Seeing Beyond Risk Canadian Institute of Actuaries Institut canadien des actuaires Voir au-delà du risque

September 30, 2013

Secretariat to the Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Re: Consultative Document – Principles for an Effective Risk Appetite Framework, released by the Financial Stability Board, July 17, 2013

The Canadian Institute of Actuaries (CIA) is the national organization of the actuarial profession in Canada. The CIA establishes the Rules of Professional Conduct, guiding principles, and monitoring and discipline processes for qualified actuaries. All members must adhere to the profession's Standards of Practice. The CIA follows its Guiding Principles, including Principle 1, which holds the duty of the profession to the public above the needs of the profession and its members. The CIA also assists the Actuarial Standards Board in developing standards of practice applicable to actuaries working in Canada.

We appreciate the opportunity to offer our comments on your consultative document Principles for an Effective Risk Appetite Framework. The thoughts presented here will be of a more general nature; we have included an appendix that provides more specific suggestions.

Overall, we appreciate the desire to develop a set of principles that can be followed by systemically important financial institutions (SIFIs).

However, while the document claims to be a set of principles, we find the detailed contents to be more a set of "best practices" that reads as a set of minimum requirements as opposed to a set of principles. We find the content to be prescriptive, and it presupposes a given organizational structure. Since SIFIs represent banks, insurers, or other significant financial institutions, the content does not provide for the principles to be applied while appropriately reflecting the flexibility needed given the different institutions' unique characteristics.

We believe that if the document focused on the principles, and how they can be applied to the SIFI's own governance structure, it would be more effective. Included in these requirements should be a principle that the SIFI governance structure should provide for the management of the risk appetite framework (RAF) with reporting to its board. Another principle is that there is in place a process for the identification and stress testing of the risks to which the organization is exposed.

We are concerned about how these requirements would be applied to smaller and medium-sized insurers. Although it may be appropriate for a SIFI to have a clearly-defined chief risk officer (CRO) role, a smaller firm may not have the need nor the capacity to create that role within its organization. The CRO functions are frequently performed by the chief actuary or others in the

360 Albert Street, Suite 1740, Ottawa ON K1R 7X7
613.236.8196 613.233.4552
head.office@cia-ica.ca / siege.social@cia-ica.ca
www.cia-ica.ca

company. The associated responsibilities as defined in this document may prove too constrictive for these companies.

As well, we note that the document has a strong emphasis on the banking sector, and does not address the particularities of the insurance or other financial sectors. Although some of our members are employed in banking roles, a significantly larger proportion are employed in the insurance industry.

We thank you for offering us the opportunity to review this document. Please contact us if you have any further questions.

Respectfully submitted,

Jacques Lafrance
CIA President

APPENDIX: SPECIFIC COMMENTS

- The leading paragraph of the introduction suggests that an effective RAF can help reduce moral hazards of SIFIs. It would be useful for the introduction to elaborate on how a RAF will address and reduce moral hazards.
- The definition of risk capacity in section II may be too narrow, ignoring other potential constraints such as rating agency capital targets or internal assessments.
- Section III.2.1(a) states that the risk appetite statement should be linked to compensation programs. We believe that decisions as to what elements are included in compensation should be left to the discretion of the company itself.
- Section III.3.1(a) could be clarified by reading as follows: “be set at a level to constrain risk-taking within risk appetite, based on an estimate of the impact of adverse events related to each material risk, on the interests of customers (e.g., depositors, policyholders) and shareholders, as well as capital and other regulatory requirements”.
- In section III.4.1(e), we suggest that management should be responsible for monitoring and reporting to the board. As well, the term “actual” should be clarified, as it could be interpreted to mean actual results or actual risk limits.
- Section III.4.2(g) refers to a “day to day basis”, which could be interpreted as daily reporting. We suggest wording such as “in the normal course of operations”.
- Section III.4 provides specific details on how a company should be organized and, in particular, what roles should exist within the company. We feel that the decision as to how a firm organizes itself should be left to its management and its own governance structure:
    - Although it may be appropriate for a SIFI to have a clearly-defined CRO role, for some SIFIs the capacity to address those functions may already be performed by other officers within its organization.
    - Another principle is that there is in place a process for the identification and stress testing of the risks to which the organization is exposed.