To: Financial Stability Board, Basel (fsb@bis.org)

Date: 30 September 2013

Re: CRO Forum and CRO Council response to Consultative Document on Principles for an Effective Risk Appetite Framework from 17 July 2013

The CRO Forum and CRO Council (CRO F&C) welcomes this opportunity to respond to the Consultative Document on "Effective Risk Appetite Framework" published by the Financial Stability Board (FSB) on 17th July 2013. The CRO Forum is an association that was formed in 2004 to advance risk management practice in the insurance industry. The CRO Forum member companies are large multi-national insurance companies. Our members are headquartered across the world with a concentration in Europe (for further details on the CRO Forum and its members see: http://www.thecroforum.org/). The CRO Council is a professional association of Chief Risk Officers of leading insurers based in the United States, Bermuda, and Canada. Member CROs represent 28 of the largest Life and Property and Casualty insurers in North America. The Council seeks to develop and promote leading practices in risk management throughout the insurance industry and provide thought leadership and direction on the advancement of risk-based solvency and liquidity assessments. Further information on the CRO Council can be obtained at http://www.crocouncil.org.

The CRO F&C **agrees with the overall goals of the paper** in defining baseline concepts on risk appetite and encouraging the implementation of risk appetite frameworks. The CRO F&C members are strong advocates of effective risk management and governance within their firms and **believe these concepts are implemented within their firms**. This has contributed to the resilience of the insurance industry during the financial crisis of 2008-9. The CRO F&C sees the paper as a useful reference that can foster dialogue on the principles underlying risk appetite between firms and their supervisors and amongst the firms themselves, allowing the industry to "talk the same language".

However, CRO F&C members stress that, for the paper to be effective and useful, there needs to be recognition that risk appetite is an internal tool for firms. We strongly believe that risk appetite **should fit the business purpose of the firm**, within the boundaries of its capacity, and in line with its desire for growth. The paper should enable supervisors to understand the risk appetites, but avoid the imposition of excessive caution and risk avoidance.

Excessive capital requirements for the sake of financial stability should not be at the cost of diminishing the industry's ability to build its business case, seize opportunities that allow the market to continue to grow and remain dynamic and deliver efficient insurance services. The paper should provide a basis for supervisors to rely upon the effective risk appetite framework as the primary tool to ensure a firm's financial stability, targeting increased capital requirements in a judicious and selective fashion.

Enhanced supervision by regulators on issues relating to internal **risk management frameworks and processes should be used as an alternative to other supervisory measures such as additional capital.** This is consistent with the need for rules coming from different supervisory sources to complement themselves rather than add on additional layers.

The CRO F&C is **against any additional external communication on risk appetite frameworks beyond the current requirements**, for example in the ORSA reports required by Solvency II and the National Association of Insurance Commissioners (NAIC).

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The CRO F&C views the part of the paper dealing with **roles and responsibilities** as important but **overly prescriptive as currently drafted**. Notwithstanding footnote 7 where the FSB acknowledges that "the structure of each firm is relevant to who will be involved", CRO F&C members believe the paper would be more relevant and have a higher impact were the FSB to place greater emphasis on which checks and balances should be implemented and how to ensure segregation of duties within a risk appetite framework, rather than attributing specific roles to designated corporate figures. CRO F&C members believe it would have been enough, for example, to separate the roles and responsibilities among Board, Executive and Control functions, **allowing firms to organize said roles and responsibilities internally as is most relevant to their specific structures**. This could be achieved by reinforcing that the roles of the CEO, CRO and CFO have the specific goal of working jointly on risk appetite.

The CRO F&C has the following specific comments:

In the section on roles and responsibilities three specific comments were made, one of which raises the question as to the interpretation of the role given to the CRO in helping firms set their risk appetite.

1. In points a) of the responsibilities of the CEO, CRO and CFO, an attempt to **"split" the task of the CEO by attributing part to the CRO and part to the CFO is seen as artificial**. Moreover, it seems to restrict the main task of the CRO to that of safeguarding supervisory expectations or, put simply, to a role attributable to compliance. This seems to defeat the purpose of many supervisors which is to encourage firms to consider their risk management teams as an integral part of the business framework that need to be relied upon to help decide and formalize their approach towards risk.

   In a mature and effective framework, both the CRO and the CFO would be involved in ensuring that the risk appetite of the firm is consistent with its strategy, business and capital plans, risk capacity and compensation program and would be equally responsible for aligning risk appetite to supervisory expectations.

2. There is a general feeling among CRO F&C members that the **role set out for the Board in the paper is in some cases too operational** (e.g. points e) and f)) and stressed that the day-to-day management of limits is a role attributable to risk management. Points h) and i) should sufficiently cover the need for supervisors to see the Board actively engaged in assessing the effectiveness of the risk appetite framework.

3. Consistent with the previous observation, in point j) of the responsibilities of the Board, discussion with supervisors on overall risk appetite was seen as in line with the role of the Board, however, discussion on material changes to the framework as well as current risk appetite levels was seen as excessive, and it should be possible to delegate such responsibilities to an executive or board level sub-committee.

With regards to the general comment on the prescriptiveness of the section and the specific comments above, we would suggest the following changes:

- Change the wording from "should" to "**there should be evidence of the following responsibilities** in the tasks performed by the [role X, Y, Z]" or alternatively split the responsibilities according to Board level (including Board level sub-committees), Executive, and Control without designating to specific roles;
- Points a) should be the same for all three roles;
- The qualifier "prudent" should not be applicable to risk appetite;

- Point j) should be given the option to be delegated to a board level sub-committee.

Throughout the document, reference is made to specific levels of granularity at which risk appetite should be defined such as, for example, legal entities. The CRO F&C members find the reference to these specific levels of granularity as overly prescriptive, because it intercedes with the ways in which firms decide to strategically allocate risk appetite. The level of granularity at which risk appetite should be defined is also guided by the level at which national authorities supervise. If this is on a Group or sub-group consolidated basis, regulators should not require risk appetite to be more granular, even if a firm for business reasons may choose to do so. Given FSB is a supranational standard setter that should reflect different supervisory regimes, we would suggest that the wording on this aspect be changed to **allow a broader interpretation of the levels of granularity, and without citing specific ones**.

Risk capacity has been defined as the maximum level of risk that a firm can assume before breaching external constraints. We would note that just as policy- and shareholder constraints (e.g. shareholder's expected return on equity) can be breached without impacting solvency requirements or liquidity constraints, there exist internal constraints (e.g. pension schemes) that could impact solvency or liquidity constraints if they are not met. We would suggest **not to restrict the interpretation of risk capacity**, but allow for the integration of certain business aspects whether internal or external that are considered "hard limits" by the firm. This could be done by adding to the list "bondholders and other stakeholders".

The definition of risk limits points only towards limits that are quantified. We would support a **wider interpretation of risk limits that includes qualitative aspects**. For instance, reputational risk can be monitored and managed using high/medium/low scales applied to underlying reputational risk factors (e.g.: perceived image of firm following an internal fraud, perceived robustness of firm in a Euro break up scenario, etc.). Although not measurable, these limits help to monitor and manage non quantifiable risks by creating escalation processes in case limits are breached that foster healthy dialogue on what can be done better to mitigate them.

To allow this we would suggest in the definition that "Quantitative measures" be changed to "Quantitative or qualitative measures" and the qualifier "measurable" be changed to "measurable even through qualitative assessments". We understand by "frequency-based" that it should be possible to update limits in the event of a changing environment, underpinning the requirement that these limits be reassessed and not result from a one-time analysis. With this our members agree, however believe it is equally possible in the context of non quantifiable measures where assessments are performed on a regular basis.

Once again, we thank the FSB for the attention brought to these comments and look forward to a constructive dialogue with our supervisors on risk appetite frameworks.

Yours Sincerely,

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