The Steps to Successful Risk Taking

Developing Effective Risk Appetite and Tolerance Statements

A RIMS ERM Committee Report
As the preeminent organization dedicated to advancing the practice of risk management, RIMS, the Risk Management Society™, is a global not-for-profit organization representing more than 3,500 industrial, service, nonprofit, charitable and government entities throughout the world. Founded in 1950, RIMS brings networking, professional development and education opportunities to its membership of more than 11,000 risk management professionals located in more than 60 countries. For more information on RIMS, visit www.RIMS.org.
INTRODUCTION

In the 2012 RIMS Executive Report, *Exploring Risk Appetite and Risk Tolerance*, the authors concluded that well-defined and well-thought-out risk appetite and tolerance practices can provide a number of benefits:

- Encourage organizations to take measured risks in order to generate value and avoid intolerable losses.
- Align stakeholders, including the board, senior management and shareholders, on the amount and type of risk the organization is willing to take.
- Create awareness about, and actions to prevent, excessive levels of risk that could lead to adverse consequences.

Furthermore, the report identified certain key elements to keep in mind when establishing an organization’s risk appetite and tolerance:

- Understand the concepts
- Balance risk and reward
- Use for more than financial measures
- Leverage positive aspects for taking risk
- Evolve risk position over time
- Communicate risk appetite and tolerance levels

Given the seemingly beneficial outcomes (and, at times, regulatory requirements) for articulating risk appetite and monitoring risk tolerances, why do so many remain skeptical? In a 2013 RIMS webcast, Rob Quail, who at the time was director of enterprise risk management at Hydro One, described some of the challenges in gaining value from risk appetite statements—what he referred to as “a solution in search of a problem”:  

- Unclear (or overlapping) definitions that create confusion
- Overabundance of new “made-up” words in enterprise risk management circles
- No public examples of any clear value

Clearly, risk management jargon has created a unique set of issues. This is especially true when organizations and regulators define and use the terms differently. Explaining jargon in a way that boards, management and operations can understand and actually use is even more difficult in this type of environment. Hence, risk professionals must first be able to clearly articulate the concepts in language the organization already understands. For purposes of describing practices in this and the previous RIMS report, RIMS uses the following definitions:

**Risk appetite:** 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.

**Risk tolerance:** 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.

**Risk culture:** Norms and traditions of behavior of individuals and of groups within an organization that determine the way in which they identify, understand, discuss and act on the risk(s) the organization confronts and takes.

**Risk target:** Desired level of risk that the organization believes is optimal to meet its objectives.

**Risk capacity:** Amount of risk an organization can actually bear.

**Risk attitude:** Organization’s or individuals’ view/perspective of the perceived qualitative and quantitative value that may be gained in comparison to the related potential loss or losses.

The promising news is that risk professionals and some regulators are closing the gap in common understanding of risk appetite and tolerance by defining risk appetite as risk-taking and risk tolerance as “boundaries” within acceptable limits. For example, the National Association of Insurance Commissioners (NAIC) defines the terms as follows in its 2014 *Own Risk and Solvency Assessment (ORSA) Guidance Manual*:

**Risk appetite:** Documents the overall principles that a company follows with respect to risk-taking, given its business strategy, financial soundness objectives and capital resources. Often stated in qualitative terms, a risk appetite defines how an organization weighs strategic decisions and communicates its strategy to key stakeholders with respect to risk-taking. It is designed to enhance management’s ability to make informed and effective business decisions while keeping risk exposures within acceptable boundaries.

**Risk tolerance:** The company’s qualitative and quantitative boundaries around risk-taking, consistent with its risk appetite. Qualitative risk tolerances are useful to describe the company’s preference for, or aversion to, particular types of risk, particularly for those risks that are difficult to measure. Quantitative risk tolerances are useful to set numerical limits for the amount of risk that a company is willing to take.
UNDERSTANDING THE CONNECTIONS TO STRATEGY AND TACTICS

Is understanding an organization’s “risk appetite” just a solution in search of a problem? Or can there be clear demonstrable value for clearly and formally considering risk appetite and tolerances? Rob Quail described a “leap” in understanding that created value in the conversations at his organization by breaking down the model into three parts:

• **Conceptual:** At the highest level, discussions about the organization’s corporate and individual perceived values in taking risks for particular rewards (risk attitude).

• **Strategic:** Discussions about the organization’s risk appetite in the context of individual strategic objectives, expressed not as a hard limit or ratio but in relative terms using specified criteria along a continuum shown in Figure 1.

• **Tactical/Operational:** Discussions about specific organizational objectives (such as technical innovation, shareholder return, or employee relations) and the varying boundaries (or limits) that the organization wishes to place on each of the objectives.

Quail’s organization obtained clear value from the following approach:

• **Provokes strategic discussion** by eliciting a deep understanding of the strategy, differentiating among business objectives, and formally recognizing the tangible relationship between risk-taking and value-building.

• **Delivers diagnostic value** by identifying gaps between target and exhibited outcomes, as well as discrepancies between the organization’s intent and management actions taken or needed. This diagnostic value also clarifies differences across lines of business and may signal a need for changes in internal communication, controls, incentives, etc.

The primary value gained is in having the conversations and developing a common understanding across the organization, not necessarily in creating the statements themselves. If the risk management objective is merely to create risk appetite and tolerance statements, management easily may become frustrated as there may be no single statement that provides clear understanding in every conceivable situation across the organization when making decisions. By way of example, at the end of the paper, we have included sample statements that have been developed by various organizations. We encourage you to review and note the broad differences in the statements. These examples illustrate how important it is to customize the concepts, development and communication of risk appetite and tolerance statements based on these conversations within an organization.

Figure 1. Risk Appetite Continuum from RIMS webcast, Risk Appetite: A Solution in Search of a Problem, 2013, Rob Quail

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Averse</td>
<td>Minimalist</td>
<td>Cautious</td>
<td>Flexible</td>
<td>Open</td>
</tr>
</tbody>
</table>

- **“Sacred”** – avoidance of risk is a core objective
- **Extremely low tolerance for uncertainty**
- **When faced with multiple options, will choose the one with the lowest risk, always**
- **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 and accept the possibility of failure**
- **Willing to trade off this objective against others**
INTEGRATING, VALIDATING AND ADJUSTING RISK APPETITE AND TOLERANCE STATEMENTS

To be fully effective, risk appetite should be integrated into an organization’s strategic framework. A three-part process can be used to apply questions regarding risk appetite and tolerances conducted not only at the time of strategy and specific business development, but through execution, as well (Figure 2).

Develop
Upon developing high-level strategies and resource allocation ask:
• Given our business context, what is our appetite for risk?
• Given our appetite, have we got the right business model?
• Are we comfortable with the assumptions we have made?

Communicate
To communicate high-level strategies down to specific business objectives:
• Define specific business objectives and appetite for specific entities or business/product segments.
• Allocate resources by risk category, product or business lines.

Execute
With respect to execution risks ask:
• Are we on-track to achieve our business objectives?
• Are we operating within appetite (are we talking too much or not enough risk?)
• Do we have the right level of controls in place?
• Are we aligning to our strategic agenda?

Integrating risk appetite concepts into business decisions, particularly on an aggregated basis, can be quite challenging. Risk professionals and business executives may differ at times in understanding the organization’s ability and constraints in taking risks. However, one thing is evident: Conversations about risk-taking and tolerance limits often reveal disparities or concurrence between various levels of returns based on the objectives within acceptable risk limits throughout the organization, whether on a strategic or tactical level. It is precisely the conversations themselves, and the adjustments in risk appetite and tolerance, that provide value. By delivering consistent guidance in pursuing opportunities, protecting against threats, and maintaining operational results within the agreed levels for risk-reward balance, organizations can remain flexible as the strategy plays out, particularly as evolving circumstances confirm or undermine assumptions made at the time the strategy was developed.

To illustrate the fact that there is no one “right” way to carry out these conversations, and how differently risk appetite statements are used, three organizations with very different approaches are described in the following sections.

Figure 2. Risk appetite integrated within an organization’s strategic framework. From RIMS 2013 ERM Conference session, Risk Appetite as a Strategy for Strategy, as presented by Frank Fiorille, Paychex, Inc.
As part of its enterprise risk management program, a manufacturer and distributor developed qualitative and quantitative risk appetite and tolerance statements. In practice, management proposes an appropriate risk appetite and manages risks to comply with risk policies, and the board approves the risk appetite and tolerance levels. Management notifies the audit committee when risks exceed policies (tolerances) and recommends adjustments to risk tolerances in response to emerging trends.

The process of developing the risk appetite statement was iterative as management and the audit committee worked closely to consider the implicit risk appetite as demonstrated in previous risk discussions and risk-taking activities documented in board strategy and plan reviews. This included review of significant investments, debt strategies and capital plans. The process included review of company policies, management and board interviews and external data such as debt covenants, shareholder resolutions and regulator expectations.

Various quantitative and qualitative factors were considered in development of the risk appetite statements including strategic goals, board expectations, corporate values and reputation, financial targets, and operational targets. The risk appetite statements address aspects relating to the organization’s financial tolerances, which are measured in quantitative statements, as well as aspects relating to the company’s values and culture, which are represented in qualitative terms.

Various drafts of the risk appetite statements were reviewed with management and the audit committee for comment and revisions. The final version was then approved during the audit committee meeting along with a review of the respective risk dashboard, risk policies, and risk map information. The final risk appetite statements include tolerance levels and a red/yellow/green evaluation depending on whether the risk limits have been exceeded, are approaching tolerance levels, or are within tolerance levels, as illustrated in Figure 3.

**Risk Appetite and Risk Tolerance Policy Statement:** Risk appetite is defined as the acceptable risk that the organization is able to manage or absorb in the event the risk materializes. Management will formulate quantitative and qualitative risk tolerances and regularly review risk exposures against these tolerances.

**Risk Response Policy Statement:** The organization will achieve its strategic objectives, while managing risk to acceptable levels. The organization will aim to actively avoid risks that could:

- Negatively affect the safety of our employees
- Negatively affect our reputation
- Knowingly breach laws and regulations
- Put the company’s future existence at risk

The CFO is responsible for reviewing and monitoring the on-going appropriateness of the risk appetite statements, the acceptable risk tolerances and the overall status (red, yellow, green). The CFO obtains input and updates from its executive leader peer group for review of metrics and status levels. The updated risk appetite document is reviewed as part of the bi-annual risk management board reporting process.

Risk tolerances are reviewed and discussed at the audit committee meetings as required, depending on the nature of the risk and whether the tolerances have been, or may be approaching, unacceptable target levels.

Proposed updates of the risk appetite statements are considered at the beginning of each year taking into account changes in the company strategies, growth goals, board input on risk evaluations, financial and operational targets, etc.

**Figure 3. Illustrative example of risk appetite and tolerance statements related to specific objectives.**

<table>
<thead>
<tr>
<th>Quantitative Risk</th>
<th>Risk Appetite Statement</th>
<th>Acceptable Risks and Actions</th>
<th>Status</th>
</tr>
</thead>
</table>
| Earnings/ Earnings Volatility | • Deliver quality earnings and avoid activities that drive short-term earnings at the expense of strategies  
• Seek a high-margin, high-return business model | • EBIT levels at XX% above break-even  
• Manage ROIC to be XX% or greater  
• Operating margin in excess of XX% | ✓ |
| Capital Requirements | • We will internally fund capital needs for business activities  
• We will operate with limited to modest debt  
• We will operate with modest leverage ratios | • Manage capital spend as a % of revenue at X% to X%  
• Debt-to-equity less than X% | ✓ |
| Financing | • We desire credit that maximizes sales, while managing risk/reward through credit and economic cycles  
• We will adjust credit policy in response to trends | • Subprime credit at less than X% of originations; losses at less than X%  
• Manage credit losses at less than X% | ✓ |
| Liquidity/Credit Ratings | • We have no appetite to operate outside debt covenants  
• We require a diversified approach to funding  
• We will maintain a minimum of XX months of liquidity | • Maintain a minimum of XX months of cash or committed credit facilities  
• Credit rating of XX or better | ✓ |
| Qualitative Risk | | | |
| Competition | • We will lead innovation in XX and XX segments  
• We will monitor market share to understand customer preferences and price/value relationship | • Share of X market segment to be at or above XX%  
• Share of XX region to remain in top X | ✓ |
| Reputation | • We will not take risks that threaten our reputation for safety, innovation, governance or sustainability  
• We manage our businesses, operate our facilities and employ our people consistent with our values  
• We prudently prepare to manage corporate crisis events | • Monitor non-compliance issues  
• Monitor brand strength and quality  
• Further enhance safety awareness  
• Crisis response plans to manage product, service, safety and quality | ✓ |
| Legal/Regulatory Compliance | • We have no appetite for illegal or unethical actions taken on the company’s behalf by employees, suppliers, other parties | • Zero tolerance for non-compliance with laws  
• Monitor audits and regulatory findings | ✓ |
| Operational Execution | • We will operate in accordance with annual and strategic business plans  
• We will develop comprehensive contingency plans | • Manage supply in line with demand  
• Annual review and refresh of contingency plans | ✓ |
| Sales Growth | • We will not enter markets that create high brand risk  
• Cost of entry, legal considerations and risk of loss with an ROI premium will be assessed prior to market entry | • Subsidiaries achieve break even within X years  
• Distributor network profitability | ✓ |
DRIVING ACTION PLANS AT A NONPROFIT SERVICE ORGANIZATION

In order to develop its risk management strategy, a nonprofit service organization first formed an enterprise risk management panel that identified the top residual risks and opportunities using a formal enterprise risk management assessment process. Based on analysis of the information, input from the executive team and the audit committee, a risk register was created. From there a risk appetite statement was created and risk tolerance statements were developed, supported by metrics.

Risk tolerance is defined as the amount of uncertainty the organization is prepared to accept in total or more narrowly within a certain business unit, a particular risk category or for a specific initiative. Expressed in quantitative terms that can be monitored, risk tolerance is communicated in terms of acceptable or unacceptable outcomes or as limited levels of risk. The risk group worked with the metric owners to determine the future possibility of receiving the data. A risk scorecard report is updated quarterly and for each underlying driver, the data source and a valuation date is included, along with a data dictionary. As part of gaining acceptance within the organization, the group took several steps to validate and periodically adjust the statements and the actions based on the desired levels. These included:

- Audit committee reviewed the statements for the purpose of approving the process (but not the metrics).
- Refined the metrics and tolerances with the owners to develop target and actual metrics (within a specific timeframe, for example).
- Once the process stabilized, discussed with the owners the weighting of each metric (initially weighted equally).
- When metrics are off-target, developed process by which owners indicate how they are monitoring and managing the risk.
- Identified metrics that indicate when risks are beyond the tolerance levels and determine what actions will be triggered.
- Evaluated using decision analysis methodologies throughout the organization.

Understanding the strategic objectives for the organization and evaluating risks that could impact the achievement of these objectives is critical. The enterprise risk management program focuses on decision analysis methodologies to evaluate programs, projects and initiatives. Decisions are made using an informed approach and in alignment with risk appetite and strategy.

Below are two examples of how this organization differentiates and applies specific metrics to tactical/operational objectives and related risks, as well as management action plans.

<table>
<thead>
<tr>
<th>Metric</th>
<th>Target</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>PCI Compliance</td>
<td>% of Compliance</td>
<td>100%</td>
</tr>
<tr>
<td>Security Risk Management Program</td>
<td>% of Completion</td>
<td>100%</td>
</tr>
<tr>
<td>ISO Compliance</td>
<td>% of compliance with ISO 27001 / 27002</td>
<td>95%</td>
</tr>
</tbody>
</table>

| Score | 78% |

Objective: Maintain Brand/Reputational Value
Risk: Failure to protect/build our brand may cause our value to erode over time and, ultimately, impair our ability to sustain value proposition.

Management Plan: Develop brand architecture statement to guide all external communications. Have retained new advertising and public relations agencies to ensure integrated communications. Re-launch website within 12 months.

Accountable Executive: Chief Marketing Officer

<table>
<thead>
<tr>
<th>Metric</th>
<th>Target</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brand Trust Rank</td>
<td>Trust Rank</td>
<td>#1</td>
</tr>
<tr>
<td>Brand Trust %</td>
<td>Score</td>
<td>50</td>
</tr>
<tr>
<td>Score</td>
<td>90%</td>
<td></td>
</tr>
</tbody>
</table>

Objective: Maintain Data/Systems Security
Risk: Ability to safeguard data and critical operational data.

Management Plan: The execution of a 12–point plan to lock down intrusion detection and protection is underway. The Security Risk Management Framework is underway and will be updated quarterly. Assess systems against ISO 27001/27002.

Accountable Executive: Chief Information Officer
A global insurance company approaches risk appetite by providing actionable guidance as it is integrated into:

- target setting of financial performance metrics;
- business group strategy, both to reflect the current risk tolerance and its effect with the business strategy and the enterprise-level strategy process that defines the tolerances;
- involvement and interaction between senior management and the board.

The scope is broad, from board-level strategic issues to operational execution, safety, and new ventures or projects, in order to help achieve targets or timelines. The end result is information to help ensure risk “ownership” for solutions and supports budgeting for treatment, allowing team members to manage risks proactively to avoid losses to people, property, and profit. Three steps are used, starting with a vulnerability and risk assessment, mapping within tolerance boundaries and then developing plans to reduce/improve risk as illustrated in Figure 4. The process shown emphasizes a customization that reflects the organization’s risk attitude towards risk as “loss.”

After the risk tolerance is agreed upon, the identified risks are plotted against the tolerance boundary. A risk owner is identified whose responsibility is to develop and implement action plans or other management actions. The action plans are implemented to reduce the level of risks that are outside of the tolerance boundary or for those risks within tolerance but are significant enough to warrant further action (e.g., to apply extra controls that reduce the likelihood or impact or to lower the risk of the event materializing).

From a responsibility perspective, all employees, regardless of seniority, are directed to manage risk in accordance with the principles outlined in risk statements and the corporate risk policy. Further, all employees have a responsibility to escalate risks and issues to senior management if they believe that a risk is not being adequately managed.

Specific risk tolerance considerations that are taken into account within this organization include:

- The (one-year) business plan is the basis of the limits. Limits are computed so as to accommodate (and not constrain) the business plan.
- Lower level limits aggregate to higher level limits, forming a consistent limit system.
- Overall quantitative and qualitative statements provide guidance on the operational risk appetite for the organization.
- Specific available risk capital limit for items such as investments and other metrics.
- Tolerances set for business operating profit risk based on the organization’s total risk profile.
- Other options that may be considered include capital, earnings, budget, reputation, solvency ratio, ROA, ROI, ROCE, volatility, EBITDA, revenue, EPS, banking covenants, safety metrics, etc.

**Figure 4.** Process steps starting with risk identification, profiling along risk tolerance boundaries leading to improvement plans.
CONCLUSION

Clearly, organizations have developed numerous and quite different approaches to applying the risk appetite “solution” to strategic and operational “problems.” The major shift, from a value perspective, is in creating a closer alignment with strategy and objectives for risk-taking within limits, rather than focusing solely on the effect of uncertainties on those objectives (“risk”). Risk appetite statements, while useful for guidance and managing, are not an end to themselves. Indeed, focusing on creating the statements alone may lead organizations off the value track. Rather, it is the conversations, connections to strategy and objectives, communication and commitment that produce tangible value for organizations.

In summary, the characteristics of well-defined corporate risk appetite statements are:

• acknowledgment of a willingness and capacity to take on risk;
• documented clearly and concisely;
• communicated at all appropriate levels of the organization;
• representative of key aspects of the business;
• reflective of strategy, organizational objectives, business plans and stakeholder expectations;
• inclusive of a tolerance for quantifiable loss;
• understood and backed by the board; and
• periodically reviewed and revised based on evolving industry trends and market conditions.

There is no “right” or “wrong” approach to defining an organization’s risk appetite—both quantitative and qualitative measures offer meaningful insight into the corporation’s collective stance on risk-taking. There are many approaches to defining risk appetites across organizations, but ultimately the approach is less important than the principle of discussing risk appetite itself. Even if an organization chooses not to use the terms “risk appetite” and “risk tolerance,” the conversations about these boundaries are certainly worth the effort.

When properly understood and clearly defined, a formal risk appetite can become a powerful strategic tool not only for managing risk, but also for maintaining an effective balance between risk and reward.
SAMPLE RISK APPETITE AND TOLERANCE STATEMENTS

Risk appetite and tolerance statements can help firms make better strategic and tactical decisions by emphasizing the risk perspective in decision making and providing greater information about risk-reward balance. They can also foster risk transparency by establishing consistent thinking, processes and actions throughout an organization.

The risk appetite and tolerance statements and related actions in these examples reflect actual statements that are used within various organizations, tailored for their specific objectives and priorities, and designed to foster appropriate actions to operate within the boundaries they have established.

When creating customized risk appetite and tolerance statements of their own, users should ask the following questions:

- What is the nature (or type) of risks to be assumed?
- What is the amount of risk to be taken?
- What is the desired balance of risk versus reward?
- Is this statement easily understood and communicated to the organization?

Disclaimer:

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COMPLIANCE

Legal/Regulatory Compliance

Appetite Statement: We have no appetite for illegal or unethical actions taken on the organization’s behalf by employees, suppliers, customers or other parties.

Tolerance: Zero tolerance for non-compliance with laws.

Action: Monitor audits and regulatory findings. All known non-compliance instances will be reported to the chief compliance officer and escalated per our compliance program.

Regulation Compliance and Allocation of Resources

Appetite Statement: Our organization has a low risk appetite for non-compliance with all regulations and laws. We direct our limited resources to programs to train and increase awareness of those compliance areas that pose the highest risk impact to our organization.

Tolerance: Because we have a low tolerance for injury or harm to our employees, customers, and community, we have a low tolerance for employee non-compliance with our safety and security policies.

Action: Employee non-compliance with our safety and security program will require action and the consequences will range from coaching to progressive discipline.

FINANCIAL

Achieving Financial Strategy and Goals—Operating Margin

Appetite Statement: Our organization has a low risk appetite for cost structure inflation and wants stabilization by keeping infrastructure costs flat to down while maintaining expense/revenue ratios of non-infrastructure costs.

Tolerance: Our organization’s risk tolerance for any increase over our target operating margin of X% is zero.

Action: Our organization will monitor our operating margin and make expenditure adjustments needed to stay within our tolerance.

Achieving Financial Strategy and Goals—Revenue Per Customer and Products Per Household

Appetite Statement: Growth must come from selling more products into our customer base. We have a high risk appetite for growth and must focus on two new growth metrics: revenue per customer and products per household. Our strategy is enabling customers to receive quotes online and change agents’ role to sales consultant from order taker.

Tolerance: Our organization’s risk tolerance on growth is X% revenue/customer and X% in products/household. The risk tolerance surrounding our strategy is that online quotes will be in place by no later than [DATE] and we will implement and have X% completion of all sales training programs.

Action: Our organization will monitor revenue per customer and products per household and make adjustments needed to stay within our tolerance.
Capital Requirements
Appetite Statement: We will internally fund capital needs for business activities. We will operate with limited to modest debt. We will operate with modest leverage ratios.
Tolerance: EBIT levels at X% above breakeven. Manage ROIC to be X% or greater. Operating margin in excess of X%.
Action: In order to operate outside this tolerance level, the CFO will need executive team and board approval.

Cash Management
Appetite Statement: We have a very low appetite for poor management of cash, turn-in times and theft, balanced against higher risk appetite for having a high degree of cash payments in order to meet our customer needs.
Tolerance: Tolerance level of cash turn-in time is 24 hours and we have zero tolerance for theft.
Action: Cash turned in over 24 hours will flag a review and theft will result in an incident review committee for possible termination.

Credit Management
Appetite Statement: We desire credit that maximizes sales, while managing risk/reward through credit and economic cycles. We will adjust credit policy in response to trends.
Tolerance: Subprime credit at less than X% of originations. Losses at less than X%. Manage credit losses at less than X%
Action: In order to operate outside this tolerance level, the CFO will need executive team and board approval.

Earnings/Earnings Volatility
Appetite Statement: Deliver quality earnings and avoid activities that drive short-term earnings at the expense of strategies. Seek a high margin, high return business model.
Tolerance: EBIT levels at X% above breakeven. Manage ROIC to be X% or greater. Operating margin in excess of X%.
Action: Monthly earnings review by executive team. Report of deviations outside tolerance levels delivered to the board.

Earnings Volatility
Appetite Statement: The organization will manage economic earning volatility by having a long-term target X% RAROC (hurdle rate) over the cycle. The organization does not want to see drops in earnings by more than X% in a 1-in-20-year event. In other words, the organization should earn at least X% RAROC with a probability of X%.
Tolerance: The overall target RAROC of X% needs to be met. The new business projection should also consider the phase of cycles for different lines of business (hard market or soft market). Maintain a minimum X% premium growth rate.
Action: Monthly earnings review by executive team. Report of deviations outside tolerance levels delivered to the board.

Liquidity/Credit Ratings
Appetite Statement: We have no appetite to operate outside debt covenants. We require a diversified approach to funding. We will maintain a minimum of X months of liquidity
Tolerance: Maintain a minimum of X months of cash or committed credit facilities. Credit rating of X or better.
Action: Monthly review by executive team. Report of deviations outside tolerance levels delivered to the board.

Liquidity Requirements
Appetite Statement: The organization will maintain a liquidity level to meet payment requirement for a 1-in-200-year event for a continuing period of three months. The organization will maintain liquidity at the confidence level of X% while the liquidity cost to meet cash payments at the confidence level of X% (1 in 200 years) is less than X% of capital.
Tolerance: In business planning, the projected overall liquidity position has to remain consistent with risk appetite. Liquidity requirements need to be considered when allocating capital to different risks. Strategic asset allocation should consider the liquidity of assets and the likely liquidity cost. It requires a bottom up approach to identify and quantify all the factors that affect required liquidity and available liquidity.
Action: Monthly review by executive team. Report of deviations outside tolerance levels delivered to the board.

Regulatory Pricing Mandates
Appetite Statement: We have a low risk appetite for regulatory pricing changes either up or down as this can create unattractive pricing for our customers and/or financial risk for our organization. As we have limited control over this external risk, we have a high appetite for monitoring this risk and diversifying our revenue sources.
Tolerance: We will not have more than X% of our revenue from one source within the next five years.
Action: We will develop a strategic plan to come within our risk tolerance.
Reporting

**Appetite Statement:** We have a very low appetite for untimely or inaccurate reporting balanced against a complex systems environment; therefore, we have a higher appetite for limited reporting at this time.

**Tolerance:** Our tolerance is focused on accuracy of reporting therefore we will accept no more than X% data errors in a given cycle.

**Action:** Errors in data quality greater than X% in a given cycle will be reviewed by the executive team and corrective action plans developed.

Tools for Employee Engagement

**Appetite Statement:** We have a low risk appetite for managers that do not support and develop their teams; therefore we have a high risk appetite for investing in managerial development and training.

**Tolerance:** We will increase our investment in management training by X% over the next three years and measure success through KPIs—retention, promotion, etc.

**Action:** We will monitor the execution and effectiveness of our management training programs and adjust in order to meet our tolerance level.

HUMAN CAPITAL

**Education and Training to Improve Compliance**

**Appetite Statement:** We have a low risk appetite for a decrease in the quality of our people and for non-compliance either out of ignorance or willfulness; therefore, we focus on education, training, and accountability.

**Tolerance:** We will execute X% on our training programs and performance plans to ensure continuous improvement in our work environment and outcomes.

**Action:** We will monitor our progress and should we be lagging additional resources and focus will be deployed.

**Health Care Costs**

**Appetite Statement:** We have a low risk appetite for the significant financial impact that the health care environment has on our operations, balanced with a high appetite to attract and retain employees and contribute to their ability to improve their health.

**Tolerance:** We will not accept more than an X% increase on any renewal.

**Action:** If an increase in cost of plans is greater than X% in a given renewal, then plans and cost-sharing strategies will be reevaluated.

**Human Capital**

**Appetite Statement:** We have a low risk appetite for a decrease in the quality of our people; therefore, we invest in their well-being and performance.

**Tolerance:** We will execute X% on our training programs and performance plans to ensure continuous improvement in our work environment and outcomes.

**Action:** We will monitor our progress and should we be lagging additional resources and focus will be deployed.

OPERATIONAL

**Building Agility into Operations to Improve Resiliency**

**Appetite Statement:** We have a high appetite for developing, implementing and testing business continuity and other recovery plans (X year cycle).

**Tolerance:** We have a low tolerance for disruption to our customer experience.

**Action:** We will complete our resiliency plan by [DATE]. We will monitor our progress and allocate additional resources and focus if we are lagging.

**Operational Execution**

**Appetite Statement:** We will operate in accordance with annual and strategic business plans. We will develop contingency plans at all levels of the organization.

**Tolerance:** We will manage supply in line with demand and conduct an annual review and refresh of contingency plans.

**Action:** Monthly gap reports from operational units will be reviewed by executive team.

**Physical Presence**

**Appetite Statement:** Our organization places customer experience amongst its highest priorities and also understands the need to balance the costs of maintaining physical locations. Our organization has a low appetite for poorly executed physical presence selection and management and this must be balanced with a higher appetite for creating an excellent customer experience.

**Tolerance:** Through surveys, our organization monitors targets by channels including branch experience. Current target is X% plan to reduce X/Y expense by X%.
Action: Any location falling below the target for more than two consecutive quarters will trigger a review of the location’s physical presence selection and management. We will monitor the plan to reach X% reduction target.

REPUTATIONAL

Third Party Behavior

Appetite Statement: We have a very low appetite for third parties who threaten our customers’ experience or do not significantly enhance the value thereof.

Tolerance: We do not have a tolerance for any third party who violates laws or regulations.

Action: Any third party who has been found to have knowingly violated a law or regulation will be replaced.

Employee Behavior

Appetite Statement: We will behave according to our code of conduct and because our appetite is very low our internal review committee will review all incidents.

Tolerance: All findings of misconduct will require action and the consequences will range from coaching to progressive discipline and we do not want to experience a greater than X% increase in events year over year.

Action: If we see an X% or greater increase in incidents then we will review and, if appropriate, revise our code of conduct and other related documents/programs. This will be monitored and if we are lagging then additional resources and focus will be put in place.

Safeguarding Information

Appetite Statement: We accept the risk of storing and transmitting data that is commensurate with our need to have timely and accurate customer information in order to serve our customers.

Tolerance: We have a very low tolerance for privacy violations or security breaches of protected information.

Action: We will ensure over the next year that all of our systems, processes (cyber or non-cyber) and third-party providers have appropriate safeguards in place. Compliance reports will be monitored by the executive team and progress will be reported to the board.

REPORTING

Accurate and Timely Reporting of Financials to Management

Appetite Statement: We have a high appetite for accurate and timely data, balanced against the deployment of new systems, which has resulted in some reporting challenges, and a desire to change from a legacy environment that was data rich and information poor.

Tolerance: We will aim to develop a limited number of reports that deliver great information.

Action: We will have a process in place to monitor and control the number and quality of the reports.

STRATEGY

Ability to Execute on Plan

Appetite Statement: In order to deliver an excellent customer experience and improve our customer value, we must be able to effectively and efficiently execute our strategy and operational plans. We have a very low appetite for time and cost overruns.

Tolerance: Initiatives and projects will not fall outside the parameters set in their project management and/or budget plans by more than an X% variance on time or expense.

Action: If initiatives and projects fall outside of the X% variance, they will receive additional review from the executive team and may be modified or eliminated.
Aligning with Consumer Trends

**Appetite Statement:** Our organization operates in a highly competitive market. To compete we must adopt a higher risk appetite related to product development and partnerships.

**Tolerance:** We will not accept a risk in a new business line that will reduce our operating earnings by more than X% over the next ten years.

**Action:** We will evaluate new lines of business and partnerships and not move forward if analysis indicates it is outside our tolerance level.

Brand/Ecosystem

**Appetite Statement:** The organization has a low risk appetite related to risk events that could harm its brand. It also has a low appetite for the length of time to deliver state-of-the-art technology.

**Tolerance:** We will closely monitor customer and community opinion to guard our brand (a change in satisfaction of greater than X% will warrant action). We expect the customer facing systems to be state-of-the-art by [DATE].

**Action:** If out of tolerance range, then the executive team will evaluate the need for additional resources.

Competition

**Appetite Statement:** We will lead innovation in X and Y segments. We will monitor market share to understand customer preferences and price/value relationship.

**Tolerance:** Share of X market segment to be at or above X%. Share of X region to remain in top X.

**Action:** If out of tolerance range, the executive team will adjust strategy and operating plan.

Global Growth

**Appetite Statement:** We will not enter markets that create substantial risk to the brand. Cost of entry, legal considerations, and risk of loss with an ROI premium will be assessed prior to market entry. We will ensure the distribution network as a whole remains profitable.

**Tolerance:** New subsidiaries achieve break even within X years and the distributor network is profitable (net profit before tax).

**Action:** All expansion to new markets will be reviewed by the executive team and approved by the board.

Leveraging Subsidiaries to Diversify Business

**Appetite Statement:** We have a high risk appetite for leveraging our subsidiaries to diversify our lines of business.

**Tolerance:** We have a low tolerance for not meeting our strategic goals with our subsidiaries and therefore any failure to execute on plan (either time or revenue) is unacceptable.

**Action:** Our organization will monitor our growth metrics and strategy metrics and adjust our resources to execute on our strategy including developing trigger points where we pull back investments to stem losses.

Maximizing Outcomes from Third-Party Partners

**Appetite Statement:** We have a high risk appetite for meeting our strategic objectives without adding costly infrastructure.

**Tolerance:** We have a low tolerance for poor third-party performance and therefore we are diligent in establishing appropriate controls around our third-party providers.

**Action:** Service level agreements and contracts will be monitored and partner risk profiles developed with tolerance KPIs and KRIs. Partners falling outside of the tolerance KPIs and KRIs will be put on improvement plans, and expected to improve or be replaced.

**TECHNOLOGY**

Technology

**Appetite Statement:** We have a low risk appetite for continuing with outdated and legacy systems. We have a high tolerance for moving forward with new systems even with some element of risk in execution and performance.

**Tolerance:** We evaluate new systems for potential “bugs” and disruption and we will not tolerate launching a system that is known to cause disruption for more than X% of our customers.

**Action:** On systems where the review indicates a known disruption of more than X% of customers, we will delay deployment.