

# Calibrating Your NP's Risk Appetite

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 Gail Taylor  
 Director, Risk  
 Network Risk Exploration

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# Definitions

	HM Treasury 2006	AIRMIC 2009	ISO 31000 2009	Risk Wise 2010	COSO 2012	RIMS 2012
<b>TOLERANCE APETITE</b>	The amount of risk that an organization is prepared to accept, tolerate, or be exposed to at any point in time	How much risk a company is willing to take	Amount and type of risk that an organization is prepared to pursue, retain or take (ISO Guide 73:2009)	How much risk an organization is willing to take on to ensure it has ample opportunity to achieve its objectives.	The amount of risk an organization is willing to accept in pursuit of value.	The total exposed amount that an organization wishes to undertake on the basis of risk-return trade-offs for one or more desired and expected outcomes.
	Not defined	maximum threshold before real financial distress (risk bearing capacity)	<b>Risk Criteria:</b> Terms of reference against which the significance of a risk is evaluated	The level to which a risk must be managed to be considered acceptable	Acceptable level of variation to accept regarding the pursuit of its objectives.	The amount of uncertainty an organization is prepared to accept in total or more narrowly within a certain business unit, a particular risk category or for a specific initiative

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**Two Elements to Deciding Priorities**

**What is your target?**  
**What constitutes success?**



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 **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"

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**Risk Decision Criteria are Unique to Your Organization**

**Criteria Depend On:**

- Your goals & objectives
- Your values
- Your capacity to manage risk
- Your resilience



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### 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 illustration shows Cookie Monster, a blue furry character with a large open mouth, standing next to three stacks of round cookies of varying heights.

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### The Blind Men & the Elephant

The illustration depicts a large elephant standing in a field. Several men are touching different parts of the elephant to understand its shape. One man is touching the ear and saying it's like a fan, another is touching the leg and saying it's like a pillar, another is touching the tail and saying it's like a rope, another is touching the side and saying it's like a wall, and another is touching the tusk and saying it's like a spear. The background is a textured blue.

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**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.

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**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?”

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**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

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## 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 1-2.5% variation in revenue

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

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## Calibrating Risk Appetite 2.0:

### Two Approaches for Defining & Applying "Risk Appetite" that use Multiple Criteria

- 1 Risk-centered
- 2 Objectives-centered

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## SAMPLE: Scale for the Risk-Centered Approach

1	Zero Risk	Not willing to accept risk (threats or opportunities).
2	Low	Unwilling to accept even a very limited amount of downside risk (threat) 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	Modest	Willing to accept downside risks (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.

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## Task: Articulate Risk Appetite for Each Risk Category

RISK CATEGORY	MEASURE				
	ZERO 1	LOW 2	MODERATE 3	MODEST 4	HIGH 5
<b>Strategic</b>					
1.1 Strategy/Policy/Performance					
1.2 Political Commitment Risk/Stakeholder and Public Perception Risk					
<b>Governance/</b>					
2.1 Governance/Accountability/ Organizational Risk					
2.2 Legal/Contractual Compliance					
2.3 Controversy/Accounting Risk					
<b>Operational</b>					
3.1 Program Caseload/Utilization					
3.2 Service/Operational Risk					
<b>Workforce</b>					
4.1 Workforce Compensation Risk					
4.2 Workforce Risk					
<b>Infrastructure</b>					
5.1 Information & Information Technology					
5.2 Capital Project Delays					

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

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## SAMPLE: Risk Appetite Statement for a Nonprofit Agency

Description of Risk	Risk Appetite
1.1 <b>Strategy/Policy/Performance:</b> We are willing to accept a high level of downside risk where there are significant opportunities to serve our core stakeholders and achieve our mission.	High
1.2 <b>Stakeholder and Public Perception:</b> As a new agency, we are willing to accept some downside risk commensurate with assessed opportunities to meet our strategic objectives and build our reputation.	Modest
2.1 <b>Governance/Accountability/ Organizational Risk:</b> Given the nature of our activities, we are willing to accept some downside risk with regards to governance commensurate with opportunities to serve our core stakeholders and fulfill our mandate.	Modest
2.2 <b>Legal/Contractual Compliance</b> We are not willing to accept uncertainty with regards to compliance with contracts, legislation and policies.	Low
2.3 <b>Controversy/Accounting Risk:</b> We are not willing to accept much risk with regards to compliance with financial and accounting policies, our budget and the stewardship of donor funds.	Low
3.1 <b>Program Workload/Utilization:</b> We are not willing to accept risk with regards to fulfilling our service obligations.	Low
3.2 <b>Service/Operational Risk:</b> Given the nature of our activities and the balancing of its resources, we are willing to accept some downside risk that specific services or products may not be delivered as planned commensurate with assessed opportunities to meet strategic objectives.	Modest
4.1 <b>Compensation Risk:</b> Given the long-term implications, we are willing to accept some downside compensation risk commensurate with assessed opportunities to meet strategic objectives.	Modest
4.2 <b>Skills/Talent Risk:</b> Given its strategic importance, we are not willing to accept much risk with regards to the agency's human capital.	Low
5.1 <b>Information Technology:</b> Given its strategic importance, we are not willing to accept much risk with regards to the our information technology needs.	Low
5.2 <b>Capital Project Delays:</b> We are willing to accept some downside risk with regards to premises and capital project delays commensurate with opportunities for better facilities.	Moderate

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## 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.

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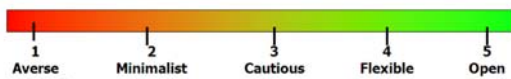
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## Risk Appetite Continuum

Source: Rob Quail, Hydro One Inc.



- “Sacred”- avoidance of risk is a core objective
- Extremely low tolerance for uncertainty
- When faced with multiple options, will always choose the one with lowest risk
- Will never trade off this objective against others

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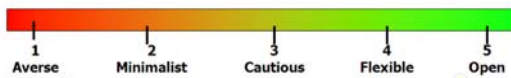
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## Risk Appetite Continuum

Source: Rob Quail, Hydro One Inc.



- “Sacred”- avoidance of risk is a core objective
- Extremely low tolerance for uncertainty
- When faced with multiple options, will always choose the one with lowest risk
- Will never trade off this objective against others

- Will take justified risks
- Fully anticipate uncertainty or volatility in results
- When faced with multiple options, will choose the one with the highest return & accept possibility of failure
- Willing to trade off this objective against others

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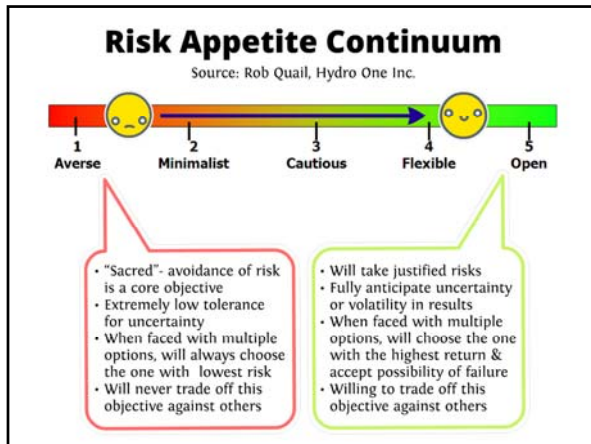
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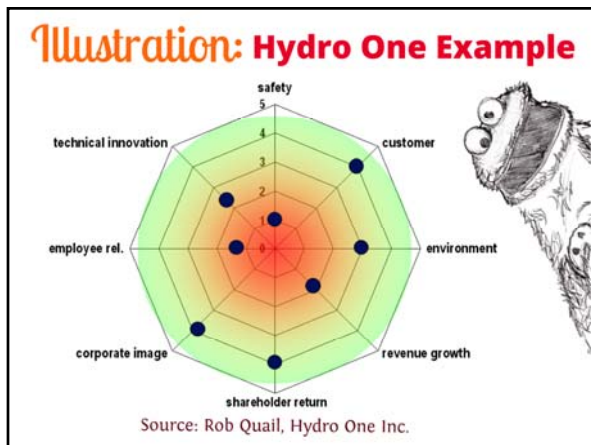
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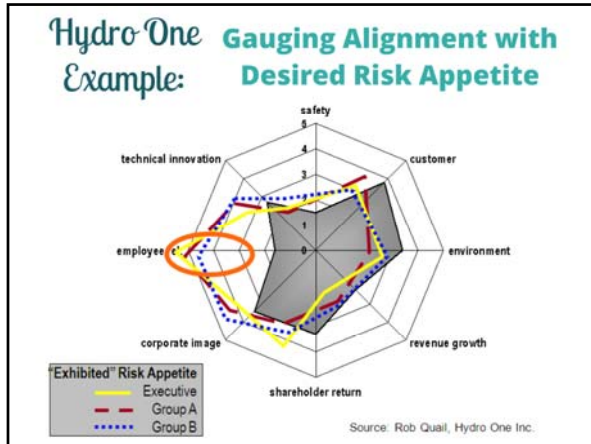
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## Set Priorities with Risk Appetite & Tolerance

### Assess & Prioritize Risks

2: Identify Risks		3: Assess and Prioritize Risks							
Risk Description	Risk Category	Current Risk Response (Risk Mitigation Strategy)	High Effective-ness Risk	Estimate of Current Likelihood	Estimate of Current Impact	Estimate of Current Risk	Appetite for risk category	Aligned with Risk Appetite (Y/N)	Risk Response phase (Y/N)
Access to key talent	4.2	Offer competitive compensation Cultivate attractive work environment Mentoring and succession planning	High	Low	High	Medium	Medium	Yes	No
Irregularities in financial reporting	2.3	Follow regulatory reporting requirements	Medium	Medium	Medium	Medium	Low	No	Yes
Change in government policy leads to reduction in funding	3.1	Cultivate relationship with ministry Diversify funding base Flexibility in program offerings	High	Medium	High	High	Medium	No	No

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### TSSA Example

#### How Risk Appetite is Used to Set Priorities

No.	Risk	Likelihood	Impact	Risk Score	Appetite	Variance	Priority
1	Economic changes	3	3	9	2	0	No
2	Political changes	4	3	12	3	-5	No
10	Information	4	3	12	2	-12	Yes
11	Processes	4	3	12	3	0	No
15	Inter - intra department relations	4	2.5	10	2	-0.5	Yes
18	System stability	4	3	12	2	-11	Yes
20	Functionality	3	3	9	2	-12	Yes
23	Culture including adaptability to change	3.5	3	10.5	2	-11	Yes
21	Management oversight and accountability	3.5	3	10.5	2	-11	Yes
24	Ability of Consumer Services (CSS)	4	4	16	3	-11	Yes
37	Chief Safety Risk Officer (CSRO)	3	3	9	2	-12	Yes

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

Source: Technical Standards and Safety Authority

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### TSSA Example

#### Priority Risks are Diamond-Shaped

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## Sample Tolerances: Hydro One Example

Business Objective	KPI	Risk Tolerances				
		5 Catastrophic	4 Severe	3 Major	2 Moderate	1 Minor
Unit Cost Reduction	Unit Cost	Unit Costs Increase by >25%	Unit Costs Increase by 15% - 25%	Unit Costs Increase by 10% - 15%	Unit Costs Increase by 5% - 10%	Unit Costs Not Reduced
Work Program Accomplishment	Critical project work pgm completion	>10 Critical Projects late or; <50% of non-critical work completed	5-10 Critical Projects late or; 50%-70% of non-critical work completed	3-5 Critical Projects late or; 70%-90% of non-critical work completed	1-3 Critical Projects late or; >85% of non-critical work completed	No Critical Projects late; >95% of non-critical work completed

Source: Rob Quail, Hydro One Inc.

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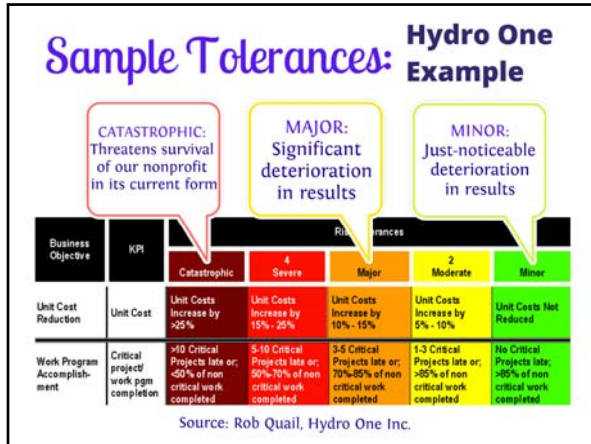
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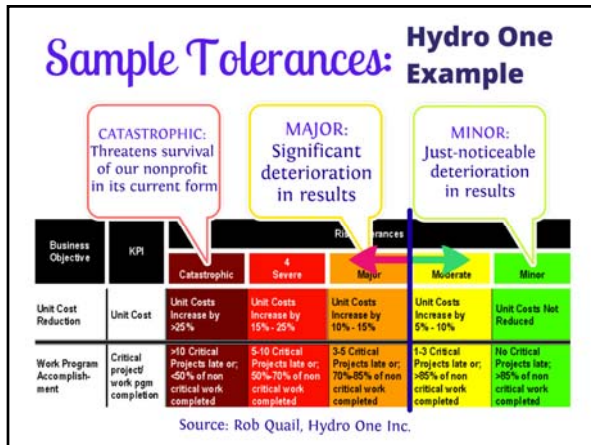
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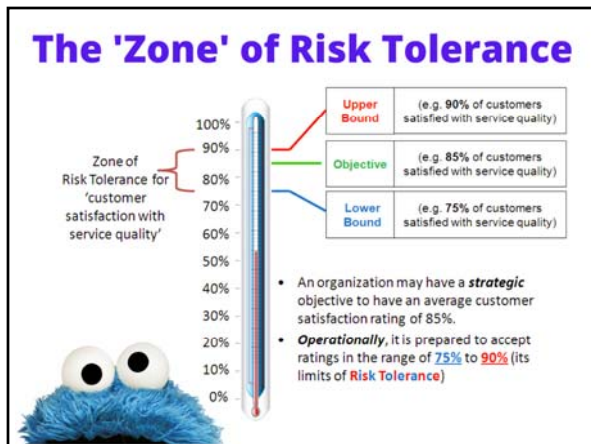
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**CMHC EXAMPLE:**  
*Applying a Risk Appetite Statement*

- 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

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**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

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1. Articulate their organization's ERM vision
  - ERM Visioning Workshop (\$2,450)
2. Assess their organization's ERM capabilities
  - ERM Performance Review "Independent Assessment" (\$25,000)
  - 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' (\$7,500 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)

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Thank You!



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