Publication of the South African Insurance Association
SAM NEWS

SAIA – (011) 726 5381 *Issue 8 / 2011*

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Feedback on Discussion Documents & Position Papers

Background as to the process of creating a Discussion Document and Position Paper:

The SAM process consists of a number of volunteers from the South African Insurance Industry. These volunteers were assigned to groups according to their knowledge and expertise and referred to as a Task Group. These Task Groups meet at least once a month and discuss the relevant topics assigned to them, for example capital requirements based on the balance sheet risks.

To guide the Task Groups, the formal consultative papers issued by the European Insurance Regulator, formerly known as CEIOPS and now known as EIOPA, are used as the basis for SAM. The main reason that the FSB is following this process is to ensure that they are able to achieve equivalence with the Solvency II Directive. The Task Groups review these consultative papers and other relevant sources and then draft what is known as a "Discussion Document".

These Discussion Documents are then scrutinized by the insurance industry and other SAM governance structures, through the process of submission of formal comments. The Discussion Document, including all the comments received, would then be adopted by the FSB's SAM Steering Committee as a "Position Paper". This Position Paper is then endorsed as being representative of the official view of the FSB's SAM Steering Committee. The Position Paper will then ultimately form the basis for the FSB and National Treasury to draft Secondary legislation and regulations. More than 80 Discussion Documents are expected to be drafted by the Task Groups.

The table below contains a list and a brief summary of all the Position Papers adopted by the FSB's SAM Steering Committee:

Position Paper	Task Group	Summary
Position Paper 12: High-level principles of information to be received by the supervisory authority	Reporting and Disclosure	This paper outlines the high-level principles of information to be received by the supervisory authority (FSB). **Principle 1:** On a regular basis insurers / reinsurers and groups shall submit to the supervisory authority the stipulated reports. **Principle 2:** The insurer / reinsurer will make a specific report available to the public. **Principle 3:** The insurers / reinsurers will provide a specific report for supervisory use to the FSB. **Principle 4:** All reports will include qualitative and quantitative information. **Principle 5:** It is recommended that the public report and supervisory report be combined as one for practical purposes. This is a deviation from Solvency II.
Position Paper 14: Undertakings using an approved internal model	Reporting and Disclosure	The Position Papers considers the principles of publicly disclosing key assumptions, issues, results and risks when using an approved internal model to measure solvency capital requirements. It states that commercially sensitive information should not be disclosed.
Position Paper 15: Structure of the Regulatory Return	Reporting and Disclosure	The Position Paper outlines the structure of the combined report (for the FSB and for the public) – and compares this to other relevant regulators. The main categories for reporting are: Businesses Performance, System of Governance, Risk Profile, Regulatory Balance Sheet [including segmented financial information], Capital Management and information from Insurers / Reinsurers with an approved internal model.

Position Paper	Task Group	Summary
Position Paper 17: Undertakings reporting policy	Reporting and Disclosure	The purpose of the Position Paper is to discuss the Board approved written policy that an insurer / reinsurer (and group) should have when it comes to reporting. The paper supports the principles proposed in Europe. **Principle 1:** The written policy shall ensure that appropriate governance procedures are in place to ensure reported information is complete, consistent and accurate. **Principle 2:** The written policy shall ensure that the reporting requirements are completed within the timeframes established. **Principle 3:** Insurers / Reinsurers are expected to develop within their policy a stable internal process through which to accurately complete quantitative templates. **Principle 4:** The written policy shall be approved by the Board of Directors and shall ensure that disclosure requirements are completed within the timeframes. **Principle 5:** Insurers / Reinsurers and groups shall use their reporting and disclosure policy to outline their view of information already available in the public domain. **Principle 6:** Insurers / Reinsurers and groups shall ensure additional voluntary information is consistent with the required information. **Principle 7:** Confidential information will not be allowed to be published without the approval of the FSB. **Principle 8:** The non-disclosure of certain information is allowed if permission is received.

Position Paper	Task Group	Summary
Position Paper 19: Level of harmonisation and quantum of data	Reporting and Disclosure	This Position Paper recommends that consideration should be given to the level of alignment between South Africa's reporting templates and the European reporting templates, in order to align the reporting format of multi-nationals, and to adhere to the principle of global convergence.
Position Paper 22: Considerations of mandating an external audit	Reporting and Disclosure	The Position Paper recommends that certain sections of the annual return to the FSB are audited by the External Auditor. It recommends that quarterly reports are not subjected to external audits.
Position Paper 23: Supervisory enquiries	Reporting and Disclosure	The FSB should have the power to request any information which is necessary for the purpose of carrying out their supervisory duties.
Position Paper 24: Information on contracts and from external experts	Reporting and Disclosure	The FSB is allowed in terms of supervisory duties to request information regarding contracts which are held by intermediaries or information from external experts. They should do so in conjunction with the insurer.
TOTAL: 8		

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The table below contains a list and a brief summary of all the Discussion Documents approved to date by the FSB's SAM Steering Committee for industry comment:

Discussion Document	Task Group	Summary	Status
Discussion Document 1: Interim Measures for Insurance Groups	Insurance Groups	The document provides the reasons and activities to be taken for group-wide supervision: **A.** Developing a group-wide supervisory framework which regulates the legal entities within the group and also assesses the group as a whole. **B.** Mitigating group contagion effects which can prompt potential insolvency or contravene regulatory requirements in relevant jurisdictions. **C.** Identifying risk concentration and intra-group transactions, which present substantial credit risk. **D.** Determining group capital adequacy. **E.** Determining the fitness and propriety of the group's Board of Directors, shareholders and senior management. **F.** Ensuring that the group has appropriate risk management and internal controls suited to its nature, size and complexity. **G**. Accessing prudential information on the group so as to effectively supervise the legal entities and the group as a whole. **H.** Eliminating supervisory arbitrage.	Closed for Comments

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Discussion Document	Task Group	Summary	Status
Discussion Document 16: A single group-wide Regulatory return	Reporting and Disclosure	The document proposes a single report for a group to be used for the information to be reported publicly.	Open for Comments
Discussion Document 21: Process of reporting disclosure	Reporting and Disclosure	The document makes recommendations on the frequency, the internal review process, submission dates and format of reporting. It also addresses some issues regarding transitional arrangements.	Open for Comments
Discussion Document 26: Classification and Eligibility of Own Funds	Capital Resources	The document proposes a methodology to classify capital resources into three tiers in order to determine eligible capital for solvency capital requirements and minimum capital requirements.	Closed for comments

Discussion Document 29:
 	
Authorisation classes of business under SAM
	Technical Provisions	The document proposes new insurance classes. For short-term insurance the recommendation is to adopt the authorisation classes as set out in the Solvency II Directive with some changes. It is noteworthy that the practical consequences of this proposed change is not insignificant.
		
		The proposed classes:
		
		1. Accident
		2. Sickness
		3. Land vehicles
		    a. Personal Lines
		    b. Commercial Lines
		4. Railway rolling stock
		5. Aircraft
		6. Ships
		7. Goods in transit
		8. Property
		    a. Personal Lines
		    b. Commercial Lines
			Open for comments

Discussion Document	Task Group	Summary	Status
		9. Engineering *10. Motor vehicle liability* *a. Personal Lines* *b. Commercial Lines* *11. Aircraft liability* *12. Liability for ships* *13. General liability* *a. Personal Lines* *b. Commercial Lines* *14. Credit* *15. Suretyship* *16. Miscellaneous* *17. Legal expenses* *18. Travel Insurance* *19. Assistance* Detailed descriptions are available in the Discussion Document.	
Discussion Document 30: Counterparty default adjustments recoverable from reinsurance contracts and SPV's (Special Purpose Vehicles)	Technical Provisions	The document recommends that counterparty default adjustments should be applied to all technical assets including recoverables from reinsurance contracts and special purpose vehicles as well as negative reserve for reinsures when calculating technical provisions.	Open for Comments
Discussion Document 33: Regulatory Balance Sheet (Article51(1)(d)) Detailed content of SFCR (Solvency and Financial Condition Report) and RTS (Report to Supervisor)	Reporting and Disclosure	The document outlines the detailed content of the reports, specifically to the regulatory balance sheet. It deals with assets, technical provisions (policyholder liabilities), other liabilities and disclosures.	Open for Comments
Discussion Document 34:	ORSA	The purpose of the document is to present the currently available international guidance on the Own Risk	Open for comments

Discussion Document	Task Group	Summary	Status
ORSA		and Solvency Assessment (ORSA) and discuss its relevance to the South African context. This is a discussion document of significant importance.	
Discussion Document 35: Use Test	ORSA	The document provides guidance on how insurance and reinsurance companies shall demonstrate that the internal model is widely used in and plays an important role in their system of governance. This is a discussion document of significant importance.	Open for comments
Discussion Document 36: Contents of SFCR (Solvency and Financial Condition Report): Capital Management	Reporting and Disclosure	The document outlines the detailed content of the reports, specific to the capital requirements, capital resources and capital add-ons.	Open for Comments
Discussion Document 40: Risk Free Rate: Dashboard	Technical Provisions	The document weighs up the various strengths and weaknesses of using either the government bond or swap curve as the base risk free rate. The paper recommends using the swap curve.	Closed for Comments
Discussion Document 43: Internal Models: Validation	Internal Models	The document provides comments on profit and loss attribution as well as validation standards including data, methods, assumptions, judgement, documentation, IT systems, model governance, use test and the validation policy relating to the internal models requirements.	Closed for Comments
Discussion Document 49:	Reporting and Disclosure	The document outlines the detailed content of the reports, specific to the Business and Performance sections of	Open for Comments

Discussion Document	Task Group	Summary	Status
Detailed contents of SFCR (Solvency and Financial Condition Report) & RTS (Report to Supervisor): Executive summary, business and Performance (Article51(1)(a))		the reports. This includes information such as significant events, trends, material business lines and group structures.	
Discussion Document 51: Detail contents of SFCR (Solvency and Financial Condition Report) and RTS (Report to Supervisor): System of Governance	Reporting and Disclosure	The document outlines the detailed content of the reports, specific to the system of governance. Information required includes general governance requirements, fit and proper, risk management, ORSA, Internal Control Systems, Internal Audit Function, Actuarial Function, Outsourcing and reporting at a group level.	Open for Comments
Discussion Document 52: Risk profile (Article 51(1)(d))	Reporting and Disclosure	The document outlines the detailed content of the reports, specific to the risk profile including; market, credit, underwriting and operational risks.	Open for Comments
Discussion Document 55: Internal Models: Statistical Quality and Calibration	Internal Models	The document discusses the principles and practices that have to be in place to ensure that the internal model is adequately designed and calibrated.	Closed for Comments
Discussion Document 56: Internal Models: Documentation and Data Requirements	Internal Models	The document address documentation requirements and data principles such as adopting a comprehensive scope of data, that data should be accurate, complete and appropriate, that data quality should be monitored, that data should be updated regularly, the use of expert judgement and a data policy.	Closed for Comments

Discussion Document	Task Group	Summary	Status
Discussion Document 57: Partial Internal Models	Internal Models	The document discusses the requirements for the use of a partial model for calculating solvency capital requirements.	Closed for Comments
Discussion Document 61: SCR Standard Formula: Operational Risk	Capital Requirements	The document proposes a formula to be applied to calculate operational risks when using a standard formula. Risks drivers are Premiums and Technical Provisions.	Open for Comments
Discussion Document 81: Interim Requirements: Governance, Risk Management, and Internal Controls	Governance	The paper addresses Board Composition, Board Structure, Duties of Individual Board Members, Governance, Resources and Performance of the Board, Board Roles and Responsibilities, Ensuring Fit and Properness, Design and Implementation of Sound Risk Management and Internal Controls Systems and Functions, Setting and Overseeing Duties of Senior Management, Setting and Overseeing Remuneration Policy and Practices, Ensuring Reliable and Transparent Financial Reporting, Ongoing Monitoring and Evaluation of the Governance Framework, Risk Management System, Compliance Function, Actuarial Control Function, Internal Audit Function and Outsourcing.	Closed for Comments
TOTAL: 20			

The table below contains a list and a brief summary of all the draft legislation and regulation approved to date for industry comments:

Draft	Task Group	Source	Summary	Status
Insurance Laws Amendment Bill	Insurance Groups and Governance	DD 1 and DD 81	2012 Interim Measures. The draft bill addresses the contents of Discussion Documents 1 and 81 – Supervision of Insurance Groups and Corporate Governance.	Closed for Comments
TOTAL: 1				

The SAIA SAM Office will provide similar updates as and when new Discussion Documents, Position Papers and Draft Legislation & Regulation are released.

For further information regarding this summary please contact Nico Esterhuizen at nico@saia.co.za

SAM Snippets

- The deadline for submission of the SA QIS1 was the 16 September 2011. The response from industry was overwhelming as close to 100 submissions were received by the FSB. This number includes short and long term insurers. Approximately 56% of the short term insurance industry participated in the SA QIS1 exercise. This equates to approximately 70% of the total market premium. According to the FSB a report on the results of the SA QIS1 is expected to be released by the end of November 2011.

- A further Quantitative Impact Study (SA QIS2) is expected to be undertaken in 2012.

- The FSB has indicated that they might waive the fees applicable for completion and submission of the Pre-Application Qualifying Criteria (PAQC) as part of the Internal Model Approval Process (IMAP).

- The FSB is hosting two workshops on the proposed Interim Measures that will take effect in 2012. The workshops will take place in Johannesburg on the 12 October 2011 and in Cape Town on the 18 October 2011. Registration for the workshops closed on the ***30th***

September 2011. Please contact us should you require any further information in this regard.

- The FSB has released a report on the responses to the questionnaire that accompanied the SAM Roadmap which was issued in November 2010. The report provided the FSB with some valuable information regarding insurer's preparations for SAM. The full report is available on the ***SAIA SAM Webpage***.

- At the FSB SAM Steering Committee meeting held on 23 September 2011 Discussion Document 29 entitled Authorisation Classes of Business under SAM, was approved to be released for public comment. Further information regarding this document can be obtained by contacting us directly.

- The FSB has revised the initial September 2011 delivery date for the following two milestones:

    - Version two of the draft Insurance Bill will now be finalised by October 2011
    - The first draft of the Subordinate Legislation will be finalised in January 2012

  These revised dates were deemed necessary due to delays in the finalisation of certain Discussion Documents. These changes will however have no impact on the final SAM implementation date scheduled for January 2014.

- The number of Discussion Documents being generated by the SAM Governance Structure continues to climb and now stands at 85.

For further information on these SAM Snippets please contact Gareth van Deventer at gareth@saia.co.za

Risk Appetite

How insurers can use risk appetite to set risk limits

Producing a risk appetite statement is not easy; cascading it into a comprehensive limit structure even harder. But the rewards for achieving this are significant, explains Karl Chappell.

Shakespeare has Macbeth say, *"Now, good digestion wait on appetite, and health on both!"* good health requires good digestion which in turn requires a good appetite.

Royal banquets are one thing, but this can also serve as a good motto for today's economy and in particular to insurers. Standard & Poor's seems to think so - in its view defining a risk appetite and digesting this throughout the organisation is an integral element of a healthy insurance company.

Standard and Poor's writes that insurers with a "strong" enterprise risk management rating must have defined a "*process for developing the risk limits from the overall risk tolerance*" and that insurers wanting to go beyond this to an "excellent" enterprise risk management rating must also have this "*implemented throughout a higher percentage of its group.*" (*Insurance Criteria: Refining the focus of insurer enterprise risk management criteria*, Standard and Poor's, June 2006)

The risk appetite framework

The profile of risk management within insurers has increased progressively over the last decade driven in part by regulatory developments (most recently Solvency II) but also by the growing recognition that risk management should form a fundamental part of an insurance company's strategy and operations rather than being a siloed back-office function. Risk management will only become more important following the global financial crisis and its impact on the financial services industry, where many insurers have observed the apparent mistakes of the banks from the relative safety of the sidelines. In this context, it is of little surprise that the position of chief risk officer (CRO) has been formalised in many organisations and that the CRO often has the ear of the chief executive officer.

So how do insurers embed the risk agenda throughout the organisation? A risk appetite framework provides the context for active risk management, from the top-of-house articulation of a risk strategy which is endorsed by the board, through to the detailed monitoring of the risk exposure relative to pre-set limits or triggers. However, achieving this is no trivial task, requiring both the engagement of the full hierarchy of decision-makers in the business and the resolution of a number of complex risk budgeting and resource allocation problems. Insurers who are serious about embedding the risk agenda into the business need to follow four steps:

1. Articulate the group risk appetite
2. Allocate limits to business units / risk types
3. Embed limits at an operational level
4. Monitor adherence to the limit structure

While each of these steps has its challenges, many insurers have achieved steps 1 and 2 only to stall at step 3.

Articulate the group risk appetite

A group risk appetite statement is at the centre of the risk management framework: it articulates what types of, and how much, risk the organisation is willing to take.

The goal of this statement is twofold: to spell out the risk agenda of the company externally to the market place and to provide the basis for an internal risk limit structure consistent with board strategy. Therefore, it should be based on tangible risk impacts rather than abstract ideas - the board needs to be able to articulate it and the market needs to be able to understand it. The statement can have much greater immediate impact if it is expressed in terms of outcomes or effects rather than inputs or drivers.

The statement itself will usually contain only a handful of primary dimensions, perhaps four to six, with each dimension stating the risk appetite of the board for a given risk measure or outcome. The actual measures chosen will depend on the insurer's business and strategy but some common dimensions are:

- Earnings - how much of the planned or projected earnings is the board willing to put at risk?
- Capital/equity - how much (economic) capital or shareholder equity is the board willing to put at risk?
- Liquidity - how much of the available liquidity, distributable surplus or free cash flow is the board willing to put at risk?
- Franchise value - how much of the company franchise value is the board willing to risk (e.g. through adverse publicity, poor reputation or as a result of poor product and distribution strategy)?
- Regulatory - how much of the regulatory solvency headroom is the board willing to risk?

Defining the dimensions of the risk appetite statement is only the first step. Having done that, it is necessary to specify the risk measures that will be used and, most importantly, specify the board's risk appetite against these measures. This can be informed by considering the range of financial and risk exposure measures currently used and reported within the organisation - the statement itself should be broadly consistent with these measures. It should also ideally be expressed in terms of undesirable events - for example the capital-at-risk appetite can be expressed as the acceptable probability of breaching some capital trigger that would lead to a "difficult discussion" with a regulator or ratings agency.

Finally, analysis of competitor statements can also provide useful benchmarks against which the organisation can measure itself.

Allocate limits to business units / risk types

While the group risk appetite statement is critical from a communication perspective, it is very difficult to manage risk solely by means of such a high-level statement. To have full impact on the company's risk profile, the risk appetite statement must be cascaded down through the organisation in a meaningful way, to reach those whose decisions steer the business. The first step in doing this is to develop a risk limit structure that sets out the amount of desired (or tolerated) risk exposure at, for example, risk-type and/or business-unit level.

The conversion of a risk appetite into cascaded business-unit or risk-type limits is no trivial task, especially when resources are scarce and business units are effectively competing for the allocation of risk-taking capacity. There is no sure-fire mechanical way of performing this allocation. In theory, optimisation using risk-return tradeoffs could provide a scheme for allocating limits but, given uncertainties in models and, more importantly, other qualitative and quantitative considerations, a more balanced and less prescribed approach is required. The task of allocating limits can, however, be made easier by providing management with an array of both quantitative and qualitative information on which to base the decision.

The following gives a summary of some types of information that should be included and considerations for each:

Current risk profile

Where risk infrastructure is already in place, the current risk profile should be calculated for each business unit or risk type across each of the defined risk appetite dimensions. This will provide a benchmark for the allocated limits by reflecting the relative appetite for risk across business units and risk types implicit in the group's current risk-taking activities (but may not have previously been explicitly determined. For example, a company may currently sell many life insurance products but relatively few motor insurance products, implying that their risk appetite is higher for mortality risks than it is for motor accident and liability risks. Therefore, a higher limit may be appropriate for mortality risks than for motor risks.

Sensitivity of risk profile

Various business scenarios should be defined for each business unit or risk type and their impact on the current risk profile determined. These scenarios should span the realistic action space open to management, i.e. what actions management can realistically take to impact the business and hence the risk profile, thereby providing the calibration points for setting the risk limits. Businesses that have little impact on the risk profile for fairly major shifts in business strategy do not need a large spare limit capacity in order to allow management operational freedom.

Risk-return assessment of individual risk types and business units

Adding an assessment of the potential return to the above scenario analysis can help define the risk-return characteristics of each business unit or risk type. This will provide an additional lever for setting the limits, particularly when the limit system is seen as a method for steering the business rather than just limiting it (the distinction here is that, in the usual course of business, resource allocation within strategic planning is the primary tool for steering the business, which should adhere to the risk limits; however, the limits themselves could also be used to steer the business by strategically setting the upper bound in the resource allocation process).

Diversifying impact of individual risk types and business units

An assessment of the risk-diversifying impact of each category within the limit framework can provide management with a view on those business units that contribute to concentrations of risk and those that do not: higher limits may be appropriate for those risk types and business units that diversify well with the rest of the organisation.

Benchmarking of event-driven losses

Management may be able to state the maximum loss they could be comfortable with disclosing to investors for specific risk events, at a similar level of granularity. This can be performed by differentiating between *strategic* risks, which investors expect the company to take; *consequential* risks, which result automatically from core risk-taking and are therefore inevitable; and *non-core* risks, which an investor would not expect the company to take at any significant level as a part of the core business strategy. Overlaying this assessment with investor reaction to historical losses (own or peer experience) provides management with the basis to set the upper bound beyond which limits should not be set.

Group strategy and strategic assessment of business units

The differentiation between core, consequential and non-core risks can extend beyond providing the maximum acceptable loss for a risk type or business unit to providing a basis for assessing the trade-off between risk types or business units. All other things being equal, core risks should be allocated a higher proportion of the overall limit allocation than the non-core risks. Moreover, the set of core risks should align with those where, over the medium term, the best risk-adjusted returns can be expected to be gained.

Steering senior management to the appropriate allocation of risk limits requires this qualitative and quantitative information to be clearly articulated into a series of straightforward decisions. The senior management responses will then naturally lead to a recommendation for the final limit allocation.

Finally the governance and monitoring of the limit system need to be able to cope with the practical complications of risk-taking. For example, the system needs to reflect that not all business units will fully use their limits. At the same time, in a unit which is aiming to utilise a particular limit fully, the process needs to manage the risk of limit breaches through the natural volatility of risk-taking. These fundamental methodology issues can be tackled by implementing appropriate governance and monitoring of the limit system.

Embed limits at an operational level

Embedding the limits at the operational (i.e. decision-making) level is key to ensuring that the risk appetite statement impacts everyday business decisions, allowing the organisation to be steered appropriately within the risk boundaries set by the board.

This step in the process requires a tailored approach for each "decision group" (which might be a business unit, function, product group etc.) as the requirements will vary significantly between them. For some decision groups the risk limits will need to be linked to the current risk measures incorporated in the business; for others new measures will need to be implemented to allow the business to track their risk-taking activities against their limit; and for still others, where the risk exposure is managed closely by the decision-group management itself, the business-unit or risk-type risk limit may be sufficient.

Any risk measures that are implemented need to be accepted as core to business decision-making and need to reflect the ability of the decision group to monitor them. For example, a capital risk limit for an asset management function may be linked to the current value-at-risk

(VaR) framework; whereas, for a natural catastrophe underwriting function, the capital risk limit may be linked to loss distributions from catastrophe models.

A tailored process is likely to be required for most business units, but we can consider three building blocks to help identify the most appropriate approach in each case:

Events: identification of the types of events the limit framework is trying to prevent.

Individuals, committees and organisational units: mapping responsibilities to individuals, committees and organisational units, e.g. defining how different limits apply to senior underwriters vs. junior underwriters, defining how different committees oversee different risk-taking activities, etc.

Rules of conduct: defining rules by event and individual, committee and organisational unit alignment, e,g, defining to what extent risk-taking responsibility can be delegated downwards, defining what happens when limits are breached, etc.

Considering these items for each decision group defines the risk landscape against which the operational limit structure can be implemented.

Responsibility for the implementation of effective risk limits could be given to business unit heads where the management has strong control over the business and appropriate incentives are in place to encourage them to manage the business within the limits. However, it is more likely that a collaborative effort between each business and the group risk function is required to ensure appropriate implementation at an operational level.

Monitor adherence to limit structure

Once the risk appetite statement is in place and the limit structure has been defined and cascaded throughout the organisation, regular monitoring of the current risk profile against the limit structure and risk appetite statement will be required.

Incorporating the risk appetite statement and the reporting of the organisation's risk position into the group risk dashboard, regularly reviewed by senior management and the board, will provide the basis for monitoring adherence to the risk appetite. Linking the business-unit risk limits to appropriate and effective risk measures, as described above, provides a common link to risk measurement and control throughout the organisation, although ultimately the group risk function will have responsibility for aggregating the information and preparing the risk dashboard.

Sitting alongside the measurement of the risk profile should be a comprehensive governance framework that, from a proactive perspective, sets appropriate incentives for business units to remain within the risk limits, and, from a reactive perspective, defines the procedures for addressing breaches of limits, including the escalation process and any prescribed corrective actions specific to each business unit.

Embedding risk appetite into an organisation is a way to ensure that day-to-day business activities are conducted in a way that satisfies the aggregate view of tolerable risk levels from the board's perspective.

While the production of the risk appetite statement is not a trivial task in itself, the cascading of this statement into a comprehensive limit structure is likely to provide even greater challenges as it touches on many more decision-makers and requires the balancing of a number of competing interests.

However, the rewards of going through this process are significant, giving the board a means to translate its ambition for risk-taking by the company into tangible actions at the operational level. Furthermore, a risk appetite statement allows the board to illustrate their risk vision to investors and demonstrate how this vision is steering the business day-to-day.
A comprehensive risk appetite framework allows resources to be directed to the most valuable risk-taking opportunities while allowing management the freedom to take decisions within a defined playing field.

Returning to our royal feast analogy, a healthy insurer is one which clearly articulates its risk appetite and successfully digests it through the organisation.

By Karl Chappell a senior manager in Oliver Wyman's Financial Services division, based in London

Article taken from: http://www.insuranceerm.com/analysis/how-insurers-can-use-risk-appetite-to-set-risk-limits.html