



Society of Actuaries in Ireland

Risk Appetite – latest developments

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Latest developments



- Focus on effectiveness

- FSB consultation

- New techniques

Focus on effectiveness

What are regulators saying?

What are firms doing?

Effectiveness checklist

Central Bank of Ireland



- Expectation

“... [a] high quality risk appetite statement that is well understood and implemented throughout the firm in practice”

- Observation

“... the quality of what we see, in a range of sectors, is uneven and ... we have been surprised by the lack of rigour and quantification in some cases. This applies to the international sector as well as the domestic one”

International Perspective



- PRA (Prudential Regulatory Authority)

“[a firm’s risk appetite is] to be integral to its strategy, and the foundation of its risk management framework”

- FSB (Financial Stability Board)

“An effective Risk Appetite Framework should provide a common framework and comparable measures across the firm for senior management and the board to communicate, understand, and assess the level of risk that they are willing to accept”

What are firms doing?



Annual Review of Risk Appetite

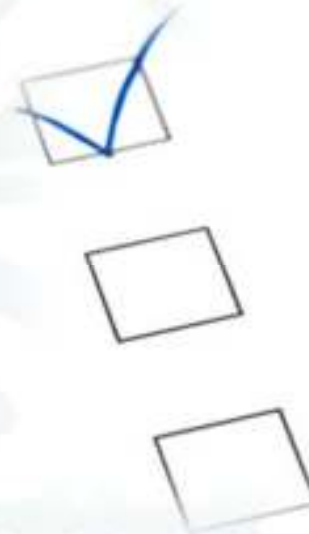
Focus on Solvency II

Linking to strategy – seeking upside

Exploring new techniques

Effectiveness checklist

- ✓ “Use Test”
- ✓ Communication
- ✓ Needs of stakeholders
- ✓ Frequency of breaches
- ✓ Prospective?
- ✓ Measureable?
- ...



It's not all about solvency coverage!

Risk Exposures

Needs of all stakeholders

Understanding the Business

An effective framework

FSB consultation on “Principles for an effective risk appetite statement”

Key points:

Measurable

Communication

Culture

Adaptable

Governance

Forward-
looking

Central Bank consultation on the Corporate Governance Code

Current consultation

- Risk appetite requirements largely unchanged

Key development

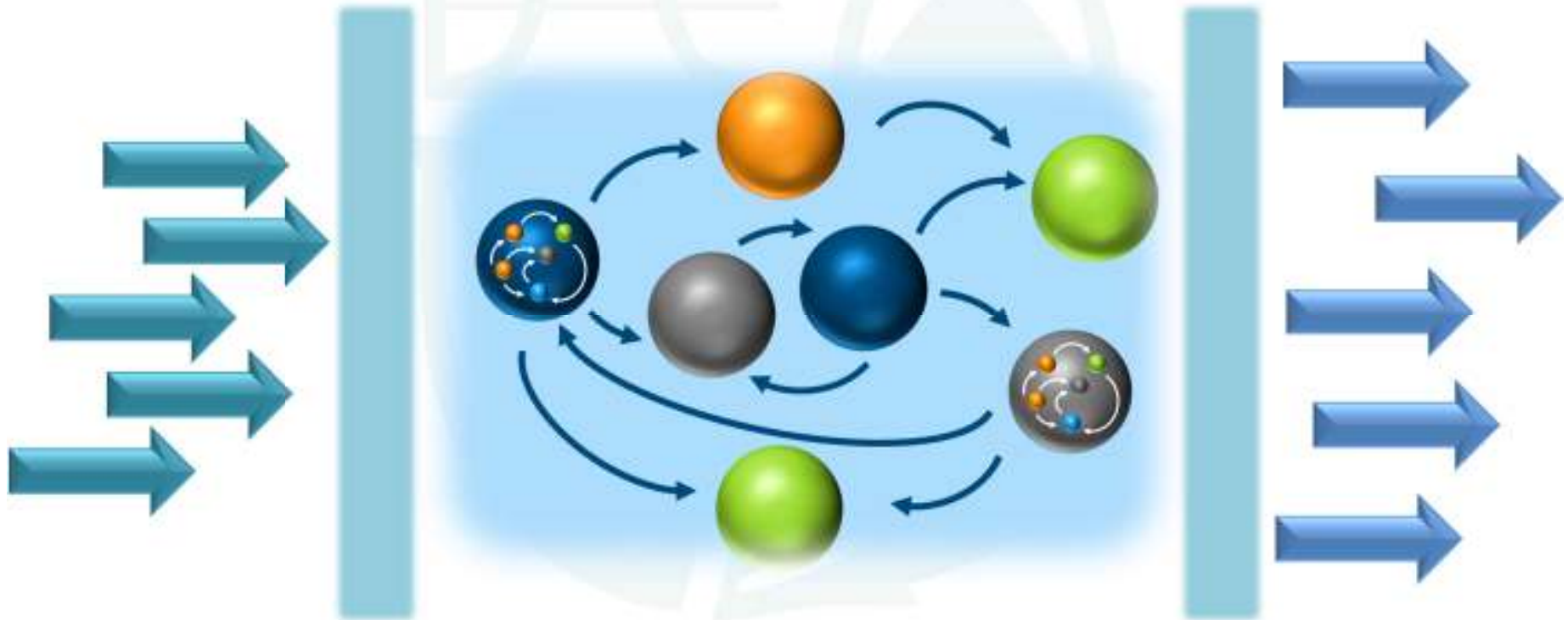
- All undertakings to have a CRO

Complex Systems – another way?

*Need to follow
multiple inputs...*

*...which flow through complex
adaptive interactions...*

*...producing multiple outputs
of different "types"*



The company as a Complex System



Underlying simplicity

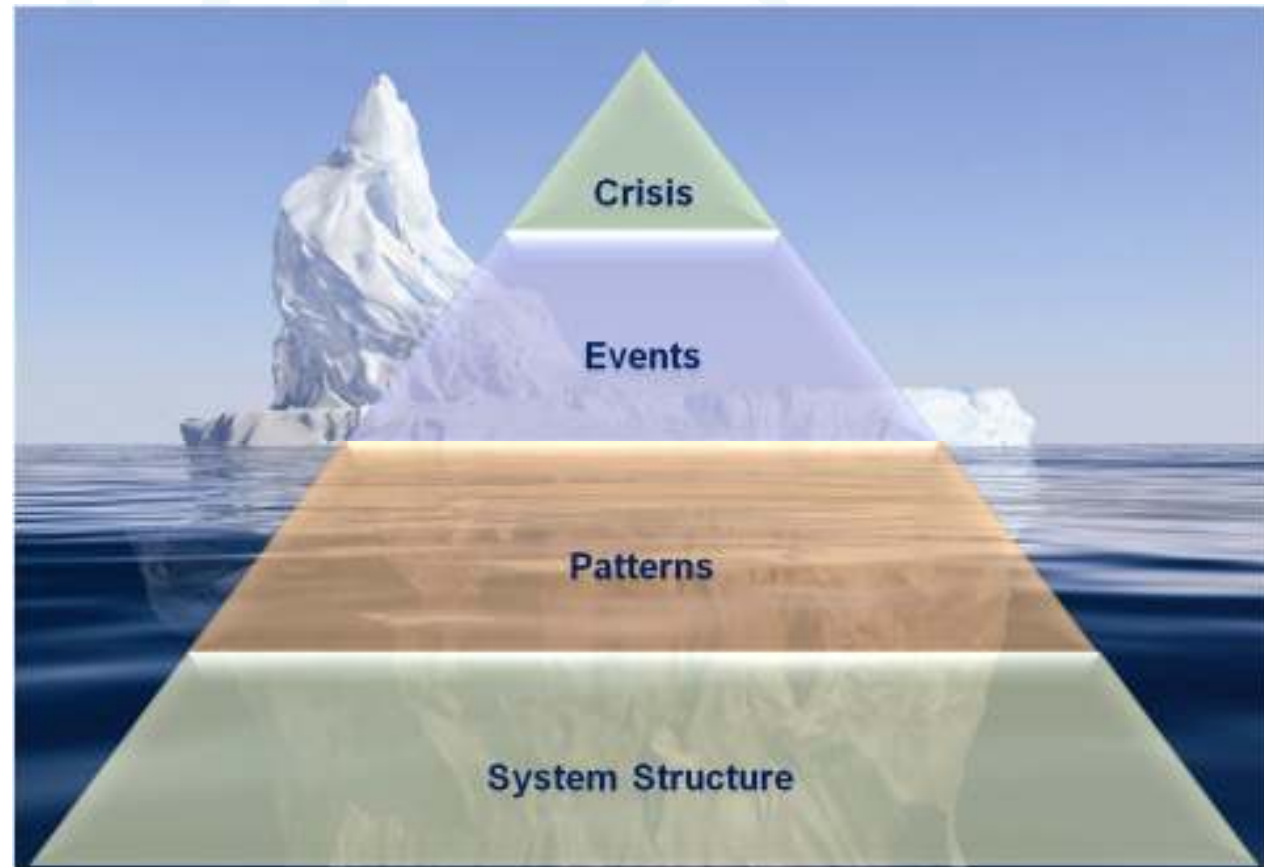
Simple inputs and processes...

...can create messy outcomes

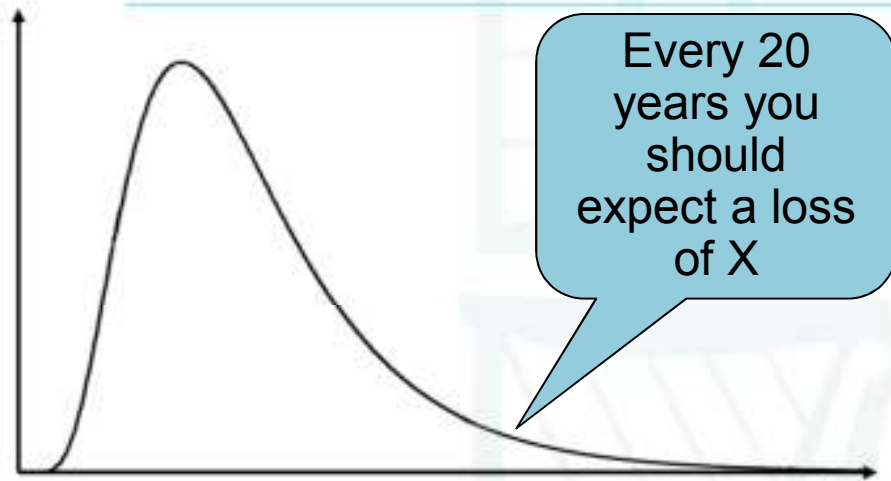


Understanding Uncertainty

Symptoms
↓
Causes
↓
Sense-making
↓
Understanding

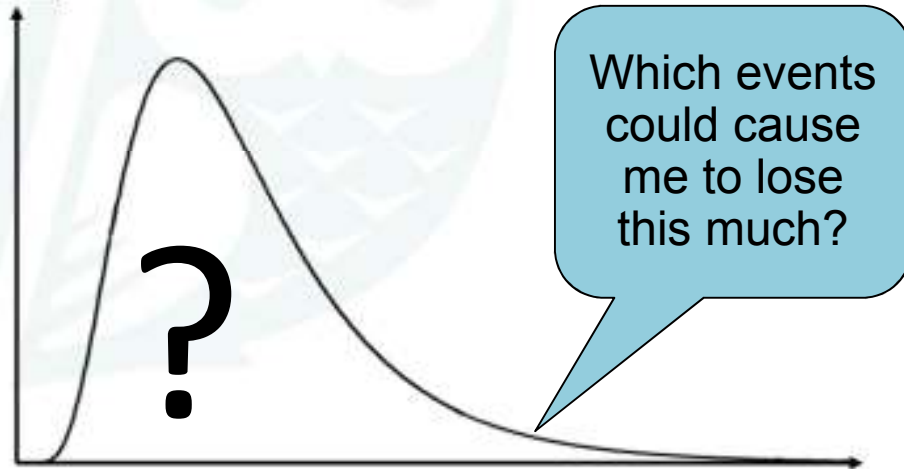


Prediction \neq Explanation

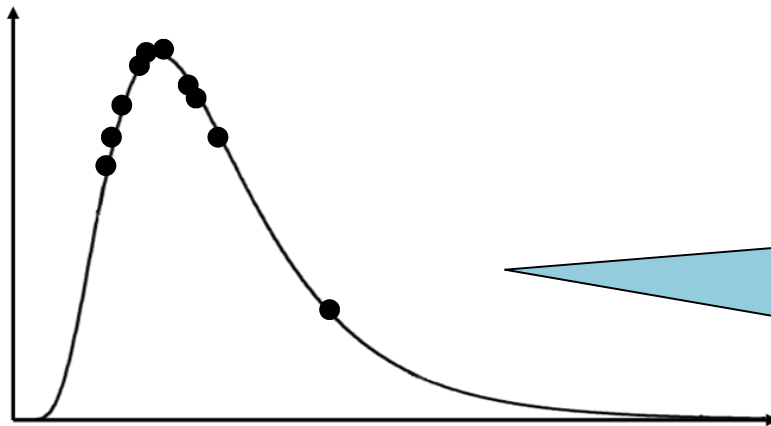


Prediction simply claims that something will happen...

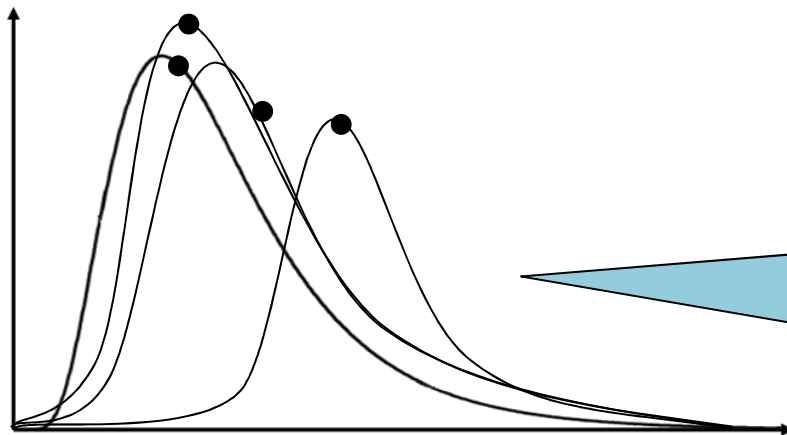
Explanation speaks about how something could happen...



Time series or Evolution?



Each observation is from a single mechanism so if I record observations long enough I will find out what it looks like

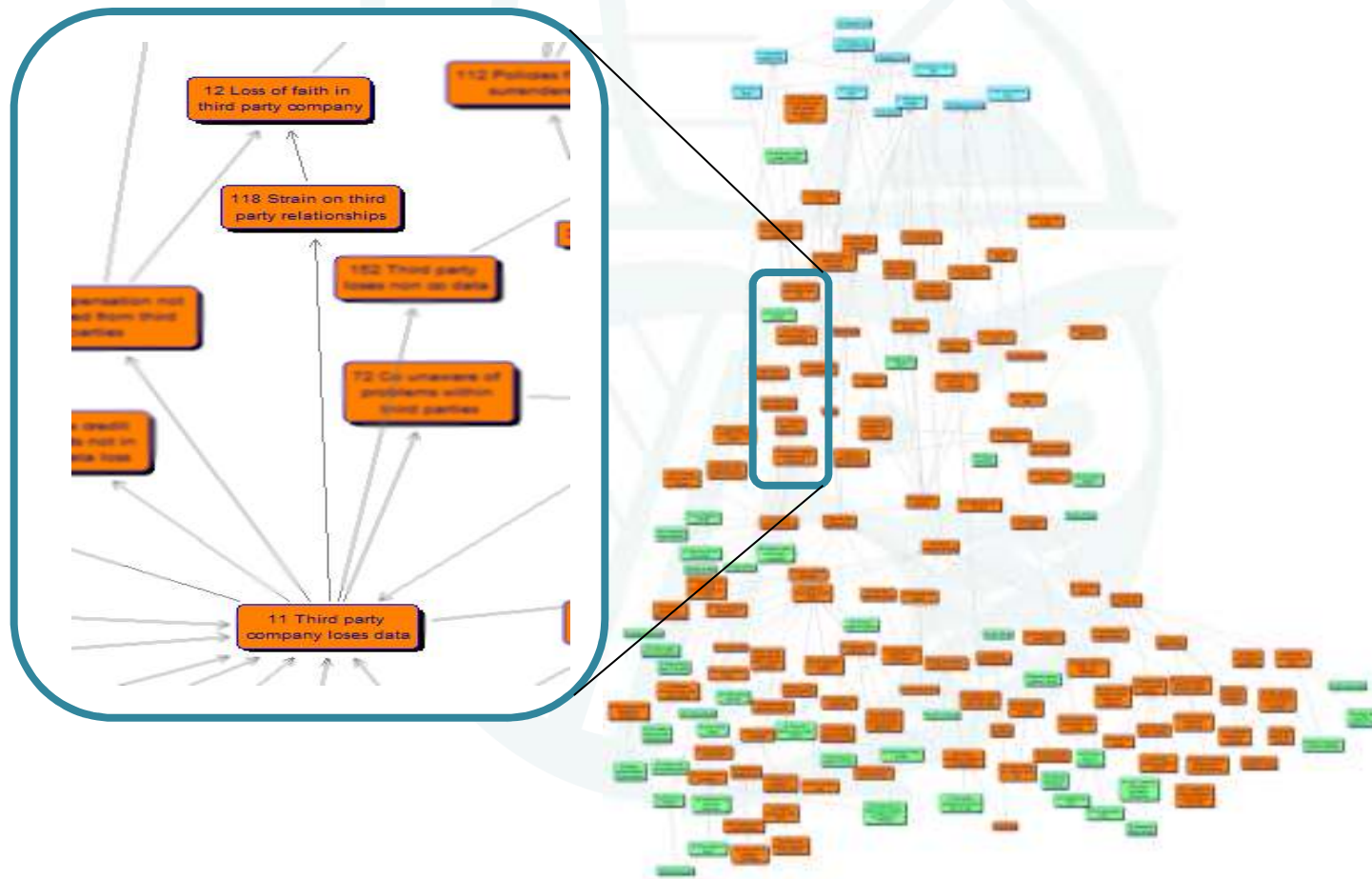


Each observation is from *the latest* mechanism so I need to update my view of what is going on based on each new observation

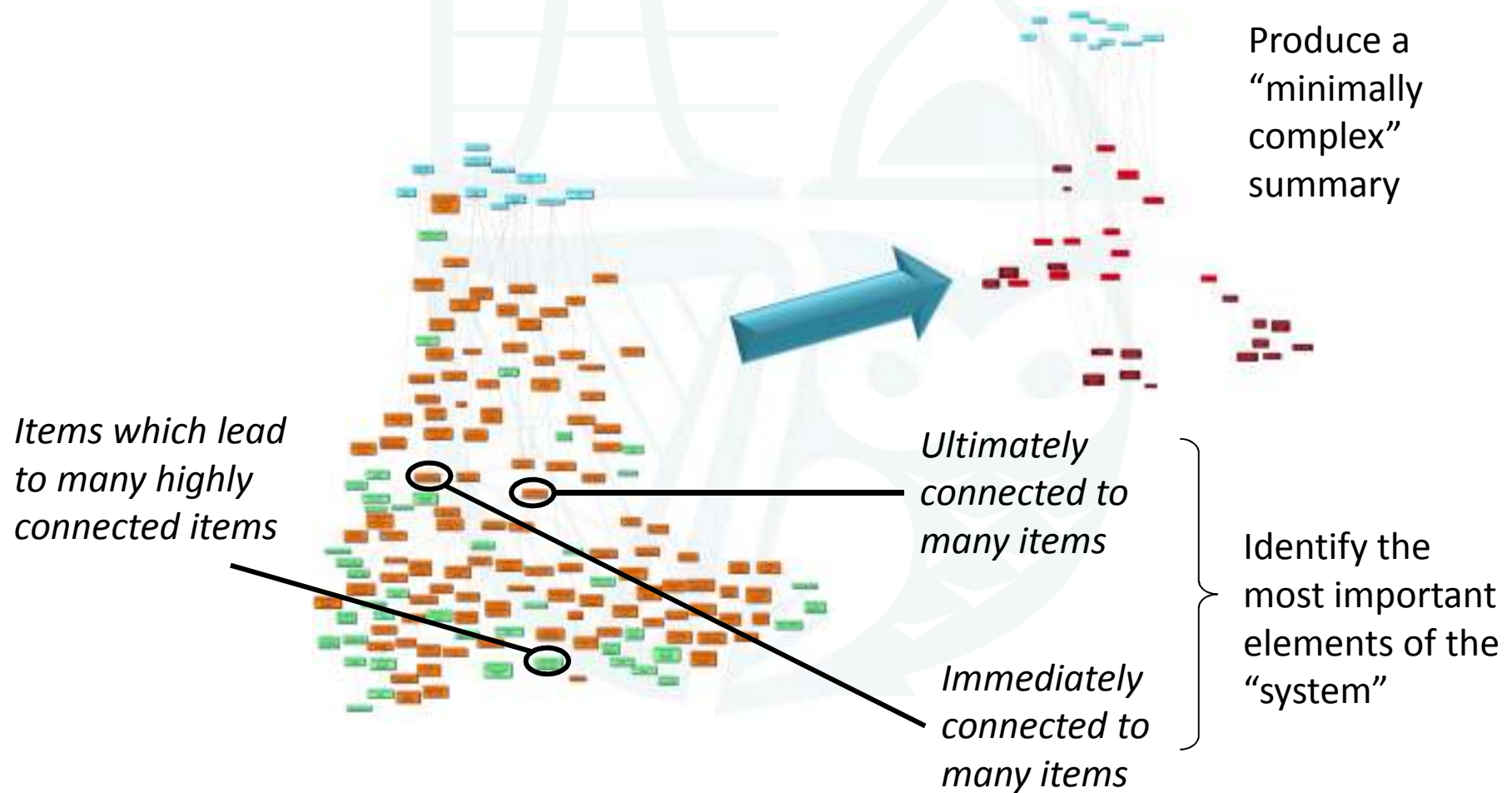
Why Complex Systems?

- Identification of key risk drivers
- Input from experts
- Interaction of risks
- Quantification of hard-to-measure risks
- Understanding and buy-in

Describing the System

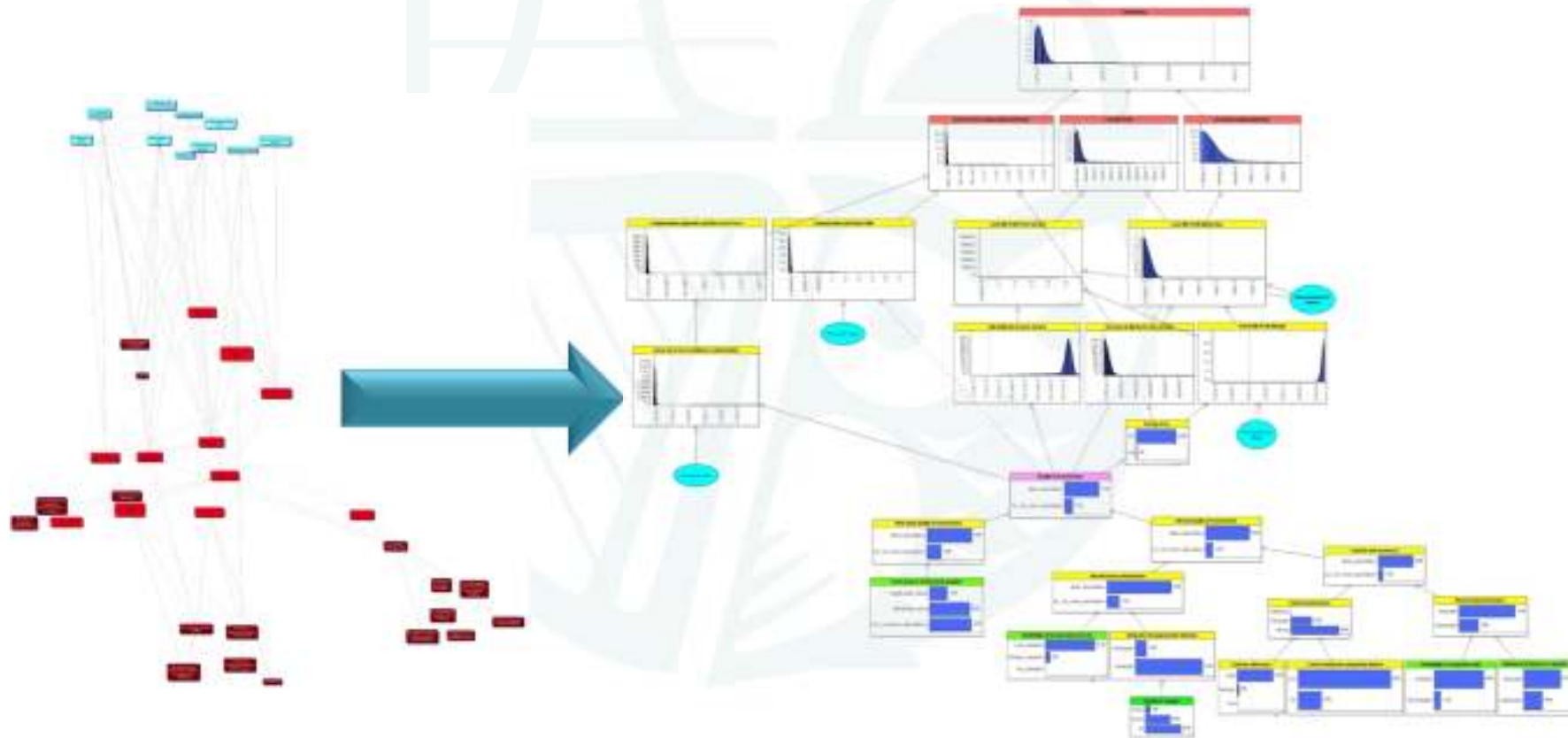


The Analysis Phase



Bringing it to life

Avoid modelling EVERYTHING...but ensure you have the critical behaviours



Source: Produced by Milliman using AgenaRisk™



QUESTIONS?

