Your Risk Appetite Statement, and How it Aligns Your ERM Program With Your Strategic Plan

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It is impossible to accomplish anything without incurring some amount of risk. The question is, how much risk can you take on and still stay safe? What are your organization's limits? If limits are not clear, do you have well known and commonly understood cultural norms? In the absence of a documented risk statements your executives will not efficiently evaluate new opportunities and the risk management function will not be able to corroborate whether growth and change is viable for your business. Your risk management team needs to be aligned with the larger business strategy, and there is no better way to do that than to know your risk appetite. A risk appetite statement is a document that explicitly states the risk limits your organization can safely work within.

CREATING YOUR RISK APPETITE STATEMENT

This risk appetite statement should acknowledge and support the strategy of the business as a whole, as well as provide specific metrics that the management team will use as parameters to keep the organization safe. Your risk appetite statement explains how your organization would like to operate, and includes information like geographies, product and service offerings, verticals, and the types of customers you're looking to attract. For each area of your organization, specific Key Risk Indicators (KRIs) should be included as a quantifiable guide for any future change to the institution. And as a last important process step, risk appetite statement needs to be created and approved by both the risk management function and your board.

KEY RISK INDICATORS

Key Risk indicators should be developed and measured based on a comparison of your organization's inherent risks, potential losses, and business strategy. The goal is to find 50-75 indicators that encompass the most critical dangers to your organization. Key Risk indicators will be used as a check to make sure your organization's growth and change strategies fall within the acceptable amount of risk.

A great way to ensure you are using the right key indicators is to overlay your indicators against your inherent risk ratings captured in your enterprise-wide risk assessment. What you find may surprise you: often organizations who go through this exercise see areas of low or moderate risks with dozens of risk indicators, while high risk areas have none or very few. If this scenario sounds familiar, realignment is required. Changing the way you monitor your risks holistically helps to realign time and budget within the risk management function.

USING A CONSULTANT

While Enterprise Risk Assessment software is incredibly helpful in saving you time and money as you integrate and organize your risk assessment results with the risk appetite statement, it cannot define the optimal scope of your key risk indicators for you. For example, one of the main difficulties risk managers have when initially looking at their risk indicators is trying to narrow down the key and critical indicators to safeguard the organization from the list of hundreds of performance indicators line management requires to operate safely and profitably. In these cases, a consultant can be a relief. ERM consultants have a global library of risk indicators to compare against your organization's list, and the ability to quickly recommend new indicators that may not be in place. As an objective party, they can bring a perspective to the appetite statement development. Note that there is a higher hard cost associated with a consultant, which may persuade your organization to keep the creation of your Risk Appetite Statement in house. It is important to look at the pros and cons of each option holistically. If you and your team will need to spend time learning how to create the statement before being able to build it at all, make sure to account for the cost associated with that time lost. If you and your team already have a framework, and you have the expertise in-house to build your institution's Risk Appetite Statement, a consultant may not be worth the cost. Conversely, if you have not done this before you may find a consultant a comparable spend, and worth every penny.

If you and your team decide to choose a consultant, you should expect them to assist you in not only creating the risk appetite statement from areas you already have outlined, but they should also be identifying gaps in your risk management processes that you have not yet articulated. They can also successfully facilitate a management and board session to help secure alignment between your executive management and risk management functions. When assisting your team in determining your KRIs, your consultants should review all policies, procedures, and committee meeting minutes. This will give them the information they need to help identify gaps in monitoring, as well as those areas where monitoring activities can be dialed down and reallocated elsewhere.

The most effective tool set the risk manager can have is an enterprise risk assessment that aligns with a risk appetite statement, and a set of (50-75) key risk indicators that match the risk assessment's high risk areas, and the risk appetite statement's documented risk limits. Whether you decide to use a consultant or do the work in-house, pulling your risk information together into these integrated documents will build the framework your organization needs to safely grow and change without jeopardizing its future viability. They will serve as the executive team's lens through which geographic expansion new product and service introductions, and new customer acquisition initiatives are evaluated.

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