

**Chief Executives Board
for Coordination**

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HIGH-LEVEL COMMITTEE ON MANAGEMENT (HLCM)

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UN System Staff College, Turin

Guidelines on Risk Appetite Statements (Final)

Background

1. At its 35th session, HLCM examined how United Nations system organisations have been developing and putting in place risk management tools and frameworks to reform management processes, improve efficiency and bring greater value in support of the 2030 Agenda for Sustainable Development. The Committee agreed on the need for joint, cross-functional engagement towards the system-wide harmonisation of risk management practices and endorsed the Terms of Reference (TOR) for a Task Force (TF), as set out in CEB/2018/HLCM/15, to be co-chaired by WIPO and WFP.
2. The TF included those organisations who responded to a call for nominations, and by October 2019 included FAO, IAEA, IFAD, ILO, IOM, OECD, UN Secretariat (including DSS and OCHA), UNAIDS, UNDP, UNEP, UNFPA, UNHCR, UNICEF, UNIDO, UNRWA, UNWOMEN, WFP, WHO and WIPO. The TF also committed to interact and consult with UN RIAS to ensure benefit would be derived from their input and contributions.
3. The TOR called for '*Pragmatic guidance for organisations intending to enhance their existing Risk Management Framework, to include considerations, limitations, benefits and drawbacks when developing key organisational risk management approaches.*' One of the deliverables outlined was guidelines for organisations wishing to express risk appetite and risk tolerance.

Working Modalities

4. For practical purposes, members of the TF self-selected area(s) of prioritised interest, which created the sub-groups, each supported by a facilitating organisation. Plenary meetings of the full TF were held monthly, to ensure broad engagement in discussions on various aspects of the guidelines and information sharing. UN RIAS was also represented at TF meetings and provided valuable input on specific matters, which were taken duly into account in finalising the guidelines. A briefing to the Joint Inspection Unit was convened to assist in alignment of timeframes with the upcoming JIU review of Enterprise Risk Management¹. A briefing was also made to the Finance and Budget Network in July 2019 in Geneva.
5. The globally located TF operated without any formally allocated budget, and as such worked almost exclusively via remote working approaches (videoconference, email, etc.). While this was a cost-

¹ Project A449: Enterprise risk management: approaches and uses in United Nations system organizations

effective solution for rapid and results-oriented delivery, it presented certain logistical and practical challenges. However, the active engagement and collaboration of members ensured that the TF arrived at an agreed set of guidelines.

6. The Risk Appetite sub-group, comprising eleven organisations, met virtually in addition to the plenary sessions, taking a collaborative approach. This included research into best practices and samples both inside and external to the United Nations system, interviews with organisations, discussing, drafting, commenting and finalising the guidelines.
7. The Co-Chairs coordinated the work to ensure appropriate consistency across the deliverables, i.e. between other guidelines, the risk information sharing and the Reference Maturity Model for Risk Management.

Risk Appetite Statement Guidelines

8. *Risk Appetite* is a concept adopted by some organisations to express and agree the amount of risk that they are willing to accept in pursuit of their mission and organisational objectives. It sets out to propose that risk taking is a business necessity, since seeking zero risk is prohibitively costly, and moreover that some objectives deserve to attract relatively more or less risk than other objectives.
9. The benefits of senior management articulating desired risk levels, and the governing body approving a risk appetite statement include more aligned strategic decision-making, timeliness of risk response implementation and safeguarding of the organisation's assets.
- 10. It should be emphasised that while this document provides key principles involved in risk appetite and sets out a series of options in order to effectively establish a risk appetite statement, it does not imply that having a risk appetite statement is essential. There are alternative ways to deal with risk-taking that an organisation might choose considering its operating environment and mandate.**
11. The document presents three interrelated sections, that represent the three key steps foreseen to propose and agree the risk appetite in an organisation's terms:
 - (i) Introduction – sets out the purpose, benefits, readiness, stakeholders and critical success factors to be considered at the outset;
 - (ii) Developing a Risk Appetite Statement – investigates the key design questions, the structure (e.g. ordered by different options, such as a results framework, risk category or organisational structure etc.), as well as the drafting, consulting and ratification process;
 - (iii) Operationalising Risk Appetite – proposes communications of the approved statement, and how to pragmatically apply it in practice (escalation procedures, exceptions and responsibilities).

Proposed Decision

12. The HLCM is invited to consider and endorse the Risk Appetite Statement guidelines, attached as an annex to this document, to be used as a practical guide to help UN organisations identify, articulate and ratify, for their own planning and other decision-making, their appetite for risk-taking in pursuit of organisational objectives.

Risk Appetite Statement Guidelines

September 2019



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1. Introduction

1.1 Background and purpose

The 2010 Joint Inspection Unit Review of Enterprise Risk Management (ERM) in the United Nations System noted that during recent decades, “the expansion of the mandate and operations of the United Nations organizations, coupled with unstable environments, has resulted in an increasing volume and complexity of risks encountered by these organizations. In addition, United Nations organizations inherently face unique challenges, such as a wide range of mandates and limited resources, a complex organizational structure and lengthy decision-making process, many objectives and lack of capacity, and reform backlogs. As a result, organizations face a risk climate that is growing increasingly more complex and prone to significant operational surprises.”

In order to deliver on their mandates, United Nations organisations have to take risks; there is no risk-free path to achieving objectives. The challenge lies in identifying, prioritising and addressing the right risks at an optimal level, in the most effective ways. In April 2019 the High-Level Committee of Management (HLCM) endorsed a Reference Maturity Model (RMM) for Risk Management in the UN System. The RMM identified six dimensions of risk maturity (ERM Framework and Policy, Governance and Organisational Structure, Process and Integration, Systems and Tools, Risk Capabilities, and Risk Culture) each of which could be rated against a five point maturity scale (Initial, Developing, Established, Advanced or Leading). The RMM recognized the importance of establishing risk appetite (or criteria) by making it an essential element for ‘Established’ risk maturity in two of the six dimensions the model outlined.

Risk Appetite can be defined as the aggregate amount (level and type) of risk an organisation seeks to assume in pursuit of its strategic objectives and mission. A **Risk Appetite Statement** (RAS) is the document that articulates the current risk appetite of an organisation in various different areas or levels. A Risk Appetite Statement should be endorsed by organisational leadership, communicated effectively and supported by a broader set of processes to operationalise it. These processes and procedures (which may or may not be elaborated in the same document as the Statement) include identification, assessment, risk response planning, monitoring, reporting, and escalation and follow-up where assessed risk is outside of risk appetite levels. Expressly articulating Risk Appetite facilitates the communication of the organisation’s “philosophy” with regard to risk.

Many organisations also use the concepts of both **Risk Capacity** and **Risk Tolerance**. The former refers to the amount and type of risk an organisation is able to support in pursuit of its objectives, while the latter can be defined as the boundaries of risk taking outside of which the organisation is not prepared to venture in the pursuit of its objectives¹. These concepts are represented graphically in Figure 1, which represents that it is possible to take too little risk as well as too much risk. Having zero or very low risk appetite can lead to inaction and paralysis and therefore reduce the likelihood of achieving objectives.

¹ Risk Appetite and Tolerance Guidance Paper, The Institute of Risk Management

Figure 1- Risk appetite and associated concepts



Although risk appetite is a key concept in effective risk management, it is also a complex and challenging one, particularly in the context of the United Nations. This document has been developed to help guide United Nations organisations in developing and operationalising Risk Appetite Statements.

This is a guidance document and is non-prescriptive. It provides key principles involved in risk appetite and sets out a series of options that United Nations organisations may consider, should they wish to establish a risk appetite statement. Given the diversity that exists between UN Organisations, this document provides a number of options, which entities may choose from when developing their own statements based on their specific needs, mandates and context. It also includes examples from existing Risk Appetite Statements, and provides suggestions and recommendations based on the experience of some United Nations and other organisations in defining and implementing the concept of risk appetite. Some organisations may as an alternative to a risk appetite statement, choose to define “risk criteria”. This document should be read in conjunction with separate guidance developed by the Cross-Functional Risk Management Task Force on embedding risk management given the close links between the two subjects, as well as the Reference Maturity Model.

The Cross-Functional Risk Management Task Force reviewed guidance and existing Risk Appetite Statements from 14 different professional bodies, international organisations and government departments². This document is informed by analysis of these different statements and guidance documents, as well as the experience of task force members who had already established risk appetite in their respective organisations.

1.2 Benefits of setting Risk Appetite

Risk appetite is not a compliance exercise to ‘tick a box’ for donors, auditors or other oversight bodies. Implementing risk appetite successfully can bring several benefits to an organisation’s ability to effectively manage risks and achieve its objectives. These benefits include:

- Helping the organisation **achieve its strategic objectives** by taking on the right kind of risks at the right level with the right risk responses in place;
- Facilitating **better strategic decision making** by requiring senior management/governing bodies to consciously consider and articulate the level and type of risk they want to pursue and are willing to accept;

² The organizations and guidance reviewed were: African Development Bank; Committee of Sponsoring Organizations of the Treadway Commission (COSO); European Bank for Reconstruction and Development; the Financial Accounting Standards Board; Gavi, the Vaccine Alliance; Global Climate Fund; Global Fund to Fight AIDS, Tuberculosis and Malaria; Institute of Risk Management; International Labour Organization; United Nations Department for Safety and Security; USAID - United States Agency for International Development; World Food Programme; World Health Organization; World Intellectual Property Organization

- **Facilitating tactical/operational³ decision making aligned with organisational strategy**, by requiring operational management to consider risk type and level as defined in the risk appetite statement, for example, in deciding whether or not to proceed with an operation/project and the secondary risks that may be introduced through the implementation of mitigation measures;
- **Bringing consistency** across the organisation in making risk related decisions at all levels of the organisation, including if and when to escalate risks;
- Detecting when risk is outside of acceptable levels at an early stage and triggering timely responses – **acting before it is too late**;
- **Communicating** to the whole organisation (and also to relevant external stakeholders) what the desired risk level of the organisation is;
- **Safeguarding the organisation** – by improving the ability to reduce the impact of critical risks to an acceptable level or to prevent them from materializing at all; and
- **Improving overall organisational performance** by managing risks appropriately and within the risk appetite.

Case Study 1. Developing risk appetite in a public-private partnership

Since 2015, we have adopted a comprehensive approach to risk management and reorganised risk management and assurance functions in line with the "three lines of defence" model. The Board also approved a Risk policy and a Risk Appetite Statement.

Our Risk Appetite Statement is structured around our strategic framework and defines, on a broad level, the amount of risk the organisation is willing to take, accept, or tolerate to achieve its goals. Risk appetite is defined at the mission, organisation and strategy level (for each strategic goal and strategic enabler) on a five-point scale between low and high. The purpose of this Board-approved statement is to align stakeholders across the organisation and guide decision-makers in taking the right amount of the right type of risks to deliver on our mission. It aims to encourage staff and stakeholders to be risk-aware, to feel comfortable to take agreed and calculated risks where appropriate, to recognise and plan for the possibility of failure, and to learn from both positive and negative results.

The statement is deliberately high-level and does not try to account for every situation, while having systems and processes in place to ensure that risk owners manage the risks in their specific context within the overall risk appetite (including appropriately balancing trade-offs between risks). The statement seeks to balance being clear and understandable with providing sufficient granularity to guide decision-makers in making complex business decisions.

Risk appetite considerations are also being highlighted during the development and operationalisation of our new strategy (potentially requiring a higher risk appetite in some areas to achieve our ambitious goals), which may lead to a need to update the risk appetite statement at the start of the new strategy period.

³ Decision making with regard to the safety and security of United Nations personnel, assets and operations remain under the purview of the United Nations Security Management System (UNSMS) and associated policies.

1.3 When to establish Risk Appetite

While it is possible to introduce a formal Risk Appetite Statement at any level of risk maturity, it may be more useful for United Nations organisations to implement risk appetite when they are otherwise at the *Developing* or *Established* maturity level in most or all of the dimensions of the Reference Maturity Model. This is because there are a number of prerequisites that need to be in place if the potential benefits of risk appetite are to be realised, and since these prerequisites all incur implementation costs in terms of time, resources and senior management attention.

These prerequisites include:

- Having clear and well-defined strategic objectives;
- Senior management and staff being sufficiently aware of current risks as well as risk management concepts, and the processes and systems of the organisation;
- Having basic risk management governance and accountability structures in place;
- Having a process and repository for collecting and analysing risks and risk information across the organisation (including in field locations if applicable) enabling risk trade off decisions;
- Having the capacity to report on actual levels of risk through measurable indicators in a timely manner; and
- Having the capacity to act in response to reported risk information in a timely and effective manner.

If an organisation attempts to implement risk appetite without these prerequisites in place, there is a danger that it will not realize the benefits, whilst still incurring costs, which may in turn lead to additional resistance.

1.4 Risk Appetite Stakeholders

While an organisation's senior leadership is responsible to articulate its risk appetite (for governing body approval), it is also important to understand and engage other stakeholders throughout the process of developing and implementing risk appetite.

A useful first step to develop an organisation's Risk Appetite Statement is to identify the key stakeholders and determine their expectations. Stakeholders can be any person, group or entity that have an interest in the organisation, its resources or output, or is affected by that output. Stakeholders tend to drive decision-making, metrics and measurement and risk tolerance and may be internal or external to the organisation⁴.

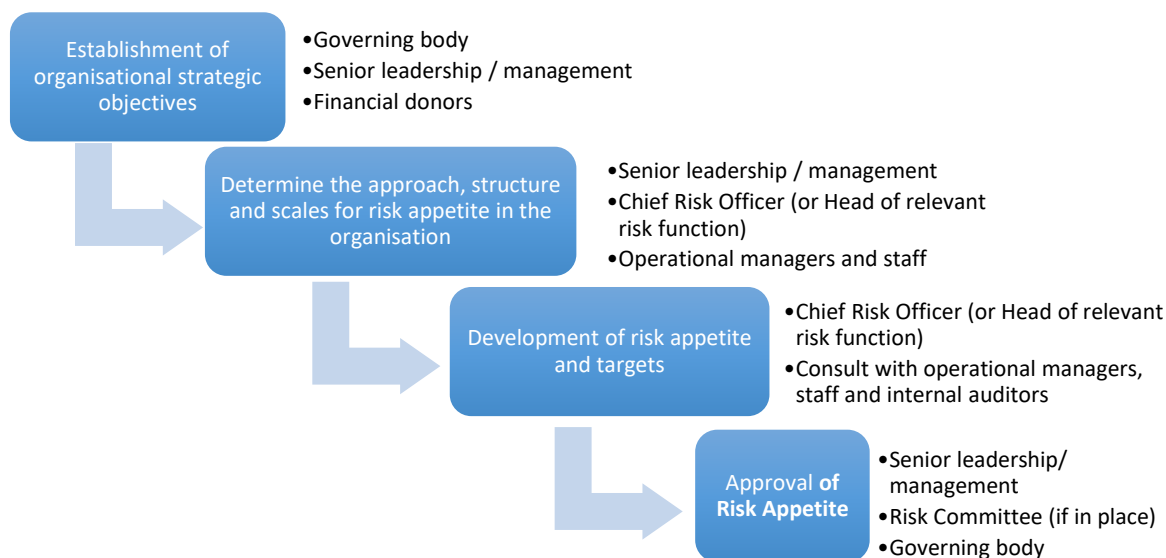
Table 1: Examples of stakeholders

Internal stakeholders	External stakeholders
Member States / Governing Body / Board / Board Committees	Financial donors
Senior leadership / management	Other United Nations agencies
Directly involved staff (e.g. risk, performance, organisational resilience, cyber security, etc.)	Other partners / trustees
Internal auditors	External auditors / regulators
Staff and personnel	Beneficiaries / society

⁴ The implications of risk appetite on decision-making at different levels of organisation, especially in the case of decentralised organisation should be evaluated through effective consultation.

The governing mechanisms⁵ of United Nations organisations vary considerably. Typically, the governing body would be responsible for approving the Risk Appetite Statement.

Figure 2 - Engagement in the development of an organisation's risk appetite



Case Study 2. Who are the stakeholders involved in RAS development?

One United Nations organisation hired a specialised risk consulting firm to assess its risk management maturity and to identify gaps compared to best practices in International Financial Institutions. As part of this assessment, the consulting firm identified developing a Risk Appetite Statement as a top priority.

As a first step in developing a Risk Appetite Statement, the consulting firm advised the agency to design an iterative process of consultation of internal and external stakeholders, in order to come up with a solid draft Risk Appetite Statement proposal, which would have submitted to Audit Board Committee for review, and then for final endorsement before the last step of Executive Board approval.

Under senior leadership, a multi-disciplinary working group with external experts, and representation from all Departments and Divisions (both at HQ and Regional/Country office level) was set up to define the key components of the Risk Appetite Statement. A zero draft Risk Appetite Statement and taxonomy was developed by the working group. A further round of consultation was performed with the Audit and Oversight Office, Evaluation Office and Ethics Office.

Externally, the agency held informal consultations with partners to understand their risk perceptions and views. The agency also consulted two other International Financial Institutions for benchmarking purposes. This facilitated further enhancements to the Risk Appetite Statement before a final internal review by senior management.

Senior management input was provided at the ERM Committee where a strategic discussion made further refinements to the Risk Appetite Statement. The stakeholder consultation cycle included a first Audit Committee Risk Appetite Statement draft review and adjustments, a second Audit Committee review for endorsement, and a final Executive Board review with all Member States.

⁵ This document uses the generic term 'governing body' to refer to the most senior governance body of an organisation.

It is left to the discretion of the organisation to determine the extent to which the expectations of governing body and donors impact the risk appetite of the organisation. However, organisations should note that there may be different risk appetites from different stakeholders that need to be reconciled. For example, financial donors may be more risk averse, to safeguard their investments, while project beneficiaries may have a higher appetite for risk if it could lead to greater returns.

1.5 Critical success factors for Risk Appetite

Five critical success factors have been identified which will increase the likelihood of risk appetite being operationalised effectively. The questions are intended to help organisations respond to those success factors.

1. Grounded with governing bodies and senior management buy-in.

Who will ultimately be accountable for risk appetite and how will senior management (and eventually the governing body) be involved in reviewing the organisation's risk maturity and risk appetite?

How will risk appetite be cascaded down to business units?

2. Clear and measurable (to the extent possible) in defining the levels and type of risk an organisation is willing to assume in pursuit of its strategic objectives.

How will the organisation ensure that risk appetite will be forward-looking and aligned with the organisation's strategic goals?

How will risk trade-offs influence the levels of various risks that are connected various strategic goals.

3. Flexible and adaptable enough to address changing operational and strategic conditions (both internal and external) while informing decision making.

How will risk appetite be tailored to the organisation?

How will risk appetite take into account differing views at a strategic, tactical and operational level?

4. Integrated and aligned with the wider control framework, ERM framework, decision making processes and organisational culture.

How will risk appetite guide decision making, facilitate measurable actions and support monitoring?

How will risk appetite be developed in the context of the control framework and culture of the organisation?

5. Sustained once established with clear ownership and constant communication, reporting and action.

How will risk appetite be communicated transparently within the organisation, and what key information will be shared with relevant stakeholders (both internal and external, as appropriate)?

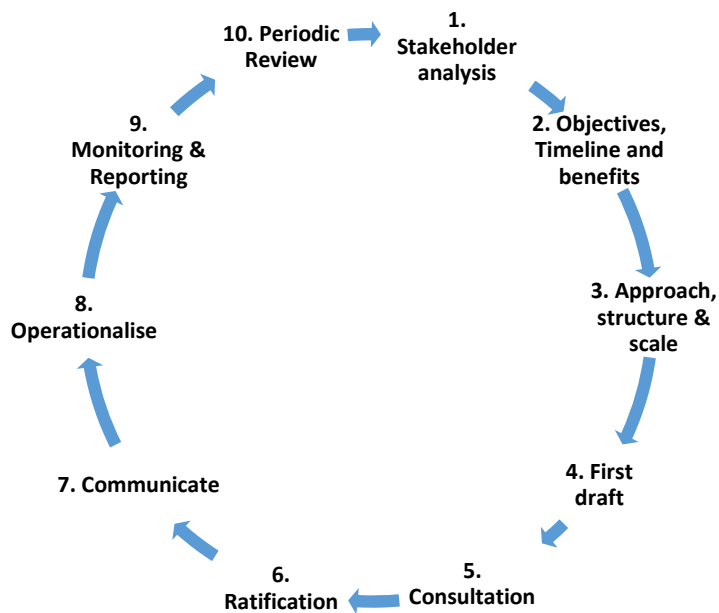
What processes will business units follow for communicating when risk appetite is nearing a breach or is breached and requesting technical assistance to respond?

2. Developing a Risk Appetite Statement

2.1 Developing a Risk Appetite Statement

The implementation requirements for risk appetite depend on the size and complexity of the organisation, the environment in which it operates, and its risk maturity. The following points provide step-by-step guidelines for developing a Risk Appetite Statement and for refining it on a continual basis that organisations could follow or tailor to their specific needs. The process would typically be driven by the Chief Risk Officer if one is in place.

Figure 3 - Step-by-step cycle of risk appetite development



1. Identifying internal/external stakeholders, their expectations and engaging them ([section 1.4](#))
2. Establish objectives, timelines and benefits of implementation ([section 1.2](#))
3. Agree approach, structure and scale of the Risk Appetite Statement ([sections 2.2, 2.3 and 2.4](#))
4. First draft ([section 2.5](#))
5. Internal consultation ([section 2.6](#))
6. Formalize and ratify the Risk Appetite Statement ([section 2.7](#))
7. Communicate the statement with wider stakeholders ([section 3.1](#))
8. Operationalise risk appetite ([section 3](#))
9. Monitoring and reporting ([section 3.1](#))
10. Periodic review ([section 3.6](#))

2.2 Key design questions

Once an organisation has determined that it is: i) sufficiently risk mature to implement risk appetite; ii) has the key prerequisites in place; and iii) has identified the relevant stakeholders, it can then begin to think in more detail about how it would create a risk appetite statement in a way that would address the critical success factors in [section 1.5](#). This section provides detailed guidance and tips on how a United Nations organisation can go about designing a Risk Appetite Statement. The following key design questions are a good place to start.

- **What does the organisation want to achieve by implementing risk appetite?** This document outlines a number of potential benefits from implementing risk appetite in [section 1.2](#); organisations should consider which potential benefits are most important for them as the priority given may have implications for the design.
- **What specific factors should the risk appetite take into account?** The design of the statement will need to be tailored to the specificities of the organisation. For example, what are the political, environmental, organisational (including centralised or decentralised), social or other factors that will influence the relative importance of the organisation's propensity to take risk and its propensity to exercise control? Is there any intention to define risk appetite metrics at the entity and/or functional level in line with the organisation RAS? Are there quantitative and qualitative measures linked to these factors that can inform the organisation's decision making with regards to risk appetite?
- **Should risk appetite reflect current practices, drive new behaviour or both?** Is the organisation clear about the nature and extent of the significant risks it is willing to take in achieving its strategic objectives? Are there some risk levels it knows it does not want to take? One approach to designing risk appetite is to initially do so in way that codifies and clarifies the existing level of risk taking in an organisation. Once existing behaviour is clearly documented, the risk appetite can be adjusted over time. The alternative is to identify the target level and type of risk taking the organisation wants to achieve and define its risk appetite to help it move towards this.
- **Will there be a default risk appetite level (such as low or medium)?** Some organisations define an overall attitude towards risks (such as – risk averse, or risk seeking) that serves as a default risk appetite. In these cases, a process would be established to justify any deviation from the default and there may be different approval mechanisms for areas that deviate from the default. A default level of risk appetite may be particularly useful for organisations that may frequently have to enter into new forms of activities that otherwise would lack a risk appetite level initially.
- **At which levels would it be appropriate for the organisation to consider risk appetite – will certain parts of the organisation have a differing risk appetite?** For example, does the organisation wish to have a single risk appetite that applies globally or to have different risk appetite levels in different geographic locations or business units or tied to different objectives? When a UN entity prepares its RAS, it could take into consideration existing policies that are already in place to determine an appropriate risk appetite (e.g. security policies that are common to the entire UN System) even though it is applying the RAS for its own entity.
- **Will the implementation of risk appetite be phased or a 'big-bang'?** In general it is advisable for risk appetite to be holistic but some organisations may wish to initially roll out risk appetite in specific areas. Such an approach may be particularly useful where the prerequisites for risk appetite are met in some sections but not across the

organisation. In these instances an organisation could pilot risk appetite in the more mature risk areas before rolling it out more widely.

2.3 Structure of a Risk Appetite Statement

There are different options that United Nations organisations could potentially select from in order to define and structure their Risk Appetite Statements.

Effective Risk Appetite Statements should not be fully stand-alone but rather have a clear anchor to the wider organisational design. The Risk Appetite Statement should be aligned with the organisation's purpose, vision and values, take into consideration the organisation's operating environment, and be informed and shaped by the risk maturity.

The non-exhaustive list in Table 2 sets out options to structure and define their Risk Appetite Statement. Depending on the approach selected, the Risk Appetite Statements could potentially be developed at multiple levels, at entity and functional level (and/or for multiple objectives). For example, if an organisation chose to anchor its Risk Appetite Statement based on its results framework, it may set risk appetite both at the impact level and possibly the outcome or output levels as well. In addition to the risk appetite level, each option also lends itself to establishing risk indicators with target levels. In general, it is advisable any chosen Risk Appetite structure, especially the entity/function or decentralised ones, be consistent with the holistic and integrated risk management principle and the three lines of defence model, promoting a coordinated Risk Appetite operationalisation process.

Case Study 3. Experience of developing a Risk Appetite Statement

One organisation's first Risk Appetite Statement was developed in 2014, using another UN agency's Risk Appetite Statement as guidance. It defined the level of risk appetite and tolerance by risk category: (i) strategic; (ii) operational; and (iii) financial, as well as highlighting reputational impact.

This initial approach worked well in terms of communicating the relative amount of risk that may be sought for each category with Member States, and also allowed the agency to highlight specific points, such as a zero tolerance for fraud risk. The Risk Appetite Statement reinforced the risk scale the agency had put in place through its risk policy, and ensured an enforceable escalation of risk and mitigation review, based on overall risk severity.

The Risk Appetite Statement was reviewed for improvement and relevance five years after its development, in 2019, but in trying to align it to the results framework, the agency struggled to express a differentiated risk appetite without running the risk of being seen to imply prioritization of some substantive organisational activity over another.

Finally, the agency adopted a structure that closely linked the organisation's accountability framework to its risk management objectives and the levels of risk that the organisation may undertake in each of the areas defined under the framework. The accountability framework model was largely based on the COSO components, and enabled the Risk Appetite Statement to cover all the critical areas for the organisation's operations.

Overall, the Risk Appetite Statement improved the dialog with Member States on risk taking and it guides how the agency plans its work and how it deals with risks that are assessed above the respective risk appetite for specific areas of the accountability framework.

Table 2 - Structures for defining Risk Appetite Statements

Structure	When to consider using it	Benefits	Possible drawbacks
<p>Based on organisation structure: For each key division or organisational unit UN examples: None found</p>	Such an approach may be appropriate in an organisation where the departments or divisions are very distinct with significant autonomy and delegated authority.	<ul style="list-style-type: none"> • Easily understood categories • Clear responsibility • Ease of implementation 	<ul style="list-style-type: none"> • Can fail to address cross-cutting risks and lead to siloed approaches
<p>Based on strategic directions or vision: For each of the organisation's strategic directions Non-UN example: Gavi Alliance</p>	For organisations with a clear set of medium to long term strategic objectives linked to measurable targets this could be a logical way to define risk appetite.	<ul style="list-style-type: none"> • Clearly links risks to strategic long term goals • Can encourage intelligent risk taking in pursuit of key strategic objectives 	<ul style="list-style-type: none"> • May focus of achieving targets at the expense of 'how' they are achieved • May be difficult for stakeholders to prioritize one objective over another
<p>Based on the results framework: For each of the categories in the organisation's results framework UN examples: None found</p>	Where organisations have a clear results framework underpinned by a strong multi-level Results Based Management this approach should be considered.	<ul style="list-style-type: none"> • Performance data and reporting mechanisms and processes already exist • Reinforces message of risks being in the context of what the organisation is aiming to achieve 	<ul style="list-style-type: none"> • Results framework may not cover all aspects of the organisation (for example security management, human resources and other enablers may not be covered)
<p>Based on Strategic Risks: For each of the Organisation's strategic risks Non-UN example: The Global Fund</p>	This approach can be useful in an organisation with a manageable number of well identified and articulated key strategic risks that remain relatively stable over time.	<ul style="list-style-type: none"> • Ensures a strong link between risk appetite and the most important strategic risks facing the organisation 	<ul style="list-style-type: none"> • Risk appetite may require regular updates as strategic risks shift
<p>Based on Risk Categories: For each category or sub-category of risks, UN example: WFP, IFAD</p>	This approach can be useful where an organisation has a manageable number of mutually exclusive and collectively exhaustive risk categories.	<ul style="list-style-type: none"> • Ensures a strong link between risk appetite and wider ERM categories, reporting and information 	<ul style="list-style-type: none"> • Existing categories may not be suitable for risk appetite (e.g. too numerous, not easily quantifiable)
<p>Based on Accountability or Internal Control Framework): For each component of the organisation's accountability or internal control framework UN example: WIPO</p>	Where an organisation has adopted a clear accountability and/or internal control framework and has the associated controls and processes in place.	<ul style="list-style-type: none"> • Establishes a direct link between risk appetite and internal controls and accountability 	<ul style="list-style-type: none"> • Risks being too technical and jargon filled if not appropriately customized and communicated

2.4 Risk Appetite scales

Central to the concept of risk appetite is the view that some objectives are worth taking risky approaches to achieve, while others may require an organisation to be cautious or conservative when managing risks to their achievement. A **Risk Appetite scale** refers to the defined levels of risk appetite that an organisation can assign to different types of risk. A simple example of a three-point Risk Appetite scale would be Low, Medium or High. By creating a risk appetite scale with clear definitions, an organisation can articulate these different approaches in a consistent and clear manner. The Risk Appetite scale should not be confused with the risk likelihood-impact matrix.⁶

For a Risk Appetite scale to be useful, each point on the scale will need to have a clear and specific definition. For example, if an organisation simply states it is 'averse' to risk around information security, or 'cautious' around operational risk, the meaning of this and the behaviours it should drive will be open to interpretation and different subjective perceptions.

The advisable approach is to define risk appetite in a way that drives desired and consistent behaviours within the organisation, in line with expectations of its senior stakeholders. To achieve this, the organisation needs to agree to the behaviours expected at different levels of risk appetite on the scale and articulate these specifically as a framework for decision making. The articulation of behaviours in this way will clarify expectations of the organisation's stakeholders and allow for the risk appetite to cascade to 'lower' levels and be embedded in the organisation.

Some key questions to determine when establishing a Risk Appetite scale are set out below. Table 3 on the following page provides a number of examples of different definitions of Risk Appetite scales used by international organisations for reference. Some additional examples from other organisations are provided in Annex II.

- **How many points should there be on the scale?** It is recommended and widespread practice to use a three, four or five point scale for risk appetite levels. More than five is too granular and two points would not provide enough range. Some organisations use a different number of points from their likelihood-impact matrix in order to reduce confusion between the two.
- **What should the actual definitions be for each point on scale?** The examples in Table 3 and Annex II can give some ideas for how the points on the scale could be defined. As a general rule the definitions should be as clear and measurable as possible so that all key stakeholders will interpret them in a consistent manner.
- **What should the consequences be of placing a risk area on any given point of the scale?** To give a basic example, if an area is assigned to the lowest point on the Risk Appetite Scale then activities in this area may require a higher level of escalation and approval and more checks and controls. Conversely, areas placed at the higher end of the Risk Appetite Scale would likely be subject to less oversight and approval.

⁶ A likelihood-impact matrix is graphical representation of the distribution of risks in a matrix with likelihood on one axis and impact on the other.

Table 3 Examples of Risk Appetite scales from United Nations and International Organisations

Organisation	Risk Appetite Scale used				
Gavi	Low	Moderately Low	Moderate	Moderately High	High
Global Fund	Low	Moderate/Low	Moderate	High	Very High
IFAD	Zero Extremely conservative: Reduce risk to the minimum level and avoid any negative impact	Low Conservative: Reduce risk as much as possible	Moderate Cautious: Willing to accept risks if they are outweighed by the expected benefits	Substantial Flexible: Take risks that are essential to achieving development impact	High Open: Willing to take risks
WFP	Specific risk appetite and tolerance levels are set against different quantified metrics which are each unique to each risk area for which appetite is set				
WIPO	Low areas in which the Organisation avoids risk, or acts to minimize the likelihood or impact of the risk event. This level of risk appetite is aligned to the Organizational overall risk appetite		Medium areas in which the Organisation must constantly strike a balance between the potential benefits, and the downside costs of a decision.		High in specific areas, the Organisation may choose to take a calculated amount of risk, with the expectation that the probability of benefits outweighs the potential for ineffective investment.

2.5 Drafting the Risk Appetite Statement

Once an organisation has considered its key design questions ([section 2.2](#)), taken a decision on how it wishes to structure risk appetite ([section 2.3](#)) and how it wants to define its Risk Appetite Scale ([section 2.4](#)) it will be in a position to begin drafting the statement itself. This section indicates the common components of a Risk Appetite Statement and elaborates on what can be included within each of them.

Generic outline of a Risk Appetite Statement

A. Preamble

This section may discuss the high-level guiding principles of the organisation, why the Risk Appetite Statement is being developed, how it was developed, and how it is to be used in various organisational control processes at a high level.

B. Definitions and explanation of the Risk Appetite Statement

The Risk Appetite Statements reviewed typically included definitions of key terms such as Risk Appetite, Risk Tolerance, Target Risk Level or other concepts that were used. The proposed common United Nations definitions outlined earlier in this document and in Annex I can be used here.

C. Explanation of the structure of the Risk Appetite Statement

The statements reviewed also often explained how they were structured, typically based on one of the options described in [section 2.2](#). Explaining the structure and linking it to other relevant organisational documents and/or frameworks will aid the reader in understanding the Risk Appetite Statement and how it relates to the overall organisation.

D. Details of the operationalisation of risk appetite

Many of the Risk Appetite Statements reviewed also provided some details of the monitoring, reporting, responsibilities and operationalisation of the Risk Appetite Statement. Guidance on these aspects is covered in [Section 3](#) of this document.

E. The main body of Risk Appetite Statement

A set of qualitative and quantitative metrics and expressions that articulate the organisation's risk appetite (see case study 4 for some examples). This section is the key part of the document that explains to the reader what the organisation's risk appetite is (in terms of the scale) for each area where they are defining it, according to the structure.

F. Reports on current levels of risk

Many Risk Appetite Statements provide the appetite level in a given area (e.g. medium) and also the current assessed level of risk (e.g. high) so the reader can clearly see where existing risk is outside of appetite or tolerance levels. This approach, however, may require regular updating of the Statement.

G. Authorization and approval

The Risk Appetite Statements reviewed by the task force contained some organisation specific version control information. Another option used by some organisations was to include the approval date, version number, and the body or position that approved the statement in the header or footer of the document.

Case Study 4. Selected sample metrics and expressions of risk appetite

Below are some actual risk statements taken from international organisations' risk appetite statements to illustrate the kinds of quantitative and qualitative metrics and expressions that may be used to articulate risk appetite. The escalation procedures for being outside of these appetite levels are determined by the processes of each respective organisation.

- Organisation A has an amber threshold of 0.2% downtime of critical systems.
- Organisation A has a red threshold for 2 or more negative media reports from a given Country Office.
- Organisation B has a high risk appetite for in-country supply chain risks.
- Organisation C has a high risk appetite for investing in areas that could provide significant improvement and innovation in its operations.
- Organisation D has a low risk appetite for reputational risks or potential conflicts of interest.

2.6 Internal consultation

After the sketch of the Risk Appetite Statement has been prepared it should ideally be socialised across the organisation for internal review and feedback from key stakeholders (see [section 1.4](#)). Based on this feedback it may be necessary to revisit some of the design decisions previously taken. If needed this step can be iterated a number of times until the relevant internal stakeholders are content with the Risk Appetite Statement.

2.7 Formalize and ratify the Risk Appetite Statement

The specific form of endorsement will vary from organisation to organisation. It is advisable that the senior leadership team take the time to thoroughly discuss and vet the Risk Appetite Statement before it is reviewed and ratified by the governing body, who should similarly discuss and challenge it before endorsement.

3. Operationalising Risk Appetite

3.1 Communication and reporting

Operationalising risk appetite requires clear communication both internally and externally. Internal communication is likely to be more detailed and more regular than external communication. Internal communication is also likely to need to be drive action. Examples of internal communications related to risk appetite include, but are not limited to:

- Regular reports to specific divisions (at HQ and decentralised/country/local levels, if applicable) or functions highlighting current risk against agreed appetite (these reports would also include any metrics or tolerance levels defined and may be stand-alone or integrated with other corporate dashboards or reports on key risk indicators);
- Target risk, prioritised risk mitigations and time to each target level of risk (normally within the risk appetite);
- Ad-hoc communications and coordination between first and second lines at the time of shaping risk appetite, setting metrics and suitable thresholds, with particular relevance in cases of function and/or countries / local entities level Risk Appetite chosen structure;
- Ad-hoc reports to senior management / risk committee highlighting areas that are outside of risk appetite or have exceeded risk tolerance levels;
- Ad-hoc communications highlighting any changes to risk appetite determined by senior management to relevant staff; and
- Communications (including training) to inform staff of the Risk Appetite Statement and what its implications are for them in their respective roles.

External communications will generally be less frequent and less detailed than internal ones although they may serve a large variety of purposes. Examples of external communications related to risk appetite include, but are not limited to:

- Periodic (i.e. annual) reports highlighting overall risk levels against existing appetite for the information of key stakeholders;
- Communications with partners (including other agencies, NGOs, governments or other donors) about the risk appetite of the organisation to assist them in effective partnership; and
- Exception reporting on instances where risk goes outside of appetite or tolerance levels – for examples, some donors may include requirements to be informed of certain instances of risk being outside of certain levels.

Regardless of the form of communication and reporting, the organisation will need to determine what it will report, to whom, when, in what format, and who will be responsible for producing and disseminating each of these reports. Determining this clearly at the outset will maximise the chances of the organisation communicating and reporting on risk appetite in a purposeful, accurate, clear and timely manner in order to drive desired behaviour and performance. The reports should contain timely and accurate information and metrics and be presented in a clear, visual manner to allow for managers to use them effectively in decision-making. More details of key risk indicators and other metrics are given in Annex III.

3.2 Escalation procedures

Linked to the reporting of risk appetite, an organisation will need to establish clear procedures for what happens when a threshold or a limit of risk appetite is breached. This includes the designation of escalation authorities, timelines and potential remedial actions. Escalation procedures should therefore define the roles of various stakeholders: the responsible business units (which could be a Central/HQ or a Country/Local unit, depending on risk appetite metrics definition), the risk management function (which could be also decentralised in some organisations), senior management and its management committees. Escalation in the case of limit breaches will depend on strictly defined escalation procedures and should generally include the risk management function at a senior level. Escalation consists of “raising the flag” to senior management and, if required, to the governing body. The level, speed and form of escalation may vary from category to category. For example, areas with lower risk appetite levels may have more serious escalation procedures for breaches than those for areas with high risk appetite.

3.3 Response to threshold breaches

Some organisations may consider that the reporting of a threshold breach should automatically lead to some form of remedial action, which might consist of raising the limits for the particular risk category, adopting corrective actions to reduce the impact of the breach, eliminating the root causes of such a breach or suspension of activities which originated the breach. In such an instance, the organisation can usefully ask themselves questions such as: is the risk assessment agreed; is the exception approved; must more mitigation action be taken now; and should more controls be implemented to prevent getting to this point again? Also, it is advisable for organisations to document each case of risk appetite being breached as well as the root causes of the breaches and details of the rationale behind any above-mentioned remedial action taken as a result. Over time, this data could be analysed to allow the organisation to identify patterns and trends that it could use to further enhance its risk management processes. It should also be noted that the organisation's leadership, including the governing body, need to be aware of how the lower level escalation procedures are structured, in order to be able to monitor the application of the whole risk appetite throughout the organisation.

3.4 Utilisation of pre-emptive trigger limits

Some organisations may adopt a “preventative” mechanism with escalation trigger limits before breaching RAS threshold, when risk appetite statement allows for both qualitative and quantitative thresholds. This mechanism aims at ensuring that senior management are notified (for their input/decision on response/corrective actions), before the RAS threshold and the critical level of losses/potential losses are reached, and that action plans are being established on a timely basis. An example applied to operational risk appetite is provided in Annex IV.

3.5 Handling of exceptions to risk appetite

Exceptions are usually handled following the same process as the risk appetite breaches escalation procedure. The following provides examples of exception types:

- **Exceptions to requirements within specific risk policies (e.g. operational risk policy, market risk policy, cyber risk policy) having risk appetite statement implications**

This exception type will be processed in line with the escalation procedure of breaches and eventually could require within the corrective action plan the amendment of the respective risk policy apart from the actions to solve the breach. Risks specifically

associated with the safety and security of UN personnel, assets and operations are managed in accordance with the UNSMS⁷ and are governed accordingly.

- **Exceptions to the risk appetite statement, whose impact may determine any breach of thresholds**

The handling will depend upon the materiality and relevance of the exception. In general, such exceptions will be assessed against their consistency with the strategic objectives and “spirit” of the risk appetite statement, and temporary breaches of thresholds will be addressed with appropriate corrective action plan. Should such exceptions imply material risk appetite consequences, the decision makers might require to amend the risk appetite statement. Hence the need to handle such cases following the risk appetite statement governance (approval/review process by delegated authority, e.g. governing body etc.).

- **Exceptions to the risk appetite statement due to new/emerging risks, whose risk appetite thresholds have not been defined**

The handling will require an amendment/update of the risk appetite statement and the approval of the delegated authority as per risk appetite approval/review process (see point above).

3.6 Reviewing and updating Risk Appetite Statements

The Risk Appetite Statement should be periodically monitored, reported on, and discussed, as required, with the governing body, donors, external auditors and regulators, and other stakeholders. This will help to ensure that the Risk Appetite Statement remains relevant, current and value-adding. It will allow for incremental improvements, and for new risks or risk areas requiring articulated risk appetites to be identified, including those that may be difficult to quantify. Additionally, revision should be backward looking to assess whether the risk appetite framework in its current form has been effective in terms of supporting strategic and risk objectives.

Organisations may wish to specify a fixed period of time after which their Risk Appetite Statement should be reviewed and updated, or identify certain trigger events (such as the materializing of a significant risk, or significant changes in operational context), ensuring that it remains in line with the expectations of the stakeholders that would necessitate such a review. Given the length of time and level of investment required to develop a Risk Appetite Statement, most organisations do not review their Risk Appetite Statements on annual basis. However, as a minimum it is recommended to review a Risk Appetite Statement at least once every five years. Where an organisation has a specified time period for reviewing its strategic plans (such as every three or four years in some cases), the Risk Appetite Statement could also be reviewed and updated as part of this process.

⁷ United Nations Security Management System

Case Study 5. How risk appetite is operationalised in a public-private partnership

The maturation of our risk management and assurance approaches has provided an opportunity to more effectively balance fiduciary risk and programmatic impact. In particular, the Board's approval of the Risk Appetite Framework and its subsequent operationalisation has been a key catalyst, providing a structured framework through which the organisation can take informed decisions on risk trade-offs.

South Sudan is an example of country in which the Risk Appetite Framework has enabled risk trade-off decisions to be taken to drive greater programmatic impact. It represents one of the most challenging contexts for Long-Lasting Insecticidal Nets (LLIN) distribution. Conflict has resulted in massive population displacement and communities sheltering in multiple Internally Displaced Person (IDP), Persons Of Concern (POC) and refugee camps in difficult-to-reach and conflict prone areas.

Standard programmatic and fiduciary verification requirements generally applied by the organisation, such as having LLIN recipients sign for nets, are not feasible in these contexts, both because the adult literacy rate is less than 70% and because many of those fleeing political conflict are hesitant to provide any identifying information.

To ensure that we could provide nets to hard-to-reach areas and IDP/POC/refugee camps, a more flexible approach to LLIN distribution verification has been applied, including more reliance on partner assurance, use of partner reporting and commodity clearance certificates as proof of distribution.

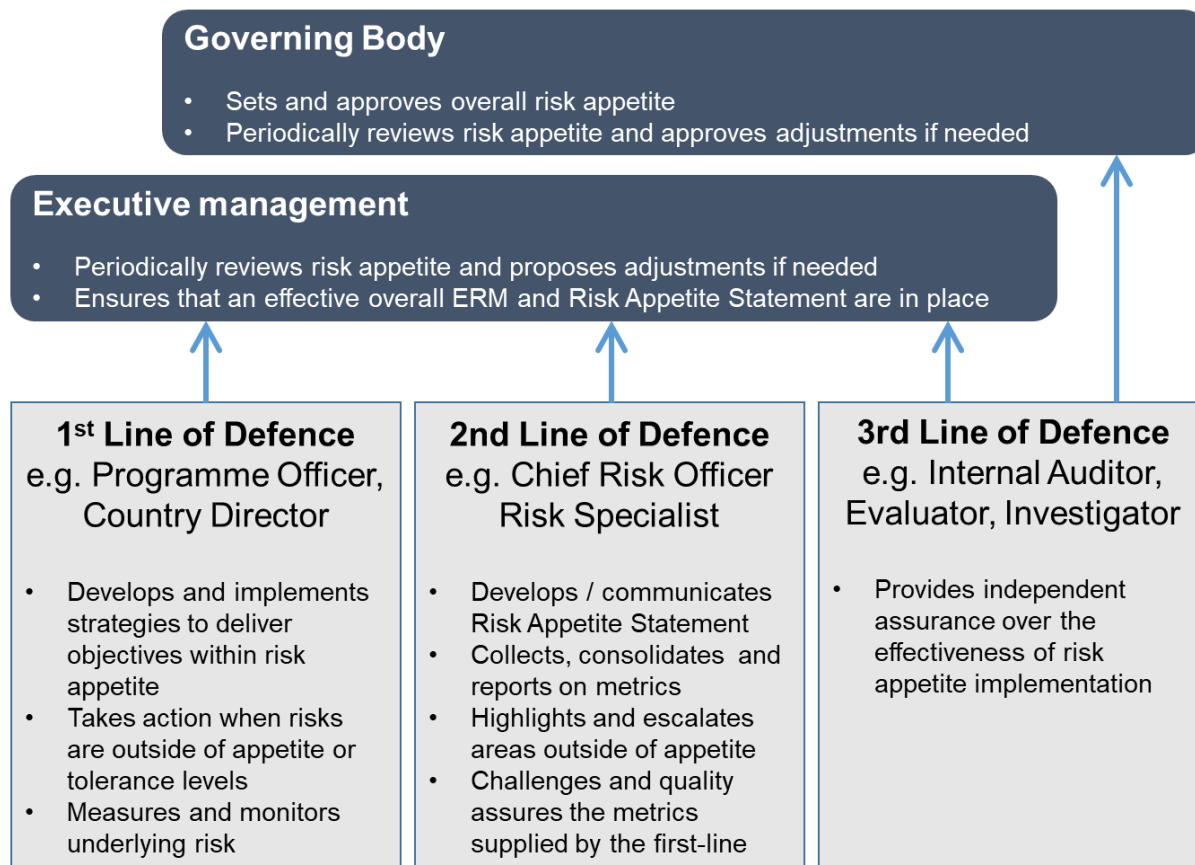
By making a strategic decision to accept additional fiduciary risk, implementers were able to nearly double the number of nets distributed in comparison to previous periods.

Achieving greater balance and taking higher risks in certain circumstances inevitably means that some risks will materialise. This cannot be avoided. However, by continually focusing on advancing the maturity of risk management, the organisation is more agile and responsive.

3.7 Responsibilities and authorities

The assigned roles, responsibilities and authorities relevant to operationalising risk appetite will vary from one organisation to another based on their differing mandates and structures, including the cases of decentralised (e.g. regional, country offices) organisation and related first and second line of defence roles and responsibilities. Despite this, an organisation seeking to operationalise risk appetite will need to assign certain responsibilities and authorities in order to do so (and these responsibilities and authorities may require review and amendment over time). This section details these key roles.

Figure 4 - Key responsibilities with regard to Risk Appetite Statements



In the **Three Lines of Defence model**, endorsed by the HLCM and used by many United Nations organisations, the first-line consists of divisions or operational units that are dealing with or taking risks. The first-line, comprising often operational staff, is accountable for managing risk within agreed appetite levels. The first-line should ideally be supported by a strong second-line risk function (potentially headed by a **Chief Risk Officer**) and a broader second-line of defence that provides support and guidance as well as policy and standard setting. Second-line functions typically include finance, security, procurement, Information Technology and other functions that oversee risk in addition to a dedicated risk function. An independent third-line (such as internal audit) would then provide assurance over the overall delivery of risk appetite.

Governing Body

The Governing Body is normally responsible to approve the organisation’s Risk Appetite Statement, adjusting it if necessary before that approval.

Executive management

Senior management’s risk responsibilities are to ensure that an appropriate Risk Appetite is proposed for consideration by its Governing body, and that a governance process for the operationalisation of its Risk Appetite Statement is established. Governance includes developing policy statements, and monitoring adherence to all aspects of such policies. Healthy risk governance requires establishment of forums at appropriate levels that review and challenge the levels of risk taken within the organisation. Such challenges should not be limited to the quantity of risk taken but need to consider the types of risk assumed.

Risk Committee

The organisation may also establish a risk committee (e.g. ERM Committee), or specific risk-focused committees (e.g. Financial Risk Committee, Non-Financial Risk Committee etc.) that hold risks leaders and senior managers accountable. A risk committee should ideally be separate from audit, corporate governance, executive or other similar board committees. It would include members with requisite risk management experience to credibly challenge those managing risk for the organisation on a day-to-day basis. One of the key roles of a risk committee is typically assessing whether the organisation is acting within its risk appetite.

Chief Risk Officer

The Chief Risk Officer is part of the second-line of defence and typically heads a risk unit. A risk monitoring function, which identifies, quantifies, monitors, reports and challenges the level of risk would also ideally be established under the Chief Risk Officer (to promote independence from first-line risk owners) or under other risk units with control function responsibilities.

All Staff

A positive risk culture, with regards to risk appetite and also more generally, relies on strong risk leadership throughout the organisation with everyone within it understanding the organisation's risk appetite position and their own roles and responsibilities under it. Operational staff are important stakeholders in the implementation of risk appetite. The organisational - eventually encompassing entity and functional - risk appetite will guide the extent to which staff feel empowered to take, or avoid, risk. The context of risk appetite may also guide how the organisation plans and budgets its work, so it is important that all relevant staff are aware of it.

4. Annexes

Annex I: Definitions of key terms

Risk Appetite:

The aggregate amount (level and types) of risk an organisation wants to assume in pursuit of its strategic objectives (and mission).

Risk Appetite Statement:

A document that articulates the current risk appetite of an organisation in various different areas or levels.

Risk Appetite Scale:

The defined levels of risk appetite that an organisation can assign to different types of risk.

Risk Criteria

Risk criteria are terms of reference and are used to evaluate the significance or importance of an organisation's risks.

Risk Profile:

The quantification and allocation of risk appetite across risk categories (e.g. Insurance Risk, Market Risk, Credit Risk, Operational Risk, etc.)

Risk Tolerance:

Acceptable level of variation an entity is willing to accept regarding the pursuit of its objectives; or put another way the boundaries of risk taking outside of which the organisation is not prepared to venture in the pursuit of its long-term objectives.

Risk Trade-offs:

Interplay between various risks when decision making happens to mitigate a particular risk. (e.g.: when the organisation improves controls to mitigate fraud risk, it can delay the implementation).

Annex II: Other examples of Risk Appetite Scales

The scale is used to define the level of acceptability (or not) of risk appetite. Figures 5 to 7 below present different levels in the scale for risk appetite reported which are used in public institutions organisations, agencies and organisations. No specific rules exist for defining such scale, since the number of levels and their definitions can be defined on the basis of respective needs and stakeholders' orientation. The best practice suggests from min. 4 to max. 6 levels to form the scale. Those levels are suggested to provide a meaning of both "acceptability/not acceptability" of risks and "actionability" in case

Figure 5 – Risk appetite scale example from a US public agency

Level	Risk Acceptability
Extreme	The impact of this risk occurring would be so severe that the related activity would need to cease immediately. Extreme risks need immediate migration strategies to be implemented.
High	This type of risk cannot be accepted. Treatment strategies aimed at reducing the risk level should be developed and implemented as soon as possible.
Medium	This level of risk can be accepted if there are no treatment strategies that can be easily and economically implemented. The risk must be regularly monitored to ensure that any change in circumstances is detected and acted upon appropriately.
Low	This level of risk can be accepted if there are no treatment strategies that can be easily and economically implemented. The risk must be periodically monitored however to ensure that any change in circumstances is detected and acted upon appropriately.

Risk Appetite Approach	Risk Appetite Scale				
	Risk Seeking	Risk Tolerant	Risk Neutral	Moderately Risk Averse	Risk Averse
Risk taking vs. reward	Agency believes aggressive risk taking is justified	Agency is willing to take greater than normal risks	Agency takes a balanced approach to risk taking	Agency takes a cautious approach towards taking risk	Agency takes caution and often accepts as little risk as possible
Objective/negative impact relationship	Willing to accept a large negative impact in order to pursue strategic sub-objective	Willing to accept some negative impact in order to pursue strategic sub-objective	Potential negative impact and strategic sub-objective completion given equal considerations	Only willing to accept a small negative impact in order to pursue strategic sub-objective	Not willing to accept any negative impact in order to pursue strategic sub-objective
Preferred risk response approach	Risk is accepted as much as Congress permits	Preference to accept or reduce risk through internal measures	No preference towards risk response approaches	Preference to avoid risk or transfer it to an outside party or use secondary mechanism	Those risks that can not be effectively treated or transferred are avoided
Risk response decision criteria	Minimum if any risk response actions are taken	Risk response actions are taken when a strong case can be made for cost effectiveness of potential outcomes	Risk response actions are made based on cost effectiveness, management priorities, and potential outcomes	Incidence costs are given a relatively higher priority when risk response actions are considered	Risk response actions are taken even though prevention costs are greater than expected incidence cost

Figure 6 - Risk appetite scale example from a UK public organisation

Risk approach definition	Averse	Minimal	Cautious	Open	Actively seeking
	Avoidance of risk and uncertainty is a key organisational objective	Preference for ultra-safe business delivery options that have a low degree of inherent risk and only have potential for limited reward	Preference for safe delivery options that have a low degree of inherent risk and may only have limited potential for reward	Willing to consider all potential delivery options and choose the one that is most likely to result in successful delivery while also providing an acceptable level of reward and value for money	Eager to be innovative and to choose options offering potentially higher business rewards (despite greater inherent risk)

Figure 7 - CGIAR risk appetite scale example

Level	Definition
High	We accept and encourage opportunities presenting risks of failure if the likelihood of risks materializing combined with their potential impact make benefits greater than potential losses
Significant	We accept opportunities presenting a risk of limited under-achievement if the likelihood of risks materializing combined with their potential impact make benefits greater than potential losses
Moderate	While accepting the possibility of under-achievement in some circumstances, we seek safe operations and program/project delivery options despite lower potential rewards
Low	We are not willing to accept risks under any circumstances that would significantly impact achievement of our objectives

Annex III: Risk Tolerance - indicators and metrics

Risk tolerance is about what you can allow the organisation to deal with. Without a doubt there will be occasions where an organisation can deal with more risk than it is thought prudent to pursue.

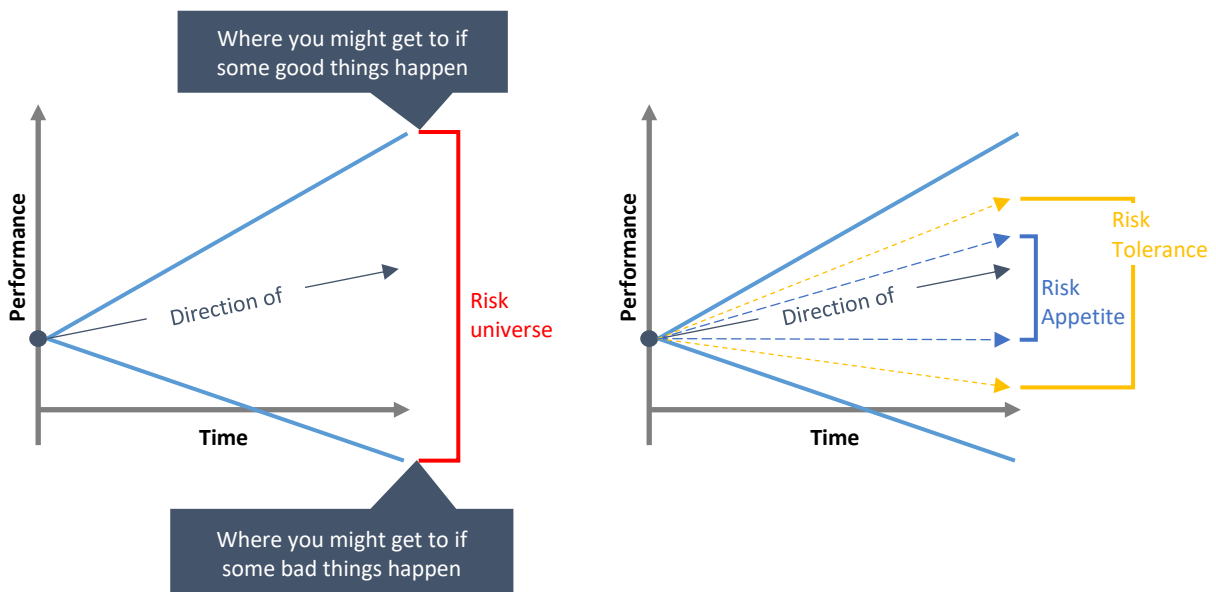
Some literature expresses risk tolerance in terms of absolutes, for example: “we will not expose more than x% of our equity to losses in a certain line of business”, or “we will not deal with a certain type of recipient”. Risk tolerance statements become “lines in the sand” beyond which the organisation will not move without prior board approval.

In this context risk tolerance has a wider scope than risk appetite, as it represents the outer limits beyond which the organisation could not cope in terms of risk capacity or performance (how much the organisation is able to live with if things go wrong).

Whereas risk appetite is the bandwidth the organisation aims to work within to achieve its objectives.

In setting risk appetite and risk tolerance organisations may consider both the gross risk position and the residual risk position to appreciate the reliance on controls and other mitigation but also the cost of these control compared to the consequences of the risk materialising. Such a discussion would also highlight the focus of assurance by internal audit and other assurance providers.

Figure 8 - Risk universe, appetite and tolerance



Risk tolerances can also be defined as quantitative thresholds that allocate the organisation’s risk appetite to specific risk types, business units, activities and segments, and other levels. Certain risk tolerances are policy limits that should not be exceeded except under extraordinary circumstances (hard limits), while other risk tolerances are guideposts or trigger points for risk reviews and mitigation (soft limits). Whereas risk appetite is a strategic determination based on long-term objectives, risk tolerance can be seen as a tactical readiness to bear a specific risk within established parameters.

Enterprise-wide strategic risk appetite is thus translated into specific tactical risk tolerances that constrain risk acceptance activities at the business level. Risk tolerances are the parameters within which an organisation (or business unit or function) must operate in order to achieve its risk appetite. Once established, these parameters are communicated downward

through the organisation to give clear guidelines to executives and managers and also to provide feedback when they are exceeded.

For this reason as specified above, risk tolerance could always be defined using metrics that are closely aligned with how performance is measured. These metrics can function at multiple levels of detail.

Risk appetite metrics are first-level organisational measures that are most directly correlated with the organisation's risk appetite. They are to be reported to the board of directors, specifically the risk committee, as well as any executive management committee tasked with active management of the organisation's strategy while ensuring strict adherence to defined risk boundaries. These metrics are designed to measure risk across the entire organisation, encompassing all regions, services, and mandates, as appropriate. They are developed with extensive input from the organisation's leadership and align with strategic objectives and the organisation's mission and vision. Metrics are typically established during the annual risk appetite and KRI assessment process and should be broadly discussed and well understood throughout the organisation.

Organisational Key Risk Indicators (KRIs) are second-level measures, subordinate to an organisation's risk appetite metrics but still measured across the entire organisation. They are intended to supplement the risk appetite metrics and are utilized and factored into risk-based decisions made at the executive management level. They may be slightly more granular than the risk appetite metrics, but will generally be broad enough to apply to most organisational divisions. As such, each organisational KRI will also be measured across almost all, if not all, divisions, with each division having specific tolerances and thresholds. Organisational KRIs are not intended to integrate directly into the risk appetite metrics but will be closely related to them. Analysis should be undertaken periodically to determine whether any organisational KRIs have become critical enough to be tracked as risk appetite metrics.

Divisional KRIs are third-level measures, specific to each division and developed by the division with appropriate support from an independent risk management advisor. As such, divisional KRIs may not aggregate directly into either organisational KRIs or risk appetite metrics, but it is important to have a thematic linkage among these metrics with regard to what is being measured. Divisional KRIs are meant to provide each division with the means to actively manage risks within the bounds of risk appetite metrics and enterprise KRIs.

The risk appetite and limits should be tested under plausible stress scenarios. Specific concerns that management might have can be translated into a "what if" scenario, e.g. what will be the impact on X if a Y event occurs? The risk management unit in conjunction with the board and senior management must ensure that they do not define mundane stress scenarios that provide a false sense of comfort. Additionally, the risk management unit must define a wide enough range of scenarios to ensure that decision makers are not blind to potentially adverse events.

Once risk appetite metrics have been aggregated, the results will be discussed with key stakeholders in appropriate risk governance fora. Divisions approaching, but not breaching, risk thresholds or other defined triggers will indicate that the organisation is taking on more risk than planned and starting to approach the risk appetite. It will have to explain this and what remedial steps are planned or have been implemented to ensure that a breach does not occur. Breaches of a risk appetite metric threshold should be reported to the risk committee and the board, if necessary. Significant changes in magnitude of risk, even if not resulting in a breach, should also be discussed. It may be that increased levels of risk are warranted given a set of opportunities that exist; on the other hand, particular operations may have to be halted to return the risk profile back to an acceptable level.

Beyond these technical steps, there will be a need to foster a healthy risk culture within the organisation. Ultimately, this will emanate from the head of the organisation and should cascade downwards from the USG through the senior management and subsequently into the divisions, services, and sections. The Chief Risk Officer will champion the process.

Senior management and the Board must have a solid understanding of what the risk metrics represent, and what the inherent assumptions and weaknesses of these metrics are. This cannot be over-emphasised as without this understanding, it is impossible to challenge the risk profile and ask probing questions. Failure to grasp risks confronting an organisation, failing to reassess risks when contemplating significant change in strategy, or failing to conduct adequate stress tests for severe adverse scenarios can have catastrophic consequences.

Establishing risk tolerance is one of the major challenges in developing Risk Appetite Statement, but it is essential to its success. There are many ways to determine risk tolerances. It is up to each organisation to determine which ones work best.

1. Board and management judgment
2. Percentage of resources disbursed or donor's equity
3. Industry benchmarks
4. Impact on the achievement of strategic business objectives
5. Stakeholder requirements or expectations
6. Statistics-based (e.g., 95% confidence level based on historical data)
7. Model-driven (e.g., economic capital for IFIs, scenario analysis, stress-testing)

Annex IV: Example of escalation matrix and mechanism with escalation trigger limits

When RAS is also defined with quantitative thresholds, a commonly implemented escalation mechanism adopts a broader concept of breaches - including RAS threshold, upper escalation trigger and lower escalation trigger - to allow for early corrective action plans, before effectively breaching the RAS thresholds.

Operations Units (first line of defence) as risk owners identify and assess the risk event and its level of breach (loss/potential loss or severity) and notify risk management function. This function (being the second line of defence) escalates to the risk committee (e.g. ERM committee or specific risk sub-committee composed by senior management members) for review and decision on corrective action plans.

The organisation's risk appetite framework might determine that some risk event types should be escalated regardless of amounts. For instance, intentional internal fraud might require immediate escalation though no financial impact occurred.

Thresholds and escalation triggers could be more granularly defined, as the organisation decides to distribute responsibilities on early corrective action plans according to the level of losses/potential losses materiality between the risk committees and other decision makers (e.g. sub-committee or senior managers). The risk management function (and when present the Chief Risk Officer) might be entitled to require immediate reporting of all losses above a certain trigger threshold.

On the other hand, though no breaches to accumulated or single loss thresholds may occur, senior management and risk committees will still receive reporting on an ongoing basis.

Table 4 – Matrix of escalation thresholds with escalating units for Risk Appetite Statement on operational risks.

Operational Risk Categories	Qualitative RAS	Quantitative Threshold	Upper Escalation Trigger	Lower Escalation Trigger	Notifying Unit	Escalating Unit	Decision Making Entity
Processes	Efficient and aligned processes make the organisation trustworthy and reliable to stakeholders	Accumulated yearly: USD 5mln Single loss: 500k	USD 4mln USD 400k	USD 2mln USD 200k	Operations	Risk Management	Risk Committee
People	Honest and highly skilled personnel make the organisation reliable to stakeholders. Health & Safety, training and honesty are priorities. No tolerance for intentional unethical behaviour.	Accumulated yearly: USD 1mln Single loss: 50k	USD 500k USD 10k	USD 25k USD 0.5k	Operations	Risk Management	Risk Sub-committee (or CRO if any)
Systems	The best and most reliable IT platform supporting business processes and compliance.	Accumulated yearly: USD 5mln Single loss: USD 500k	USD 4mln USD 400k	USD 2mln USD 200k	Operations	Risk Management	Risk Committee
External Events	Mitigate losses to external factors (vendors, suppliers, fraud). Special attention to threats jeopardising our strategy and business objectives.	Accumulated yearly: USD 1mln Single loss: 50k	USD 4mln USD 400k	USD 2mln USD 200k	Operations	Risk Management	Risk Sub-committee (or CRO if any)

Figure 9, shows a visual representation of two states (plus the desired one), where the operational risk profile of the organisation is displayed relative to its risk appetite and thresholds. For each state, the corrective actions which might be required will differ depending on where the risk profile sits within the risk appetite range. When defining escalation levels, it is advisable to ensure that each category aligns with the risk appetite and tolerance defined by the organisation.

Figure 9 – Mechanism of trigger limits and RAS threshold

