

RISK APPETITE

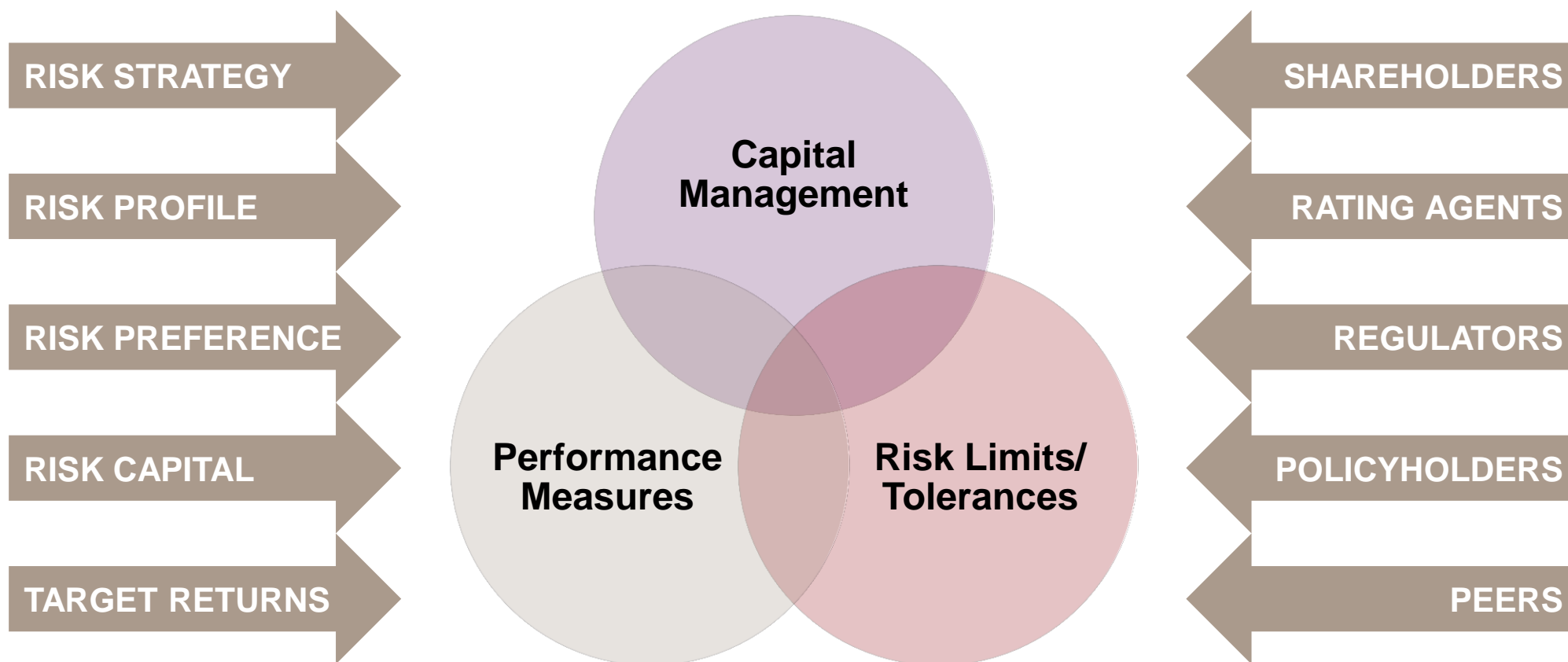
OMAR RIPON, PARTNER, HEAD OF RISK ADVISORY

21 May 2013



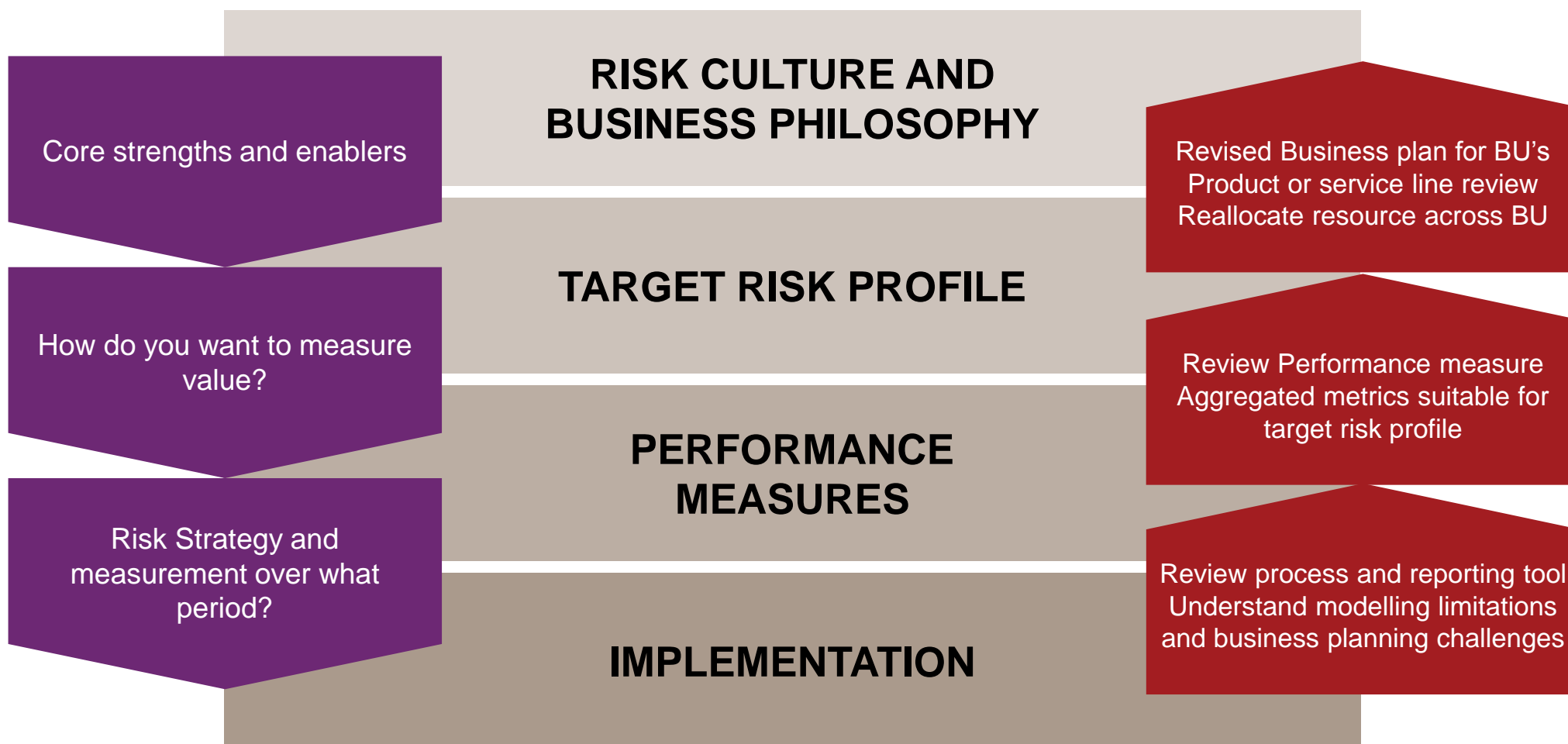
Risk Appetite Framework Overview

Risk Appetite Framework should include both capital management and appropriate performance measures to ensure risk limits set as part of the risk strategy can be monitored, reviewed and reported for continual improvements.



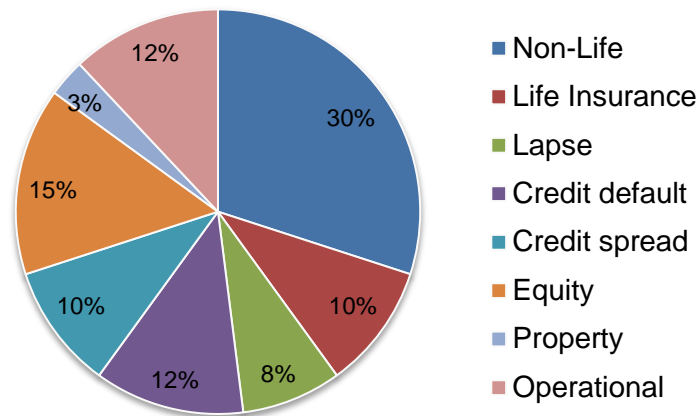
How do you set your Risk Strategy?

All insurers should have a clearly articulated risk strategy that considers strategic aims, business philosophy, and organisational risk culture which can be translated into a measureable target risk profile. The risk strategy is realised by implementing limits and tolerances across risk classes and/ or business units which reflect the target risk profile.



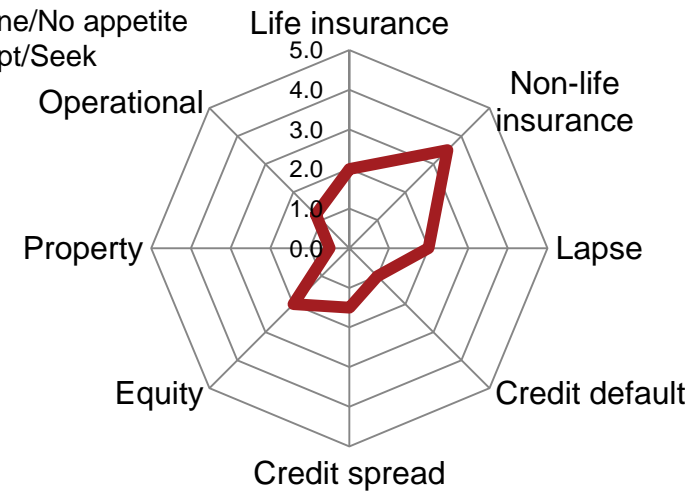
Setting your target Risk Profile

Current Risk Profile

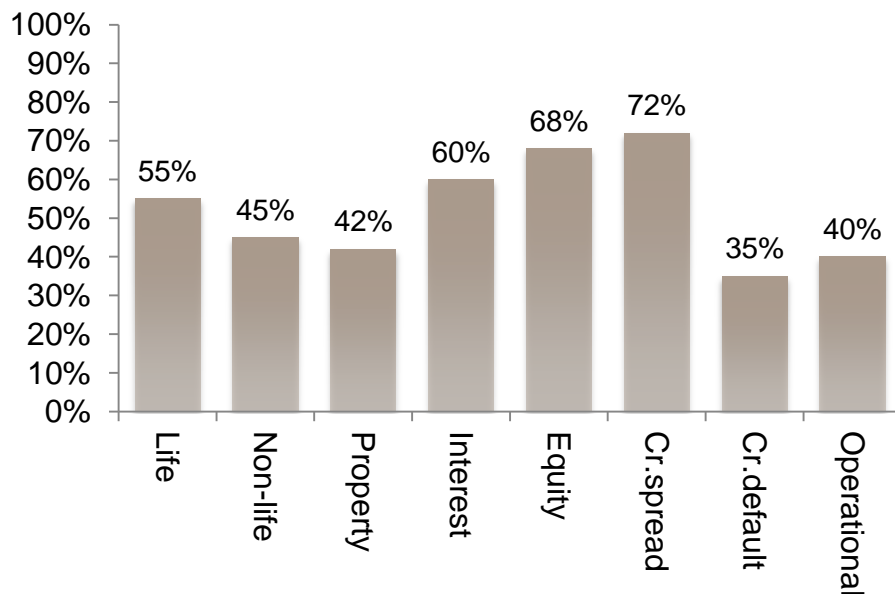


Risk Preference

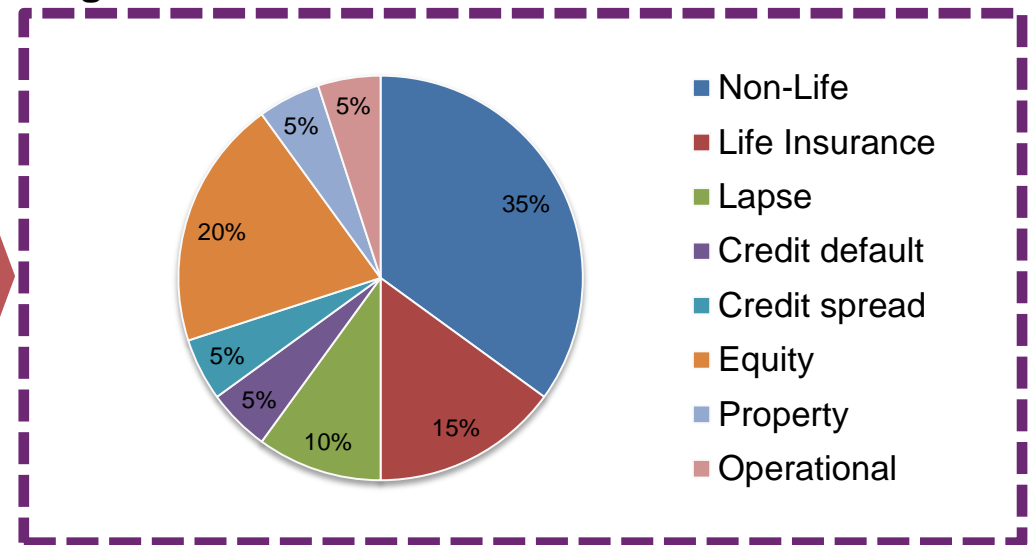
0 = Decline/No appetite
5 = Accept/Seek



Marginal contribution to risk capital



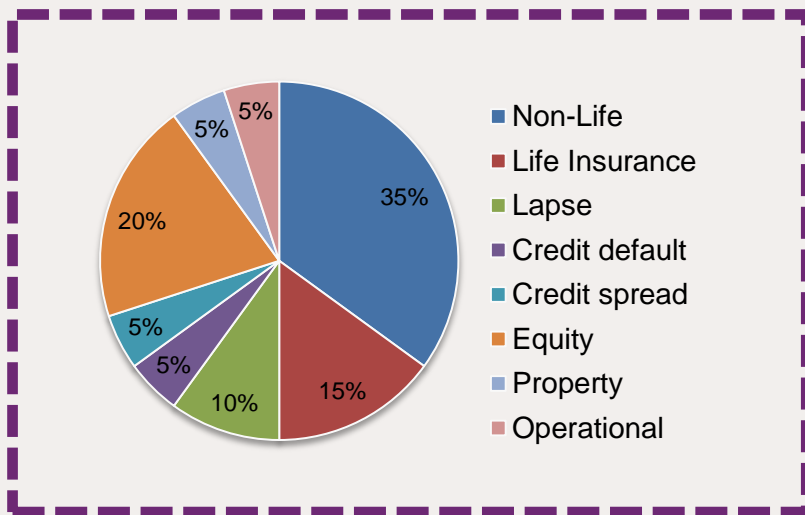
Target Risk Profile



Linking Risk Metrics to target Risk Appetite

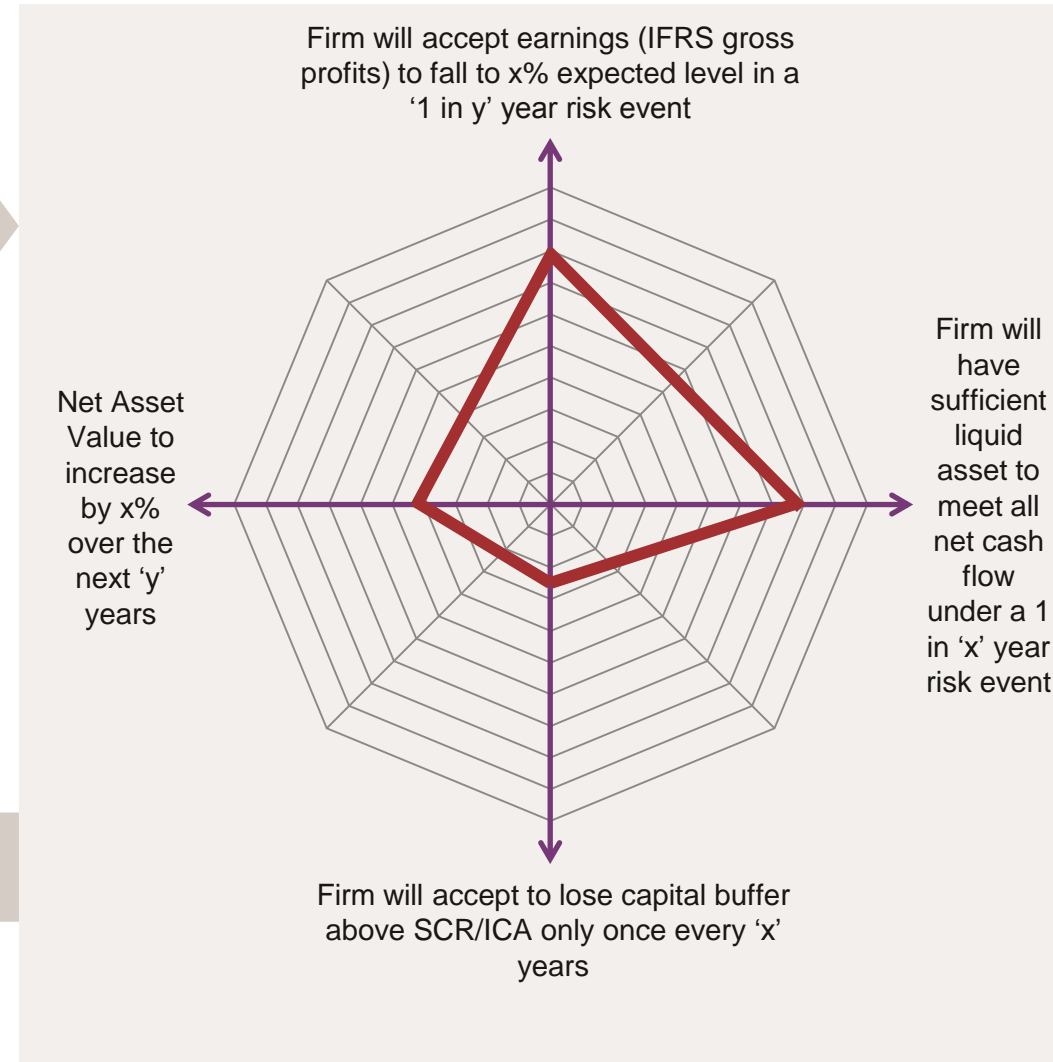
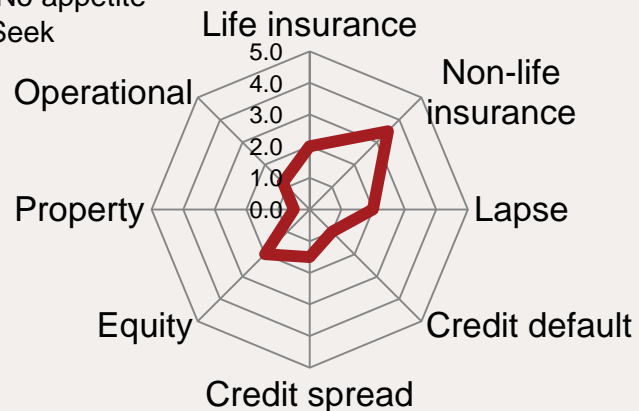
The target risk profile should reflect the firms strategic objectives in terms of growth, cash flow management, financial stability and earnings volatility.

Target Risk Profile



Risk Preference

0 = Decline/No appetite
5 = Accept/Seek



Performance Measures

Note: RBC Profit can be either Solvency II profit or ICA realistic balance sheet profit measure (i.e. change in Own funds or available capital)

$$\text{Economic Value (EV)} = \underbrace{\text{Risk Based Capital (RBC) Profit}}_{\text{Profit measurement (£)}} - \text{Hurdle Amount}$$

$$\text{EV} = \underbrace{\text{RBC Profit}}_{\text{Profit measurement (£)}} - \underbrace{\text{Required Return for Risk-taking} - \text{Frictional Cost of Capital}}_{\text{Hurdle required ('required return on capital penalty')}}$$

$$\text{Frictional Cost of Capital} = \text{Risk Capital} \times \text{Frictional Cost of Capital rate}$$