

## Questions on Risk Appetite Statement

### (1) Should all organisations have a risk appetite framework?

We feel that all organisations should have a risk appetite framework in place. All organisations face risks as a result of the environment in which they operate, the strategies which they pursue and the unique characteristics of the organisation itself. A formalised approach is required to successfully identify and manage all risks. The basis for the successful management of risk is an appropriate statement of a firm's risk appetite to act as a benchmark against which to target and monitor risk. Without engaging in the exercise to define and establish an organisation's risk appetite the risk management process will lack an appropriate anchor.

### (2) What led to your organisation putting a formal RAF in place?

We felt that having a risk appetite framework in place was a core part of the risk management process. It fits well with our belief that the RM process must be a "top down" process.

### (3) How are risk appetite and strategy related?

The two are inextricably linked. Setting strategy without reference to the risk preferences of the organisation will tend to result in either of the following consequences

- a. The strategy will fail because insufficient, or the wrong type of, risk is taken on
- b. The organisation may fail because too much risk is taken on

On one hand each strategy brings with it certain risk characteristics which are a consequence of pursuing that strategy, on the other hand, defined risk appetites will dictate a limited range of strategies which are available to the organisation.

### (4) Would a Central Bank forum recommending best practice be desirable?

A forum representing the diverse range of interests and firm sizes of Irish financial service providers would be desirable. It would be important that the forum considered what would represent good practice standards for the industry as a whole and not just the largest firms.

## Questions on Risk Appetite, Risk Tolerance and Risk Limits

### (1) What definition of risk appetite does your organisation consider to be appropriate?

The definition that we use is as follows – "risk appetite is the amount of risk that the organisation is willing to accept in pursuit of value, the implementation of its strategy and the attainment of its objectives"

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

In our opinion, the risk management process will need to consider all three elements – appetite, tolerance and limits- as necessary elements in the overall risk strategy adopted by the firm. A solution that does not contain due consideration for each of the three elements will be ineffective. Construction of a plan for each element cannot be done in isolation.

There must also be appropriate consideration of the other elements and the firm must reach an understanding of how they interact and influence each other. For example, setting risk limits such that the level of risk taken was above the stated risk appetite for the firm would clearly mean that the limits would only become effective after a point where the amount of risk that was appropriate to the firm's strategy had been exceeded. Similarly setting low risk limits while it may appear prudent may in fact generate longer term business risks as limits that are unnecessarily low relative to risk appetite may impede the achievement of strategic objectives. Tolerance levels that we set also needs to reflect and be proportionate to the risk appetite and limits.

### (3) How does your organisation use risk limits and risk tolerances around those limits?

Our firm tends to place most emphasis on risk limits. We set these in reference to our risk appetite and have definable metrics in order to measure these, and specified consequences that occur if the limits are exceeded. How the firm's risk tolerances are implemented is more subjective. Our risk tolerances are set close to our risk limits. There is a small amount of tolerance that is permitted above risk limits. What this is ultimately a valued judgement of the Risk Manager and the Board.

**(4) How does your organisation facilitate early warnings reporting of potential breaches of risk appetite?**

As a result of the firm's small size, concentrated investment activities and frequent meetings of our Investment and Management Committees there is widespread and timely knowledge of the risk that the firm is taking on and how this relates to our Risk Appetite.

## **Questions on Risk Culture and Responsibility**

**(1) How does your organisation assess risk culture?**

The firm's measures its risk ethos/culture by reference to the following questions

- I. How open are its communications?
- II. How regular are its communications?
- III. How well do all employees understand the firm's risks?
- IV. Are employees encouraged to speak up?
- V. Are the penalties for breaching risk limits effective?
- VI. How are the firm's strategies communicated?
- VII. Are risk limits open and communicated?
- VIII. Does the firm promote ethical behaviours?
- IX. Is there leadership from senior management?
- X. Does the firm promote personal accountability?

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

The primary challenges facing the firm are

- I. Communicating the fact that risk is not necessarily a bad thing and that we are in the business of managing risk
- II. A general lack of familiarity with our type of business and the markets in which we participate
- III. Convincing stakeholders that a small early stage firm such as ours can have a sophisticated and robust risk management framework

## **Questions on expressing risk appetite**

**(1) The Central Bank has suggested characteristics of an effective risk appetite statement. How would you improve this? -**

In the discussion paper the Central Bank provides a list of the high level characteristics of a risk appetite statement. It does not seem possible that a "brief and clear" RAS could be formulated which addresses each of these "characteristics". To effectively treat each of the ten characteristics which are outlined in the discussion paper would require a Risk Appetite Statement running to many pages or a series of lists. We agree that the suggested characteristics should form part of a firm's risk management framework but their inclusion in the RAS in any level of depth would mean that the RAS would inevitably lack simplicity, clarity and brevity. It would cease to

become a “statement” and would take on the characteristics of a policy document. We believe that a RAS which is a high level statement of firm’s relationship with, and attitude to risk would be more effectively for being just that, rather than becoming overly detailed and complex. Communication of the RAS is a critical part of the risk management process. An overly complex and detailed RAS would make this process less likely to succeed.

**(2) How does your organisation determine the metrics that are most appropriate for your business?**

The metrics used are driven by the firm’s activities, its strategies and the metrics that are most effective given the risk being monitored.

**(3) How has the use of metrics changed in your organisation?**

The firm is relatively new and its core activities are largely unchanged since its inception. Hence, our metrics have not changed to any degree.