



KEY ELEMENTS OF AN EFFECTIVE RAF



Risk appetite is the primary mechanism that links risk with performance

Risk Appetite	Is the nature and amount of risk we are willing and able to assume in pursuit of its strategic business objectives (qualitative and quantitative statements)
Risk Tolerance	Refers to the conditions under which we are willing to assume the risk in pursuit of its strategic business objectives (qualitative and quantitative limits)
Key Risk Indicators	Refer to the measures used to enable early warning of changes of risk exposures to ensure risk remains within risk appetite and tolerance at all times



An effective RAF will set out the approach and requirements for setting, maintaining, applying, monitoring and reporting risk appetite

1 Objectives and principles

2 Risk Appetite Statements

3 Risk Appetite Framework Components

4 Application of the RAF

5 Roles and responsibilities

6 Enterprise Limits & Tolerances

7 Monitoring and reporting of breaches

The RAF, like any other framework, formally sets out a common approach and expectations for setting, maintaining, applying, monitoring and reporting on risk appetite, to enable consistent understanding and application of key concepts and requirements enterprise-wide.

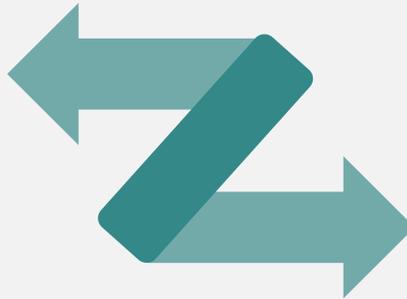
Let's examine each element in the context of operational risk...

1. Objectives and Principles

The RAF should set out clear objectives (what is the purpose and use of the RAF) and principles to help guide consistent understanding and application of the framework enterprise-wide

The core objectives of the RAF are to...

- 1** | Set parameters for the nature and amount of risk the company is willing and able to take in pursuit of its strategic business objectives.
- 2** | Enable efficient achievement of the company's short- and long-term strategy.
- 3** | Enable a risk-based approach to management of risks.



The core principles of the RAF are to...

- 1** | *Board and executive management will provide the support and means required to proactively communicate risk appetite in a way that sets the tone-at-the-top and is easy for all stakeholders to understand.*
- 2** | *It is the accountability of all employees to be aware of, understand and operate within the boundaries set by the Board approved risk appetite statements and limits/tolerances.*
- 3** | *Risk appetite must explicitly reflect and inform the company's strategic plan (i.e., risk appetite is an explicit consideration in the business planning process).*

KEY ELEMENTS OF AN EFFECTIVE ORAF

Leading practices are pushing the boundaries of operational risk appetite objectives

Risk Appetite is intended to define the *nature* and amount of risks the firm is willing to take on in pursuit of strategic objectives. To this end, there is opportunity to leverage the ORAF to promote and reinforce the behaviours that are needed not only to protect value but also to create it.



Value creation

- Value-based statements that are aligned to purpose, strategy, and corporate responsibility objectives
- Culture as a differentiator in the marketplace (brand driver)
- Attraction and retention of talent
- Attraction and retention of new clients
- Target behaviours are obvious and linked to incentives and compensation

Value protection

- Products, services, and behaviours are ethical
- Behaviours and activities are legal
- Decisions lead to outcomes within limits
- Breaches are contained and self-reported
- Prohibited behaviours are explicitly communicated and monitored

There is also an opportunity to leverage the Code of Conduct in a much more inclusive way – explicitly the positive behaviours needed just as much as the behaviours that must be avoided.

2. Risk Appetite Statements

ILLUSTRATIVE EXAMPLES OF OPERATIONAL RISK APPETITE STATEMENTS

Qualitative Statements

- ❑ Only take on risks that we understand and are mitigated through appropriate investments in talent, technology and infrastructure.
- ❑ Avoid activities that may compromise our Vision, Values, and Code of Conduct.
- ❑ Never put profits over our reputation or the trust and wellbeing of our customers and employees.
- ❑ We have zero tolerance for internal fraud.
- ❑ We will only offer products and services that are ethical, sustainable, and socially responsible.
- ❑ Zero tolerance for OREs caused by pervasively unresolved issues.

Quantitative Statements

- ❑ Ensure sound management of operational risks.
- ❑ Avoid excessive concentrations of risk.
- ❑ Ensure timely resolution of known issues.
- ❑ Maintain effective processes, controls, and resilience to change.
- ❑ We have appetite for elevated op risk when first-to-market but only with a formal risk acceptance.
- ❑ Maintain appropriate safeguards to ensure continuous delivery of critical services at all times.
- ❑ Avoid unnecessary regulatory findings

EXAMPLES

OSFI is leading by example

High appetite for early intervention, low appetite for surprises

We recognize that it is not cost-effective or realistic for us to intervene on all risks facing regulated institutions and pension plans. As such, we're willing to accept the orderly failure of a regulated institution, but we have a low-risk appetite for a surprise failure.

No appetite

Although a "no appetite" approach is often impractical, we have no risk appetite for:

- material breaches of confidentiality of sensitive information
- real or perceived regulatory capture

Creating a workplace culture that fosters diversity

We're willing to assume more risk to create a workplace culture that is:

- psychologically safe
- inclusive
- innovative
- diverse in thought and background

Agility and efficiency over perfection in decision-making

We have a higher appetite for agility and efficiency over perfection in how we make decisions.



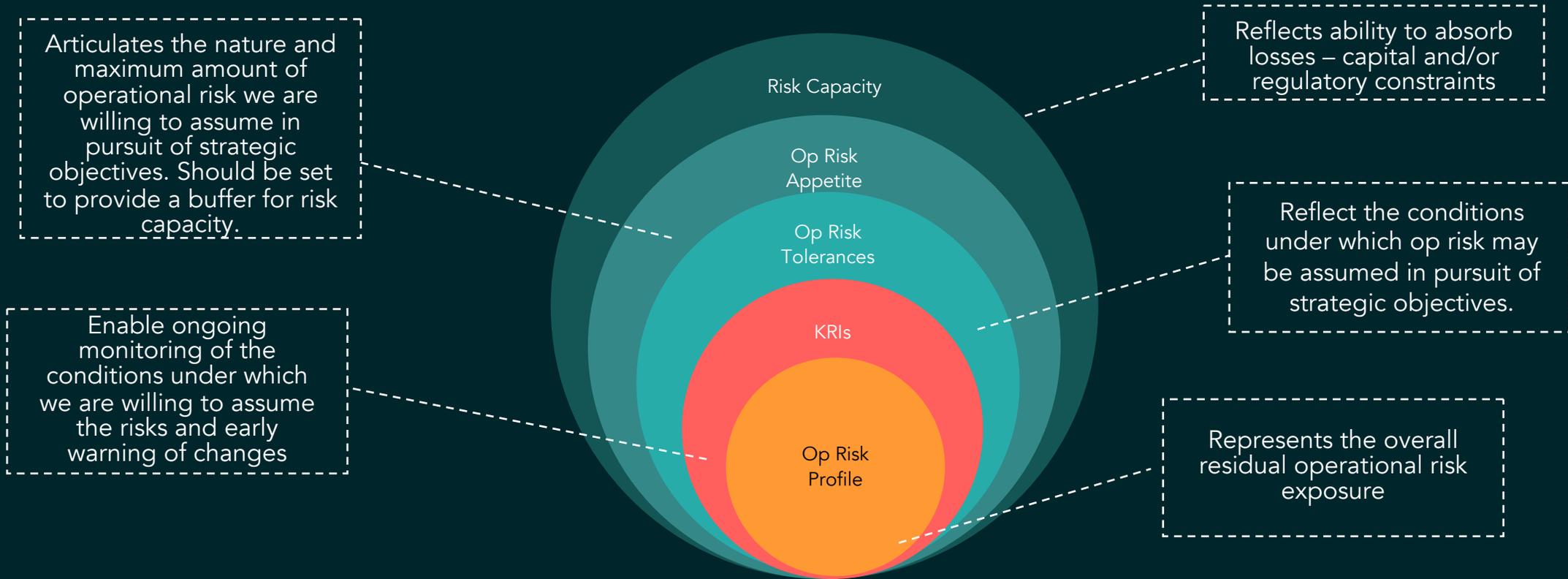
Our high appetite for early intervention means that we will respond early and proactively to address vulnerabilities associated with a deterioration in the risk profile of a federally regulated financial institution or pension plan.

This approach will also help sustain the trust of Canadians and our international counterparts.



3. Risk Appetite Framework Components

The ORAF should be comprised of the key components:



4. Application of RAF

There are several opportunities and methods by which RAF can be applied within the organization:

Delegations of authority

- Operational Risk Appetite Statements and measures should be allocated to the lines of business, central control functions, and regions, as applicable.
- Formal delegations of authority should also cascade down from board to committees to executive committees to executives themselves to enable efficient risk-based management of risks against risk appetite measures.

Strategic Business Planning Process

- Risk Appetite is integrated into the periodic strategic, financial, and capital planning processes and ongoing business decision-making processes.
- These processes are reviewed continuously to ensure Risk Appetite considerations are appropriately embedded, including new product approvals, customer onboarding, transaction suitability, projects and initiatives, etc.

Incentives & Compensation

- As part of the formal compensation governance model, employees/officers who may have a material impact on the Operational Risk Profile should have relevant risk appetite measures explicitly considered in their compensation payouts.
- Applying Risk Appetite within executive compensation practices serves to ensure unacceptable risk-taking activities, outcomes and behaviours are not rewarded, even if financial performance is strong.

Code of Conduct

- Integrate the qualitative operational risk appetite statements within the Code of Conduct
- Consider incorporating value-creating behaviours into the Code of Conduct OR creating a culture memo, similar to what very successful tech firms have done

Change Management

- Explicitly integrate and incorporate operational risk appetite statements and measures into the assessment and prioritization of new initiatives
- Consider incorporating risk appetite considerations earlier in the innovation life-cycle to proactively ensure new initiatives reflect and inform risk appetite measures

Risk Management Methodologies

- Explicitly integrate and incorporate operational risk appetite statements and measures into key risk identification, assessment, monitoring, mitigating, and reporting tools and techniques.
- E.g., risk assessment, KRIs, surveillance, testing, issues management, reporting, etc

5. Roles and responsibilities

<p>Board</p>	<p>Senior Management</p>	<p>ERM</p>	<p>ORM</p>
<ul style="list-style-type: none"> • Ultimately accountable for establishing Risk Appetite and Tolerance for the organization • Delegating authority to manage risks within certain limits • Ensuring risk-taking remains within approved risk appetite and tolerance 	<ul style="list-style-type: none"> • Day-to-day implementation of approved Risk Appetite and Tolerance • Ensuring controls are adequate and in place to manage risks to within risk appetite and tolerance 	<ul style="list-style-type: none"> • Owner of the Risk Appetite Framework and approach to establishing risk appetite and tolerance • Communicating RAF enterprise-wide • Independently reporting on enterprise risk exposures against approved risk appetite and tolerance 	<ul style="list-style-type: none"> • Establishing and proposing operational risk appetite and tolerance that aligns with the Enterprise RAF • Communicating ORA enterprise-wide • Independently monitoring and reporting on operational risk profile against approved risk appetite and tolerance
<p>Oversight Functions</p>	<p>Central Control Functions</p>	<p>Business</p>	<p>Internal Audit</p>
<ul style="list-style-type: none"> • Providing input to the development of operational risk appetite and tolerance at the enterprise level • Independently monitoring and reporting on specific operational risks against risk appetite and tolerance 	<ul style="list-style-type: none"> • Providing input to the development of 1LOD KRIs used to monitor changes in the risk environment that could affect the conditions under which we are comfortable taking on risk • Centrally reporting on specific operational risks against approved risk appetite and tolerance 	<ul style="list-style-type: none"> • Remaining familiar with approved risk appetite and tolerance • Establishing KRIs to monitor changes in risk environment that could affect the conditions under which we are comfortable taking on risk • Reporting on business adherence to risk appetite and tolerance 	<ul style="list-style-type: none"> • Independently review and test the adequacy of the design and operating effectiveness of the RAF • Escalate any material concerns regarding management’s risk-taking and/or effectiveness of risk and compliance management activities

6. Enterprise Limits and Threshold-Setting

The RAF should also include the approach taken to set limits and thresholds and include a list of enterprise-level limits.

Limits may be defined in absolute or relative terms. Absolute measures are fixed, whereas relative measures are variable and move in proportion to another element. Examples of each type are listed below:

Absolute Measure

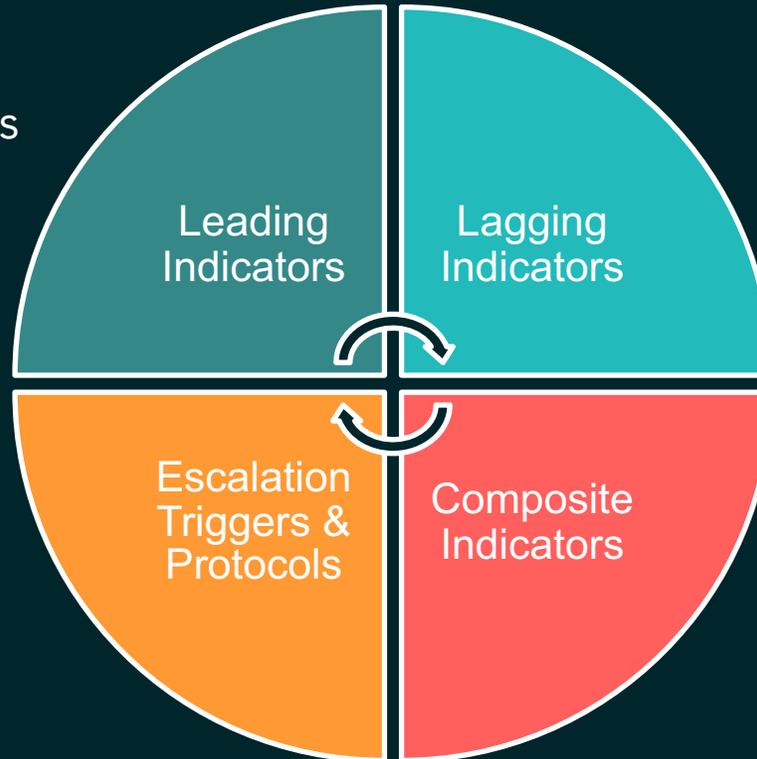
- Operational losses will not exceed \$10M per month
- Zero breaches of regulatory requirements
- Critical systems downtime not to exceed 15 minutes
- Customer complaints do not exceed 200 per month
- Losses from external fraud do not exceed \$50M per month
- Total number of customer complaints

Relative Measure

- Operational losses will not exceed 1% of revenue
- Lower instance of Compliance Orders than peer group
- Critical systems availability to remain >99.25%
- Customer complaints do not exceed 0.5% of active customer base
- Fraud losses will not exceed 25 bps (of card revenue)
- High priority customer complaints as a % of total customer complaints

7. Monitoring and reporting of breaches

KRIs that monitor changes in causes of risks



KRIs that monitor changes in risk exposures

Thresholds that when triggered signal the need for more, different, higher management attention and/or approach

Composite index of KRIs that synthesizes complex results into a single measure. Also used to monitor the relationships/correlations amongst risk factors

Thank-you!

Visit www.kmriskconsulting.com for more
courses