Calibrating Your NP's Risk Appetite

Wednesday Webinar: Dec. 5th, 2012

Diana Del Belluz, M.A.Sc., P.Eng.
President of Risk Wise Inc.
diana.belluz@riskwise.ca
416.214.7598

Erin Gloeckner
Project Manager @ NRMC
www.nonprofitrisk.org
erin@nonprofitrisk.org
202-785-3891
Risk Management Resources!

Sign up for our E-News!
www.nonprofitrisk.org

Enroll as an Affiliate Member!
www.nonprofitrisk.org

- Unlimited RISK HELP
- Risk Tips of the Month
- 2013 Webinar Series
- Webinar Vault (90+)

Discounts:
- RM Software
- Custom Webinars
- On-Site Training
- Publications
- SUMMIT Registration

Welcome!
Thank you for joining our risk management center! Our mission is to provide valuable risk management tools and resources to organizations and businesses. To learn more about the center, please visit our website:

http://www.nonprofitrisk.org

The Masterpiece
For dinner, we ordered lasagna.
After two bites, I decided to order pizza instead.
You're probably thinking, Why not just order pizza in the first place?
You're right; I should have ordered pizza in the first place. But I ordered lasagna...
Two Elements to Deciding Priorities

What is your target?
What constitutes success?

Risk Appetite
“I’m so hungry I could eat a horse”

Risk Capacity
“...due to distensible properties of stomach... it can hold up to three liters of food”

Risk Tolerance
“To stay healthy I will eat two slices of cheese pizza and a green salad”

Risk Decision Criteria are Unique to Your Organization

Criteria Depend On:
• Your goals & objectives
• Your values
• Your capacity to manage risk
• Your resilience
Use Risk Criteria to Decide Priorities for Action

#1 Ingredient for Effective Risk Management: CULTURE

What is Risk Management?
“The culture, processes & structures directed towards realizing potential opportunities whilst managing adverse effects.”

AS/NZS 4360: 2004
"Tone at the Top" Matters
How Corporate Culture is Formed

Actions of Leaders

Artifacts (Observable)
(Shared) Values
Tacit Assumptions

Without a risk appetite statement, each risk manager must infer it.
This will cause:
• Wide range of risk criteria interpretations
• Misalignment with desired risk appetite

The Blind Men & the Elephant
Steps for Defining & Applying “Risk Appetite”

1. Define parameters/principles for risk-taking.
2. Calibrate your appetite.
3. Verify that your risk taking culture is aligned with the risk appetite statement.
4. Apply the risk appetite statement when evaluating risks.
5. Review risk appetite statements on a periodic basis.

An Approach for Defining Parameters of Risk-Taking

- Ask leaders and managers for examples of:
  - Past risk-taking decisions that staff & stakeholders agree were appropriate
  - Past decisions that were inappropriate
- Discover the basis of good vs. bad risks:
  - Ask leaders, “What made that an appropriate/inappropriate decision?”

SAMPLE:

- “Feels right” - culture/mission consistency
- Level of due diligence supports an informed decision process
- Right thing to do for patients
- Innovative - Improves patient care, safety, or satisfaction; improves resource efficiency
- Benefits many patients
- Is consistent with evidence-based practices
- Represents good stewardship of resources
- Supports strategic plan
Steps for Defining & Applying “Risk Appetite”

1. Define parameters/principles for risk-taking.
2. Calibrate your appetite.
3. Verify that your risk taking culture is aligned with the risk appetite statement.
4. Apply the risk appetite statement when evaluating risks.
5. Review risk appetite statements on a periodic basis.

Calibrating Risk Appetite 1.0:

The search for a single criterion...

- Setting boundaries on an impact-likelihood grid
- Economic capital measures
  - Financial institutions set aside ‘buffer’ capital to help absorb unexpected losses
- Changes in credit ratings
- Profit and loss measures
- Corporate value
  - Probability of ruin or default
- Limits / targets or thresholds for key indicators
  - 5% in profit or ±2.5% variation in revenue

Source: “Research into the Definition and Application of the concept of risk appetite”. Marsh and University of Nottingham, commissioned & published by atmec 2009

Calibrating Risk Appetite 2.0:

Two Approaches for Defining & Applying “Risk Appetite” that use Multiple Criteria

1. Risk-centered
2. Objectives-centered
**SAMPLE:** Scale for the Risk-Centered Approach

1. **"Zero Risk"**
   - Not willing to accept risk (threats or opportunities).

2. **Low**
   - Unwilling to accept any very limited amount of downside risk (threats) in most circumstances unless the upside risk (opportunities) exceed the downside risk.

3. **Moderate**
   - Willing to accept some downside risk (threats) in certain circumstances that include opportunity.

4. **Moderate**
   - Willing to accept downside risk (threats) commensurate with the potential upside risk (opportunity).

5. **High**
   - Willing to accept a high level of downside risk (threats) in circumstances where there are significant or important opportunities.

Copyright © 2011 Leslie Thompson and Diana Del Bel Belluz

---

**Task: Articulate Risk Appetite for Each Risk Category**

![Task Diagram]

- Use voting technology to articulate your risk comfort level for each category.

---

**SAMPLE: Risk Appetite Statement for a Nonprofit Agency**

1.1 **Strategic/Performance:** Where our values support a high level of downside risk when there are significant risks, we are willing to take these risks.

1.2 **Distribution and Public Perception:** If we are perceived as being competitive, we are willing to accept moderate risk in most circumstances.

1.3 **Regulatory/Compliance:** We are willing to accept moderate risk in most circumstances.

1.4 **Program/Service:** We are willing to accept moderate risk in most circumstances.

1.5 **Environmental:** We are willing to accept moderate risk in most circumstances.

1.6 **Marketing:** We are willing to accept moderate risk in most circumstances.

1.7 **Financial:** We are willing to accept moderate risk in most circumstances.

1.8 **Information Technology:** We are willing to accept moderate risk in most circumstances.

1.9 **Capital Project Delivery:** We are willing to accept moderate risk in most circumstances.

---
Calibrating Risk Appetite using the Objectives-Centered Approach

For Each Objective, Ask:
- How “sacred” is achievement?
- How much uncertainty or volatility are we willing to accept?
- When faced with more than one option, how willing are we to choose one that places this objective at risk?
- How willing are we to trade this objective off against the others?

Source: Rob Quail, Hydro One Inc.
Risk Appetite Continuum
Source: Rob Quail, Hydro One Inc.

- “Sacred” avoidance of risk
  - Averse
  - Minimalist
  - Cautious
  - Flexible
  - Open

- Will take justified risks
- Fully anticipate uncertainty or volatility in results
- When faced with multiple options, will choose the one with lowest risk
- Will never trade off this objective against others

Illustration: Hydro One Example

Source: Rob Quail, Hydro One Inc.

Steps for Defining & Applying “Risk Appetite”

1. Define parameters/principles for risk-taking.
2. Calibrate your appetite.
3. Verify that your risk taking culture is aligned with the risk appetite statement.
4. Apply the risk appetite statement when evaluating risks.
5. Review risk appetite statements on a periodic basis.
**Steps for Defining & Applying “Risk Appetite”**

1. Define parameters/principles for risk-taking.
2. Calibrate your appetite.
3. Verify that your risk-taking culture is aligned with the risk appetite statement.
4. Apply the risk appetite statement when evaluating risks.
5. Review risk appetite statements on a periodic basis.

**Set Priorities with Risk Appetite & Tolerance**

**Assess & Prioritize Risks**
### TSS&A Example: How Risk Appetite is Used to Set Priorities

**Diagram**

<table>
<thead>
<tr>
<th>No.</th>
<th>Risk</th>
<th>Likelihood</th>
<th>Impact</th>
<th>Risk Score</th>
<th>Probability</th>
<th>Frequency</th>
<th>Risk Priority</th>
<th>Risk Appetite</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>High</td>
<td>Very High</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>2</td>
<td>Medium</td>
<td>Moderate</td>
<td>Moderate</td>
<td>Medium</td>
<td>Medium</td>
<td>Medium</td>
<td>Moderate</td>
<td>Moderate</td>
</tr>
<tr>
<td>3</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
</tr>
</tbody>
</table>

Notes:
1. Variance = Impact - Appetite. The larger the variance, the higher the priority.

Source: Technical Standards and Safety Authority.

### TSS&A Example: Priority Risks are Diamond-Shaped

**Diagram**

- **Legend**
  - Low: Green
  - Moderate: Yellow
  - High: Orange
  - Critical: Red

- **Legend**
  - Probability: 1-4
  - Impact: 1-4

- **Risk Matrix**
  - Low: 1-4
  - Moderate: 5-9
  - High: 10-14
  - Critical: 15-19

### Sample Tolerances: Hydro One Example

<table>
<thead>
<tr>
<th>Business Objective</th>
<th>KP</th>
<th>Risk Tolerances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1. Critical</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Moderate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3. Low</td>
</tr>
</tbody>
</table>

- **Unit Cost Reduction**
  - Unit Cost: Increase by 5%
  - Unit Cost: Increase by 10%
  - Unit Cost: Increase by 15%
  - Unit Cost: Increase by 20%

- **Work-Program Accomplishment**
  - Critical project not completed, critical work not started, critical work not started
  - Critical project not completed, critical work not started, critical work not started
  - Critical project not completed, critical work not started, critical work not started

Source: Rob Quail, Hydro One Inc.
CMHC EXAMPLE: Applying a Risk Appetite Statement

- Include in ERM policy
- Educate/advise senior managers on Risk Appetite Statement
- Regular reporting against Statement
- Regular reporting of risks by risk categories
- Regular reporting of new & emerging risks
- Board & senior management engagement in reviewing risks & mitigation strategies
- Consider as part of long term Strategic Plan

Source: CANADA MORTGAGE AND HOUSING CORPORATION

3 Common Reasons Executives Fail to Articulate their Risk Criteria

#1 Fear of giving permission for “risky” behavior

#2 Lacking knowledge of how to develop a reliable gauge of risk appetite & tolerance

#3 Unclear on how to apply risk appetite & tolerance at the operational level

QUESTIONS?
1. Articulate their organization’s ERM vision
   - ERM Visioning Workshop ($2,450)
2. Assess their organization’s ERM capabilities
   - ERM Performance Review “Independent Assessment” ($75,000)
   - ERM Performance Review “Self-Assessment” ($9,750)
3. Chart their organization’s ERM development roadmap
   - ERM Roadmap Workshop ($2,450)
   - ERM Jump Start ($1,450)
4. Improve their ERM capabilities and capacity
   - Risk Management ‘Personal Trainer’ ($2,500 per year)
   - Risk Management ‘Sounding Board’ ($4,750 per year)
   - Customized packages to meet your specific training and implementation support needs (priced to fit your budget)

---

**Thank You!**

Risk Wise
Diana Del Bel Belluz M.A.Sc., P.Eng.
Risk Wise Inc.
416-214-7598
Diana.Belluz@riskwise.ca
www.riskwise.ca

---

2013 Webinar Discount!
Sue@nonprofitrisk.org

<table>
<thead>
<tr>
<th># of Webinars</th>
<th>Purchased BEFORE 5:00PM on Monday, Dec 20th 2012</th>
<th>Total Cost</th>
<th>Savings</th>
<th>Cost per Webinar</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$55</td>
<td>2%</td>
<td>$55</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>$110</td>
<td>20%</td>
<td>$55</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>$282</td>
<td>25%</td>
<td>$94</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>$567</td>
<td>33%</td>
<td>$141</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>$829</td>
<td>40%</td>
<td>$165</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>$1,209</td>
<td>50%</td>
<td>$201</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>$1,689</td>
<td>55%</td>
<td>$241</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>$2,177</td>
<td>60%</td>
<td>$272</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>$2,665</td>
<td>65%</td>
<td>$296</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>$3,153</td>
<td>70%</td>
<td>$316</td>
<td></td>
</tr>
</tbody>
</table>

Webinar Series = $459 $420