

Risk Appetite Service

Under the direction of the board, senior management should ensure that the bank's activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the board. It is also appropriate for many banks, especially large banks and internationally active banks, to have a board-level risk committee or equivalent, responsible for advising the board on the bank's overall current and future risk tolerance/appetite and strategy, and for overseeing senior management's implementation of that strategy.

Principles for enhancing corporate governance, Basel Committee on Banking Supervision October 2010



Real-time exposure profile of the firm

Risk appetite is a concept that many firms have trouble quantifying and incorporating into their management activity. In addition to sensible business practices, there are very specific regulatory requirements around having a clear statement of risk appetite and incorporating it into business decision making. The issues have always been: What does this actually mean? How do we do it? Some firms have introduced checks in their risk assessment asking whether the subjectively estimated exposure is acceptable from a risk appetite or not, but that is very static. For risk appetite to become meaningful, the firm needs to consolidate all of its disparate and widely-dispersed risk exposure information as and when it changes, then monitor the resultant exposure against defined thresholds.

Management is also often in a quandary around risk appetite – should they adopt an approach focussed on appearance, for example, zero tolerance of fraud, on absolute quantification, for example, maximum loss from error is \$20,000 per year, or according to what is acceptable in managing the business in pursuit of its strategic objectives, for example, a medium exposure to external fraud is “within tolerance” but a high exposure to system failures is “beyond tolerance”.

In looking at a specific exposure, for example, internal fraud and theft, there are numerous sources of data across the firm which could inform the current exposure level, such as audit findings, identified weaknesses in controls arising from risk and control self assessment, actual internal loss data, similar cases which have happened to peer firms or are reported in the public domain, staff appraisals and performance records, general ledger suspense account balances, IT security log records, behavioural key risk and performance indicators, HR records, etc. Not only is it difficult to aggregate all of this disparate data, it is a continuously changing picture where as any of these input data sources change, the aggregated exposure changes as well.

Another complicating factor is that different data sources have different attribute classification structures. When aggregating data in such a situation, the typical result is “fruit salad”, caused by grouping disparate data together. To resolve this, the firm needs a common classification “taxonomy” which it can use across all aspects of the firm's activity to ensure that that data is correctly and comparably classified.

Risk appetite is often reflected as a finite monetary amount which the firm sets as a limit on the specific risk to which it has been attached. However, given that most single data sources provide information after the event, this implies that measurement against risk appetite occurs after the risk appetite limit has already been exceeded. What is needed is an up-to-date exposure profile which is constantly updated with aggregated exposure information as and when any of the underlying data sources reflects a change. Managers understand the interrelationship between the causal factors affecting their exposure levels – using aggregation to mimic these interrelationships allows for a real-time perspective on exposure and for management to initiate remedial action before the risk appetite limits are reached.

The RiskBusiness Risk Appetite Service allows the firm to establish at multiple levels of its hierarchy the specific data sources for its various exposure profiles, then to decide what proportion of the exposure is provided by each data source. The firm can then elect how it wishes to convert the source data into a common risk rating and how these ratings will be aggregated upwards across the firm. Alternately, in order to avoid the impact of averaging which can arise when aggregating upwards, a separate exposure profile structure can be established at higher levels which uses the same source data but across a broader part of the firm and which then delivers a more accurate picture of its exposure at that point.

With the option to establish exposure profiles by product type, by geographic location, by business entity, by legal entity or by division, the potential granularity of exposure information is virtually limitless. Each exposure profile seeks to measure the current exposure to each risk category which the assessment entity has within each process type which that entity delivers. Each such "snapshot" of exposure is referred to as an "exposure point".

Having established the data sources, weightings and appropriate aggregation techniques for each exposure point, the firm can then set a variety of thresholds for each exposure point, with multiple alert triggers for when those thresholds are reached or breached. For each trigger, the specific individuals, functions or groups of people who need to be notified and the means of notification, such as e-mail, instant message, mobile phone message or on-screen warnings can also be stipulated.

On a real-time basis, as any new source data is received, the Risk Appetite Service immediately recalculates all exposure points for which that data source is used, then compares the recalculated exposure against the defined thresholds, generating alerts according to the predefined thresholds as and where appropriate. When an authorised user then looks at the relevant exposure profile, the relevant exposure point is shown updated and with the user-defined colours against it. If any exposure point changes while the user is working with the exposure profile, the user is advised through changing colours and symbols onscreen. A full audit trail of all exceptions and alerts generated is maintained, while authorised users can establish and manage remedial actions against exposure points beyond acceptable tolerance levels.

The RiskBusiness Risk Appetite Service is a web-based service, available either as an integrated component of the RiskBusiness RiskIntelliSet™ or as a standalone service. It uses PKI-technology to safe-guard the firm's data.

For more information on the RiskBusiness Risk Appetite Service, please contact RiskBusiness Services Limited through our website or email us at info@RiskBusiness.com.

LATEST ALERTS 30/06/2012 09:40:10 - Risk Appetite Thresho

Real-time onscreen "ticker" displaying alerts

Alert	Business Function	Risk Category
200802012 09:40:10 - Risk Appetite Threshold Breach - Value 11.00, Threshold: 10.00, Business entity: Demo Bank	Instruction Management	External Fraud and Theft
200802012 10:00:00 - Risk Appetite Threshold Breach - Value 11.00, Threshold: 10.00, Business entity: Demo Bank	Advisory Services	Unauthorized Activity
200802012 10:00:24 - Risk Appetite Threshold Breach - Value 11.00, Threshold: 10.00, Business entity: Demo Bank	Instruction Management	External Fraud and Theft
200802012 10:50:43 - Risk Appetite Threshold Breach - Value 11.00, Threshold: 10.00, Business entity: Demo Bank	Credit Review and Approval	Internal Fraud and Theft

Listing of risk appetite alerts generated

