XV Reunión de Auditores Internos de Bancos Centrales

“Apetito por Riesgo”

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Risk Appetite

XV CEMLA Meeting of Central Bank Internal Auditors

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Overview

- Risk Appetite
- The Bank of Canada Experience
- Internal Audit Considerations
Risk Appetite: Definitions

Appetite
The **extent to which** an organization is **prepared to accept risks** in pursuing its goals within the boundaries of its risk capacity

Tolerance
The **maximum level of risk** the company is willing to assume

Capacity
The level of risk the company is **able to accept without endangering its future** taking into account its capital and liquidity position and external requirements

Universe of risks
**All potential risks** facing the company
The Bank of Canada Experience: The Nature of its Risk Appetite

The Bank’s Risk Appetite describes the type and amount of risk that the Bank is prepared to take or accept, to achieve its mandate and strategic objectives.

- We seek to minimize and manage the impact of risks that could undermine the Bank’s ability to fulfill its mandate.
- We take informed risks to foster innovation, advance our research and policy development, and to improve our operations and business practices.

Risk Appetite

Considerations
- Mandate
- Strategic Objectives
- Vision & Values
- Risk Philosophy
- Capacity to Bear Risk

Outcomes
- Tone at the Top
- Consistent Risk Culture
- Understanding of Allowable Risk Taking
- Operating Style
The Bank of Canada Experience: What Influences Risk Appetite

The Bank exercises judgment in weighing and managing risks in light of their potential impact on its credibility and reputation, as well as its ability to achieve its long-term goals.
Minimize & Manage Risk Over Core Functions
- prevent the occurrence of material risk events
- evaluate the consequences of major policy and operational decisions
- anticipate and assess new risks
- respond to risks effectively

Informed Risk Taking to Foster Innovation
- encourage leading-edge research / innovative lines of inquiry
- constructive public discourse and debate
- process and technological innovation to respond to emerging risks
- consider alternative futures

The Bank of Canada Experience: Spectrum of Risk Taking
# The Bank of Canada Experience: Benefits of the Risk Appetite for Stakeholders

<table>
<thead>
<tr>
<th><strong>All Employees</strong></th>
<th><strong>Business Owners</strong></th>
<th><strong>Strategic Planners</strong></th>
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<tbody>
<tr>
<td>Sets the context for the Bank’s Risk Tolerances</td>
<td>Supports assessing and managing risk at the business level</td>
<td>Provides direction on the allowable amount of risk that can be taken</td>
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<td>Practical uses:</td>
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<td>Departmental risk assessments</td>
<td>Support for:</td>
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<td>Risk mitigation action planning</td>
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<td>Discussing tradeoffs</td>
<td>Turning strategy into action</td>
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<td>Understanding allowable risks</td>
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<td>Pursuit of known and alternate futures</td>
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</tbody>
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**Guidance on:**
- Acceptable risk ranges
- Development and application of tolerances
Internal Audit Considerations

- Source of risk and control intelligence
- Operational indicators to support monitoring compliance with risk tolerances
- Focuses testing of controls where risk tolerance is low
- Aligned understanding between the three lines of defense

- Undefined risk limits allow for:
  - (i) different perspectives on the importance of control gaps
  - (ii) accepting risks associated with Audit observations

- Insufficient risk information limiting Audit’s ability to support
Thank you
Additional slides
Risk Appetite: Challenges in Establishing it

- Understanding the organisation’s objectives and risks.
- Gaining management interest in defining a risk appetite.
- Getting everyone to understand the concept of risk appetite statements.
- Addressing multiple perspectives on risks.
- Writing a statement that is short and simple, yet meaningful, measurable, and covers all fundamental risks in a way that avoids unintended constraints.
- Being forward looking (3-5 year horizon).
- Fitting the control culture of the organisation.
Risk Appetite: Reasons to Have it

- Assists in the achievement of strategic goals.
- Increases the capacity to take risks in pursuit of innovation.
- Enables better governance and better strategic and tactical decisions.
- Promotes transparency and accountability.
- Encourages consistent behavior and a common risk language.
- Allows for more meaningful and targeted risk reporting (e.g. meaningful early warning indicators and risk limits).
- Frames risk tolerances and limits and informs risk capacity.