful business from one that is not is the ability to take on calculated risks in order to realise strategic goals. The goals achieved and the risks undertaken to achieve them should be demonstrable to stakeholders. The RAS enables the organisation to demonstrate that the achievement of its strategic goals has not been the result of luck.

Setting a risk appetite is not about elimination of all risks; rather it is about embracing risks in areas in which management has the appropriate skills, knowledge and experience to take advantage of the opportunities presented, whilst limiting risks in other areas. When considered with strategy this explains why an organisation 'does' and 'does not' do what they do.

A clearly defined risk appetite provides the directors, management and staff with a framework which facilitates the identification and management of both risks and opportunities. Clear and concise strategic objectives should underpin the RAS. Even though this implies that risk appetite and strategy are interlinked, it is clear that one does not lead the other; risk appetite and strategic planning occur and evolve in parallel.

An effective risk appetite statement is empowering in that it enables the decisive accumulation of risk in line with the strategic objectives of the organisation while giving the board and management confidence to avoid risks that are not in keeping with the strategic objectives.

3.2 Establishing a common risk language in the organisation

3.2.1 Defining risk appetite - a common challenge

Since the financial crisis many financial institutions have developed RAF's against which they seek to measure the risks that the organisation is exposed to. The articulation of a clear and meaningful risk appetite is a key step in the establishment of any RAF. While the term risk appetite has been in use for a number of years a common challenge remains in that there is no single agreed definition. Good practice necessitates that the directors of a financial institution document the institution's risk appetite. However, unlike certain other international supervisors, the Central Bank does not currently define what is meant by risk appetite.

Following a literature review on the subject it is apparent that while different organisations apply similar definitions to the term risk appetite, the associated terms used when describing risk appetite such as risk tolerance, risk limits, risk capacity and risk culture have different interpretations which result in different approaches to risk management.

There are a variety of risk management standards available which organisations may apply, many of which contain different definitions of risk appetite and risk tolerance. Appendix 2 gives details of some of the definitions of risk appetite that are used by National Competent Authorities and risk management standards.

A common thread linking these definitions is that risk appetite is set on the basis that the organisation must accept a certain level of risk so as to achieve its strategic goals. The Central Bank considers that the FSB definition of risk appetite is suitable for the majority of organisations.

Risk Appetite: The aggregate level and types of risk an organisation is willing to assume within its risk capacity to achieve its strategic objectives and business plan.

The Risk Appetite Statement is the formal articulation of an entity's willingness to take on certain risks and avoid or minimise other risks in the pursuit of its strategic objectives.

3.2.2 Risk capacity

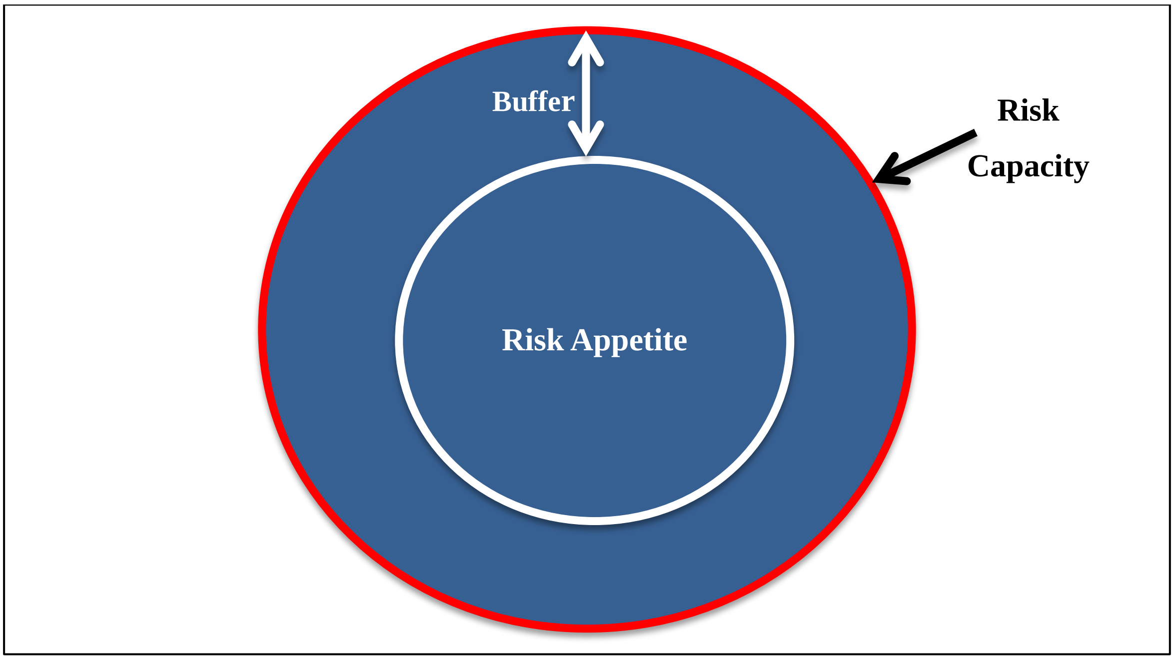
Risk Capacity is the maximum amount of risk which the organisation is technically able to assume before breaching one or more of its capital base, liquidity, borrowing capacity, reputational and regulatory constraints.

Setting risk appetite without taking into account the risk capacity of the entity may have serious consequences. The board and management should understand how the risk capacity impacts on the business. Risk capacity may be easy to quantify in terms of capital or required funding but it is more challenging to consider the point at which an organisation's reputation is beyond repair.

The board needs to understand the risk capacity of the organisation prior to framing strategy and setting risk appetite. The risk capacity represents the upper limit beyond which a breach is likely to result in failure (see figure 1 below).

Sound practice is for organisations to set a series of buffers around risk appetite such that a breach of risk appetite does not necessitate the failure of an institution. These buffers become an important management information tool in that they assist in the identification and communication of adherence to or breaches of stated risk appetite, which taken in aggregate may result in a breach of risk capacity.

Figure 1 – Contextualising Risk Capacity and Risk Appetite



3.2.3 Risk tolerance and risk limits

During the Central Bank's research, it became apparent that risk appetite, risk tolerance and risk limits are phrases which are frequently used interchangeably by organisations for the purposes of developing their own RAF. Far from having the same meaning each of these concepts describes a different dimension of the overall risk framework and, therefore, a clear distinction should be drawn as to the exact context of each of these risk dimensions.

As in the case of risk appetite, there are several different definitions of risk tolerance put forward by the various regulatory authorities and risk management standard setters as evidenced in Appendix 2.

Risk limits should clearly set out the qualitative or quantitative parameters used in assessing a specific category of risk and also a measurement of the aggregate amount of that risk. Risk limits need to be measurable and specific. **Risk tolerance** refers to the acceptable variability around the risk limit. There will be many reasons why some tolerance around limits is appropriate. In all cases, however, the Board should have a clear understanding of how much risk it is willing to tolerate against the level of risk that it is willing to accept. Boards may consider building both upper and lower tolerance bands around risk limits. This is to ensure that the organisation is taking sufficient risk in order to achieve strategic goals.

3.2.4 Use of Risk Limits

Organisations require appropriate information systems in order to have appropriate and timely data on how much risk is being taken by the organisation. The information is used not only to monitor risk limits but also to ensure that the organisation is taking a sufficient amount of desirable risks in order to achieve its strategic objectives.

A breach of a risk limit will typically act as a trigger for corrective action. Business units need to be aware of the existence of risk limits and the consequences of breaching such limits. Once a risk limit is breached, a series of actions is triggered that are designed to correct the breach. This can be thought of as a flashing amber light in terms of warning levels. The key is to provide business unit management with a decision point as to whether or not to continue to pursue a certain course of action.

Breaching a risk tolerance threshold should serve as an alert for management resulting in actions being taken to reduce the risk position. A clearly defined escalation process should be put in place which allows such actions to be taken in a timely manner, including notification of the appropriate authorities that a breach has occurred and the timely execution of steps to remedy the situation. Management needs to obtain a clear understanding of what led to the breach and then, based on that, corrective measures may be taken where necessary.

In either case remuneration, promotion and disciplinary structures serve to reinforce risk culture. For a risk appetite to be mirrored in the culture of an organisation then it must be supported through the incentive structure of that organisation.

Breaching a risk limit should typically represent a ‘yellow alert’ for management whilst the breach of a risk tolerance should serve as a ‘red alert’. The risk position must be brought back within the limits outlined in the risk appetite statement and such breaches may have other implications including triggering the requirement to notify the Central Bank of the breach.

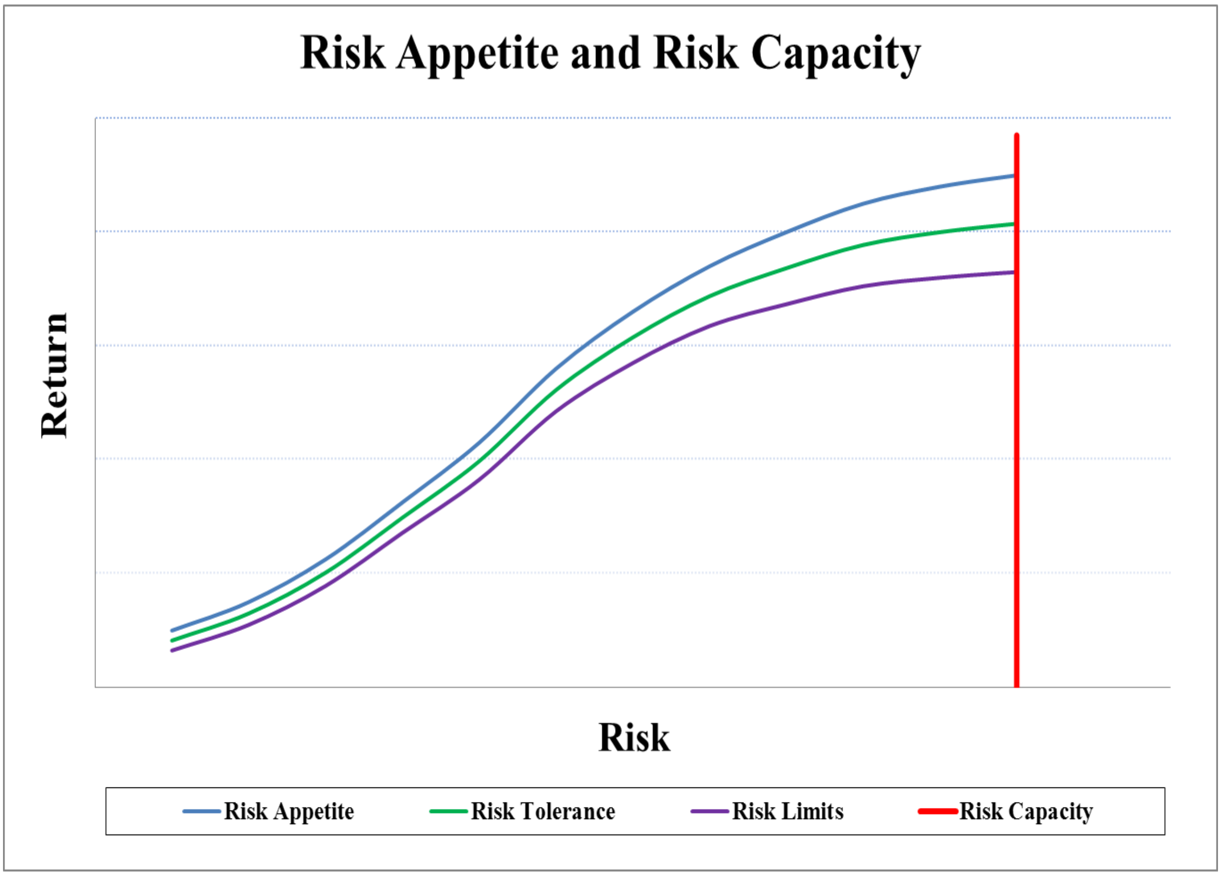
3.2.5 Use of Risk Tolerance

Risk tolerances should be set such that they remain within the risk appetite even if they are exceeded but may be flexible enough to permit increased risk taking (whether by choice or because of market changes) in one or more areas or businesses without requiring an equal offset of risk from others.

3.2.6 Risk taxonomy – the hierarchy

The following graphic (**Figure 2**) illustrates the relationship between risk capacity, risk appetite, risk tolerance and risk limits. The red vertical line represents risk capacity. This is the absolute maximum amount of risk that the organisation can take at this point in time, regardless of the opportunity that is available. The blue line represents risk appetite and the purple line represents risk limits. The risk limits line is below the risk appetite line for all risk and return points. This is because risk appetite is the sum total of the organisations risk limits plus a buffer (risk tolerance) for prudence. Risk tolerance is represented by the green line.

Figure 2 – Risk and return – the relationship



The risk return trade off in figure 2 illustrates that the strategic goals of an organisation cannot be achieved without taking risk. The amount of risk that an organisation can take is expected to be commensurate with the return available up to a maximum of amount of risk that the organisation can bear at any one time. It is the duty of the board to consider what represents an acceptable and an unacceptable risk in the context of the organisations strategy.

Questions on Risk Appetite, Risk Tolerance and Risk Limits

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

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

3. **How does your organisation use risk limits and risk tolerances around those limits?**

4. **How does your organisation facilitate early warning reporting of potential breaches of risk appetite?**

4 Responsibility and Risk Culture

4.1 Risk culture and risk appetite

A clear RAS is a necessary condition for an effective RAF but it is not sufficient on its own. An effective RAF is often best evidenced through an assessment of the culture, in particular the risk culture, of an organisation. The FSB/IIF define risk culture as “the norms of behaviour for individuals and groups within an organisation that determine the collective ability to identify and understand, openly discuss and act on the organisations current and future risk.”

An organisation with a strong risk culture is one where employees, management and the board clearly understand what risks should be accepted and what risks should be minimised or avoided. There should be no confusion as to where the limits and tolerances lie. Communication is encouraged regarding risk accumulation and risk measurement. The desired culture is enforced through behaviour from management and directors as well as the use of incentives and sanctions.

The extent to which the risk appetite of the organisation is evidenced by the behaviour of individuals in that organisation is a key factor in reinforcing risk culture. Rewarding employees and management for achieving goals that were attained by breaching risk limits undermines the effectiveness of the RAF. When assessing the RAF of an organisation one should question ‘whether the end justifies the means’.

4.2 Board responsibility

The role of the Board is to ask the following basic question when setting strategies and expressing risk appetite; 'in pursuing our objectives which risks are we willing to take and which risks do we seek to avoid?’. The responsibility for risk is not simply the risk management and compliance function. Effective risk management begins with the identification, acceptance and management of risk at the board level, carried through the management function and operationalized in the front office. Boards must have the flexibility to change the organisation’s risk appetite in response to a dynamic environment; that flexibility should be exercised with responsibility. However a board would regularly change the risk appetite so as to accommodate regular breaches (or near breaches) of risk appetite may suggest of a lack of understanding of risk appetite and its connection with strategy.

4.3 Setting accountability

In the most effective risk cultures, risk is the responsibility of all individuals within the organisation. Regardless of who identifies a potential risk to the organisation, actions which are timely, appropriate and proportionate are taken to mitigate the risk. For risk mitigation to be effective individuals need to understand their responsibility upon encountering a potential risk.

Strengthening roles and responsibilities throughout the organisation in respect of risk management and enhancing the communication and training around risk has a significant impact on embedding a strong risk culture within the organisation. All individuals must be accountable for their actions and initiatives should be put in place which consistently reinforces the desired behaviours within the organisation.

The Consultation Paper on "Principles for An Effective Risk Appetite Framework" published by the FSB in July 2013 set out in detail the roles and responsibilities of the Board, the Chief Executive Officer (CEO), the Chief Risk Officer (CRO) and the Chief Financial Officer (CFO) with respect to establishing and approving an organisation's RAF.

All organisations should clearly define and document the roles, responsibilities and formal reporting structures for the identification and management of material risks throughout the organisation's operations.

Questions on Risk Culture and responsibility

1	**How does your organisation assess risk culture?**
2	**What are the challenges that organisations face in terms of communicating risk culture to stakeholders?**

5 Expressing risk appetite

5.1 Characteristics of an effective risk appetite statement

The Central Bank does not wish to recommend a prescriptive approach on what should or should not be in a RAS. It is the responsibility of the board of directors to express the organisation's risk appetite and understand how it relates to the organisation's strategy. That said it may prove helpful to outline what may be some high level characteristics of an appropriate RAS.[6]

Risk Capacities: Does the organisation understand the current limits to its risk capacity?

Desirable Risks: What risks does the organisation wish to actively take? Strategically, this is why the organisation exists. How does the organisation optimise these risks in order to generate a return?

Undesirable Risks: What risks does the organisation wish to avoid? Strategically, what does the organisation not do?

Unavoidable Risks: How are these risks managed?

Interlinkages: How do risks identified influence other risks?

Risk timelines: Is consideration given to the risks that may materialise over short, medium and longer term horizons?

What ***information, controls and systems*** do the board, executive management, line management and employees actually require in assessing the nature of risks and how they relate to on-going strategic choices?

Incentives and Compensation: How are the strategic choices and attendant risks linked to incentives and compensation? Culturally does the organisation reward the attainment of risk adjusted return or simple return?

Escalation and mitigation: How are risks that are outside of risk appetite identified, communicated and mitigated?

Brevity and Clarity: Is it possible to communicate the appetite concisely in an understandable form?

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[6] We are grateful to Michael Alix, Federal Reserve Bank of New York for insights in this area.

Importantly, the RAS needs to be simple and understandable by all of the organisation's stakeholders. It is generally unhelpful if a RAS is overly long or requires in depth specialist expertise in order to understand the concepts contained therein. The RAS is most certainly not a list of risk limits; rather it is supported by risk limits. The RAS is expected to be a forward looking and dynamic document that over time reflects changes in the internal and external environment.

5.2 *Disseminating a single definition of Risk Appetite*

An essential starting point for establishing a RAS should be clearly defining a single view of what risk appetite means for the organisation as a whole, how it will be used and what the expectations of the board relating to risk appetite are. The board should agree and document a single definition of risk appetite, risk tolerance and risk limit for use across all business units in the organisation. How risk appetite and strategy are linked is required to be understood by the board and communicated across the organisation.

Good practice is to establish a RAS consisting of an over-arching central risk appetite supported by a number of narrower risk limits which are contextualised by the nature of the risk category to which they relate. Sensible risk tolerances are then built around these limits.

It is expected that risk appetite drives strategic decisions at Board level. At Senior Management level, risk tolerance is used to set boundaries which facilitate tactical decisions based on the organisation's strategy but also ensures the level of risk taken on is being monitored. At an operational level, risk limits act to constrain or guide the activities of the business units to which they apply.

It is sound practice for organisations to develop and disseminate a glossary of commonly used terms. This encourages the use of a common risk language allowing for the consistent implementation, application, monitoring and measurement of risks. This is seen as a key pillar toward building and reinforcing sound risk culture throughout an organisation. This common language of risk should extend beyond the definitions applied to risk appetite and risk tolerance to include a common view of the criteria to be applied by the organisation for the identification of risks, monitoring and reporting and all other areas which are considered fundamental to the development, implementation and operation of an effective RAF.

5.3 Metrics

An appropriate RAS describes the level of risk that is both desirable and undesirable. When an organisation sets its risk appetite it needs to establish thresholds for reporting on risk events to Management and the Risk Committee. These thresholds are a series of metrics that drive the nature and extent of the organisation's response to risk events based on their perceived severity in relation to risk tolerances. Such metrics will show:

- How much risk within an individual risk limit is being consumed?
- How has that allocation of risk changed?
- Is the limit close to a breach?
- How certain risks are related to other risks?
- What happens in the event of a breach of risk limit?
- When does it become acceptable to tolerate a breach of risk limit that lies within risk tolerance?
- How is this monitored?
- Under what set of circumstances does a tolerance for a breach of risk limit conclude?

Risk limits and other metrics do not by themselves indicate an effective RAF. For example, two organisations may have a similar RAS and similar risk limits; the organisation that monitors limits and escalates breaches will have a very different outcome to one that consistently ignores limit breaches. The difference between both is the organisation's risk culture.

Determining metrics is challenging for risk management functions as the provision of too few metrics does not provide the Board and Senior Management with sufficient information to make informed decisions whereas too many metrics may overwhelm the ability of the business units to prepare the information and potentially result in confusion at the top levels of the organisations. A key question the board should ask is whether IT systems are fit for purpose in terms of risk reporting. The business of financial services is in a large part the business of risk intermediation. Systems need to be designed and updated so that they are ready to support the overall business strategy in this area.

The RAF should establish a series of quantitative measures that can be used by the board to distinguish between acceptable and unacceptable risks. Not all risks lend themselves to be easily quantified. There are referred to as hard to measure risks. This difficulty in measurement should not stop the organisation from registering these risks and developing a clear qualitative frame of reference which sets out their appetite for taking-on or avoiding risks of this type. Examples of measures which may be of use include the use of qualitative statements to express the organisation's appetite for taking on or seeking to avoid a certain type of non-quantifiable risk, setting out example behaviours (both desirable and non-desirable) or establishing probability and impact boundaries which clearly set out the Board's expectations in respect the organisation's stance in respect of such risks.

Questions on expressing risk appetite

1	**The Central Bank has suggested characteristics of an effective risk appetite statement. How would you improve this?**
2	**How does your organisation determine the metrics that are most appropriate for your business?**
3	**How has the use of metrics changed in your organisation?**

6 Conclusion

This discussion paper outlines what the Central Bank considers to be a useful roadmap for staging a discussion with stakeholders regarding risk appetite. Organisations should see the benefits to having an effective RAF that explains what risks will be taken in order to achieve the strategic objectives. While some financial institutions are required to produce a RAS in compliance with regulations, the Central Bank feels that all organisations should accept the need for an effective RAF. The Central Bank is keen to encourage dialogue on the issue of risk appetite and encourages organisations to share their views on the subject.

Appendix 1: Definitions of Risk Appetite

Source	References to risk appetite
Supervisors	
Australian Prudential Regulation Authority (APRA) (Australia) Prudential Standard - SPS 220 Risk Management[7] (July 2013)	… (a) **the degree of risk that the RSE (Registrable Superannuation Entity) licensee is prepared to accept in pursuit of its strategic objectives**, giving consideration to the interests of beneficiaries (risk appetite);
Office of the Superintendent of Financial Institutions (OFSI) (Canada) Guideline – Corporate Governance - Sound Business and Financial Practices[8] (January 2013)	The risk appetite statement reflects the **level of aggregate risk that a FRFI (Federally Regulated Financial Institution) is willing to assume and manage in the pursuit of the FRFI's business objectives**.
Autorité des Marchés Financiers (AMF) (France) Integrated Risk Management Guideline[9] (April 2009)	Risk appetite refers to a broad notion whereby a financial institution determines **the aggregate level of risk it can assume or accept in connection with its strategic objectives.**
Nederlandse Vereniging van Banking (NVB) (Netherlands) Banking Code[10] (September 2010)	Risk appetite (in Dutch: risicobereidheid) refers **to the amount of reasonably foreseeable risk that the bank – given its proposed activities – is prepared to accept in the pursuit of its objectives.**
Institute of Directors Southern Africa King Code of Governance for South Africa[11] (2009)	**The level of residual risk that the company is prepared or willing to accept without further mitigation action being put in place, or the amount of risk the company is willing to accept in pursuit of value.**
Standards & Guidance	

[7] http://www.apra.gov.au/Super/PrudentialFramework/Documents/Final-SPS-220-Risk-Management-July-2013.pdf

[8] http://www.ecgi.org/codes/documents/osfi_cg_guidelines_jan2013_en.pdf

[9] https://www.lautorite.qc.ca/files/pdf/reglementation/lignes-directrices-toutes-institutions/2009mai25-ld-gestion-integree-des-risques-en.pdf

[10] http://www.nvb.nl/en/media/document/000601_code-banken-uk.pdf

[11] http://african.ipapercms.dk/IOD/KINGIII/kingiiireport/

Source	References to risk appetite
Financial Stability Board (FSB) Principles for An Effective Risk Appetite Framework[12] (July 2013)	**The aggregate level and types of risk an organisation is willing to assume within its risk capacity to achieve its strategic objectives and business plan.**
European Insurance and Occupational Pensions Authority (EIOPA) Final Report on Public Consultation No. 13/008 on the Proposal for Guidelines on the System of Governance[13] (September 2013)	**Risk appetite addresses the attitude of the AMSB (administrative, management or supervisory body) toward the main categories of risks.** It needs to be clear and detailed enough to express and reflect the strategic high level objectives of the AMSB.
European Banking Authority (EBA) EBA Guidelines on Internal Governance ("GL44")[14] (September 2011)	'Risk tolerance/appetite' is a term that embraces all relevant definitions used by different institutions and supervisory authorities. These two terms are used here interchangeably to describe both the **absolute risks an institution is a priori open to take (which some call risk appetite)** and the actual limits within its risk appetite that an institutions pursues (which some call risk tolerance).
Basel Committee on Banking Supervision Operational Risk – Supervisory Guidelines for Advanced Measurement Approaches[15]	Risk appetite is a high level determination of **how much risk an organisation is willing to accept taking into account the risk/return attributes**; it is often taken as a forward looking view of risk acceptance.

[12] http://www.financialstabilityboard.org/publications/r_130717.pdf

[13] https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP08-13/EIOPA-13-413_Final_Report_on_CP8.pdf

[14] http://www.eba.europa.eu/documents/10180/103861/EBA-BS-2011-116-final-EBA-Guidelines-on-Internal-Governance-%282%29_1.pdf

[15] http://www.bis.org/publ/bcbs196.pdf

Appendix 2: References to Risk Tolerance and Risk Limits

Source	**References to risk tolerance**
Supervisors	
Australian Prudential Regulation Authority (APRA) (Australia) Prudential Standard - SPS 220 Risk Management[16] 15 November 2012	(b) for each material risk, **the maximum level of risk that the RSE licensee is willing to operate within** expressed as a risk limit that, where possible, is based on a measurable limit of the risk remaining, after taking into account the mitigants for the risk where appropriate (risk tolerance).
Autorité des Marchés Financiers (AMF) (France) Integrated Risk Management Guideline April 2009[17]	Risk tolerance levels refer to **acceptable variations for each of the risks identified** in connection with the fulfilment of the financial institution's objectives.
Standards & Guidance	
European Insurance and Occupational Pensions Authority (EIOPA) Final Report on Public Consultation No. 13/008 on the Proposal for Guidelines on the System of Governance[18] 27 September 2013	b) "Overall risk tolerance limits" expresses **the restrictions the undertaking imposes on itself when taking risks**. It takes into account: i. the relevant constraints that effectively limit the capacity to take risks. These constraints can go beyond the framework of solvency as defined in Solvency II; ii. the risk appetite; and iii. other relevant information (e.g. current risk profile of the undertaking, interrelationship between risks).
Basel Committee on Banking	"Risk tolerance" is a more specific determination of the

[16] http://www.apra.gov.au/Super/PrudentialFramework/Documents/Final-SPS-220-Risk-Management-July-2013.pdf
[17] https://www.lautorite.qc.ca/files/pdf/reglementation/lignes-directrices-toutes-institutions/2009mai25-ld-gestion-integree-des-risques-en.pdf
[18] https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/CP08-13/EIOPA-13-413_Final_Report_on_CP8.pdf

Source	References to risk tolerance
Supervision Operational Risk – Supervisory Guidelines for Advanced Measurement Approaches[19] June 2011	**level of variation a bank is willing to accept** around business objectives that is often considered to be the amount of risk a bank is prepared to accept.

[19] http://www.bis.org/publ/bcbs196.pdf