Board's Risk Oversight - Appetite and Tolerance of Strategic and Financial Risks

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Introduction:

Uncertainty about future developments and the course of events is a natural risk for any business. Innovation and the ability to be a step ahead of in an era when risk can become reality in the blink of an eye, companies should seek new capabilities and approaches for managing strategic risk.

The Board plays a crucial role in risk oversight. It is responsible for determining the nature and extent of the principal risks the company is willing to take in achieving its strategic objectives. To achieve this, the Board should maintain sound risk management and internal control systems. In order to have a sound risk oversight, the Board needs to clearly define two things "risk appetite "and "risk tolerance".

Risk Appetite

Risk Appetite should be at the centre of the company's overall strategy and risk management programs. A Risk Appetite process can provides greater clarity of the risks that the Company wants to assume and a better understanding of the relative trade-offs between risks and returns.

The Board's role in overseeing Risk Appetite

Risk Governance is the most valuable contribution the Board can make to the organisation. The entire Board is accountable for overseeing risk management. But, how does a Board do this? It should have regular substantive discussions about the company's Risk Appetite and strategic objectives and should monitor the implementation of the company's Risk Appetite process.

A company's strategic objectives and risk profile may change with new strategies and with changes in the business environment, economic conditions, competition, and other factors. Directors would need to take these dynamics into account and make sure they stay current on their understanding of the Company's Risk Appetite. For this, the Board should have open dialogue, use insights regarding risk, revise the Committee charters to include risk-related concerns, benchmark the company's practices against peer companies, obtain guidance from associations of directors and similar sources, focus on risk management and its value and shortcomings.

Further, the Board should promote a "Risk Intelligent Culture" in which all the levels in the organisation manage as such a culture in the organisation will help will encourage employees to express concerns and maintain processes to elevate concerns to appropriate levels instead of being risk averse.

To make the Risk Appetite approach effective, the Board should delineate the role and responsibility of senior management for risk management.

Following are the major points covered in the risk appetite for the company:-

1. **Geo-political uncertainties affecting the International Business Environment:**

   Geopolitical risks can cause sudden yet fatal harm to firms' core business.

   From a micro perspective, the Board shall mitigate the risk that may arise due to unstable interstate environments that shall encourage more foreign direct investments. High volatility usually affects traditional industries such as oil and gas and may lead to irreversible consequences.

   From a macro perspective, the Board shall mitigate the risk that may arise due to rising nationalism which makes the governments in emerging markets set stricter regulations thus burdening the companies to absorb extra costs in order to enter those markets, losing economies of scale.

2. **Risk landscape from emerging threats to impact: Evolving risk**

concerns in Asia

Key points

a) Critical Infrastructure failure or shortfall mainly in following sector Transportation Infrastructure and Energy Infrastructure

b) Talent Shortages – retaining skill human resources, aging population in each country

c) Geopolitical power shift: Rising Income &Wealth Disparity, Aging Population, Water Crisis and Environmental risk –Climate Changes

d) Technological risk –Cyber risk and large scale adoption of automation in every industry

In brief

First, global and regional geopolitical shifts are increasingly permeating to risks in other areas, notably technological and economic developments. Geopolitics continues to be the wild card for businesses and sudden changes in this regard can catch executives off guard.

Second, Asia-Pacific will continue to be one of the key sites for technological innovation. However, the frameworks to address new operational, security and ethical risks that arise from these advancements are not necessarily in place yet, which means businesses may need to put in place mitigation systems of their own. On the other hand, executives will also need to pay attention to changes in the regulatory landscape in anticipation of policy responses by governments to these threats.

Third, it is important for businesses to realize that the rapid pace of change in the region – especially in the areas of geopolitics and technology – is happening against the backdrop of persisting socioeconomic and environmental vulnerabilities. This presents an extra layer of consideration for executives as they plan their businesses' future development.

From this broad overview of the Asia-Pacific risk landscape, we focused specifically on two risks, namely critical infrastructure failure or shortfall, and talent shortage, and their potential impact on businesses. They represent various threats to the two key developmental pillars for the region – physical infrastructure and human infrastructure.

It is clear that businesses will have to react swiftly in response to these risks. To aid business leaders in this endeavour, we have suggested some directional changes companies can take as the first step towards a comprehensive response. Looking forward, however, businesses will need to look deeper into their own organizations to devise suitable and workable strategies.

3. Global Governance insights for Emerging Risks:

Global risks are intensifying but the collective will to tackle them appears to be lacking. The world's move into a new phase of state-centred politics, noted in last year's Global Risks Report, continued throughout 2018. The idea of "taking back control"—whether domestically from political rivals or externally from multilateral or supranational organizations—resonates across many countries and many issues.

The energy now being expended on consolidating or recovering national control risks, weakening collective responses to emerging global challenges. We are drifting deeper into global problems from which we will struggle to extricate ourselves.

The Board shall focus on the following sections of concern highlighted in this year's Global Risks Perception Survey (GRPS), which frame much of the analysis in subsequent chapters:

I. Economic vulnerabilities

ii. Geopolitical tensions

iii. Societal and political strains

iv. Environmental fragilities

v. Technological instabilities

4. Is a Universal Technology Platform, the Key to Addressing Banking Woes?

Risk is indispensable for Banking Business, proper assessment of risk is an integral part of a bank's risk management system. Banks are focusing on the magnitude of their risk exposure and formulating strategies to tackle those effectively.

In their operations, Banks are particularly exposed to or may potentially be exposed to the following risks:

- Liquidity risk,
- Credit risk (including residual risk, dilution risk, settlement/ delivery risk, and counterparty risk);
- Interest rate risk;
- Foreign Exchange risk and
- Other Market Risks
- Concentration risk, particularly including risks of exposure of the bank to one person or a group of related persons;
- Bank's investment risks; risks relating to the country of origin of the entity to which a bank is exposed (country risk);
- Operational risk particularly including legal risk; risk of compliance of the bank's operations; risk of money laundering and terrorist financing; and strategic risk.
- Payment risk is the risk of loss due to a default on a contract, or more generally, the risk of loss due to some "payment event"

Banks today are able to gauge how risk-heavy a particular loan applicant could be, using vast data reams and financial records. Ever-increasing analytic capabilities are crunching on this data to streamline specific processes.

IT risk-related challenges in financial services will grow in number and importance in the years ahead. Technology is the great enabler, but it also presents pervasive, potentially high-impact risk. Cyber risk in the form of data theft, compromised accounts, destroyed files, or disabled or degraded systems is "top-of-mind" these days. However, that is not the only IT risk that the board and management should be concerned about.

Board of Directors overseeing a bank's operations are important partners in supervisory efforts. Prudent oversight is rooted in the directors sending a clear message to staff that they value a strong risk management culture that includes a strong ethical culture,

As a part of working with management to establish the bank's short- and long-term business objectives, Board of Directors should have a solid understanding of the institution's risk profile. Having a solid understanding involves more than simply reviewing the bank's financial condition as of today. It also includes:

i. Assessing how risky the business model is. This means understanding the types of products and services the bank offers and how they are delivered.

ii. Evaluating risk management. How does the bank manage the risks associated with its business model and growth plans?

iii. Considering external threats. This means looking outside the financial institution to consider what about the operating environment could pose a hazard.

In banking sector, Technology Risk ranks higher in vertical domain of Operational Risk.

As systemic risks arise from unsustainable credit growth, increased inter-connectedness, pro-cyclicality, development of new activities beyond the supervisory framework, risks for FinTech products may also arise from cross border legal and regulatory issues.

Data confidentiality and customer protection are major areas that also need to be addressed.

Technology Risk and Fraud risk occurs at the Universal Technology Platform which is greatly impacting the banking sector.

Electronic financial fraud is a growing and difficult to solve problem. The fraud opportunities presented by the SWIFT messaging system have proven particularly lucrative for sophisticated fraudsters, but financial institutions are lagging in their response.

Criminals have repeatedly taken advantage of weaknesses in an institution's internal controls to manipulate the SWIFT payment messaging system, transmitting funds to accounts controlled by fraudsters. Successful attempts involve a mix of opportunistic timing, editing the parameters of a payment message and the quick erasure of tracks in order to hamper the recovery of funds.

To oversee IT risk, boards must understand the risks technology poses to the institution, and have questions for management that drive a real understanding of the risk landscape and set clear direction and expectations.

Some of the most significant risks in technology in financial services include:

- Strategic risk of IT
- Cyber security and incident response risk
- IT resiliency and continuity risk
- Technology vendor and third-party risk
- Data management risk· IT program execution risk
- Technology operations risk
- Risk of ineffective risk management

It serves as a primer for board members on each of these risks and can be used to drive more meaningful conversations with key stakeholders on IT risk.

5. Widening Role of Insurance and Safety technology Solutions in Mitigating Corporate Risks:

The Board shall adopt new technologies which would lead to the better understanding of the risks of emerging technologies and ensure the appropriate risk management capabilities are in place to manage these new risks.

With the help of the new technologies the Board can eliminate the risk arising due to lack of historical data and by providing the insurers to embrace alternative sources of information to better understand emerging technology risks. In addition to alternative data sources, the Board shall help the insurers to consider new forms of modelling where past losses are not solely effective in predicting future threats.

Risk Tolerance

Risk Tolerance is the acceptable levels of variability in achieving strategic objectives. The company should establish and maintain a Risk Tolerance Statement which would set out its overall quantitative and qualitative tolerance levels and define tolerance limits for each relevant and material category of risks by taking into account the relationship between various risk categories.

Establishing insurer Risk Tolerance involves making strategic choices. The process must be connected with setting strategy and long - term direction of the company. It is the Board who must decide on Risk Tolerance based on business plans and Company's strategy and articulatethe boundaries of how much risk the Company is prepared to accept.

I would like to conclude by saying that a world of ever evolving risks and constant regulatory change, boards shall take a thoughtfully defined approach and proactive steps for overseeing risk and mitigating impact of various risk within Risk Appetite of the Company. ■

Excerpts from the Speech delivered by
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