J. W. Mayo CONSULTING

Defining Risk Appetite and Tolerance

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Agenda

- Risk Appetite and Tolerance
- Eliciting Appetite and Tolerance
- Risk Policy
- Reporting Against Appetite and Tolerance

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Risk Appetite

- The terms appetite and tolerance often appear synonymous
- Tolerance must be defined after appetite is define
- Appetite and tolerance must be defined in the risk policy

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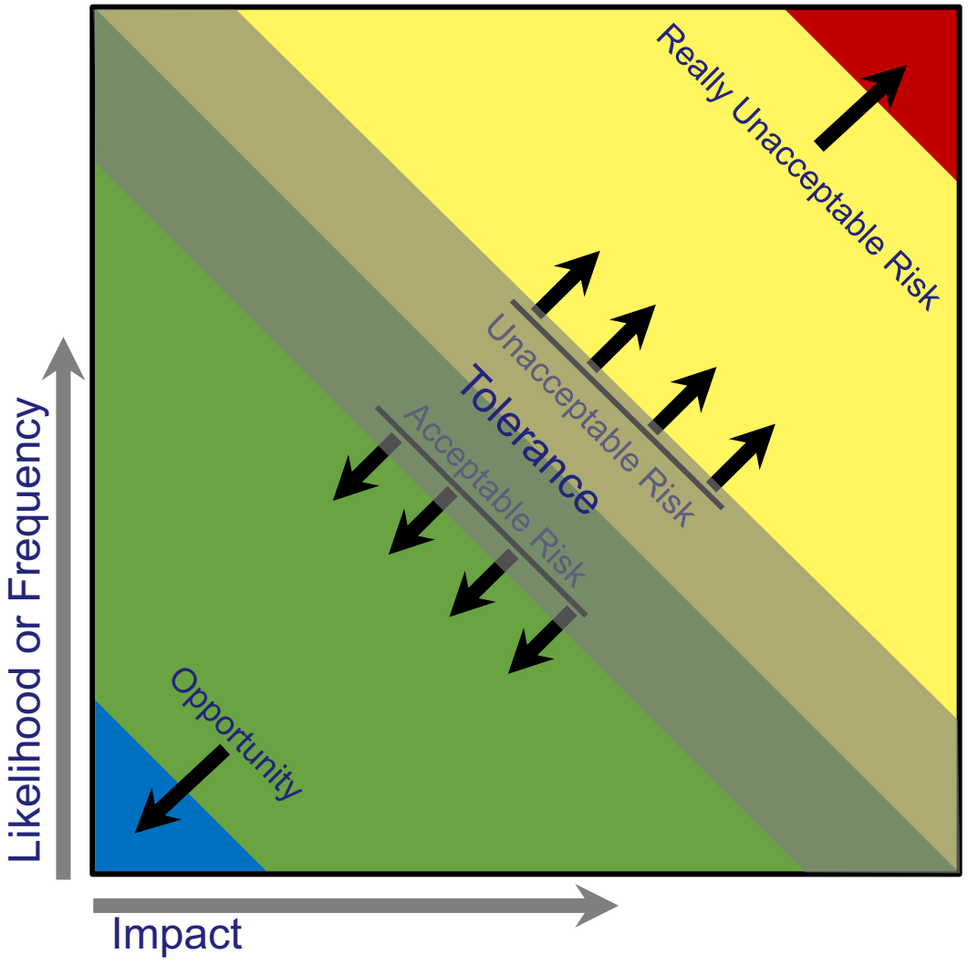
Risk Appetite

What is your risk appetite for

- Safety Risk
- Reputation Risk
- Quality Risk
- Budget Risk
- Schedule Risk
- Operational Risk



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Risk Appetite - Examples

- University of Edinburgh is an excellent example[1]
  - *Compliance – The University places great importance on compliance, and has no appetite for any breaches in statute, regulation, professional standards, research or medical ethics, bribery or fraud. It wishes to maintain accreditations related to courses or standards of operation, and has low appetite for risk relating to actions that may put accreditations in jeopardy*
  - *Financial - We will limit borrowing over 1 year to 35% of net assets except in exceptional circumstances approved by Court… We will deliver a minimum annual Operating Surplus of at least 2% of turnover over any three year period unless Court approves a specific alternative*

[1]University of Edinburgh Risk Policy and Risk Appetite, https://www.ed.ac.uk/corporate-services/risk-management/risk-management-information

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Eliciting Risk Appetite and Tolerance

- How much is too much?
  - Pick a number between 1 and 1,000,000; lets use 209
    - Half the result set and ask

      “Is our number greater than the lowest number?”
    - If No then half the result set again, and so on
    - If Yes then ask

      “Is our number greater than the highest number?”
    - It takes three iterations to determine that our number is between 122 and 244
    - 100,000,000 only requires 1-2 more iterations

1,000,000
500,000
250,000
125,000
62,500
31,250
15,625
7,813
3,906
1,953
977
488
244
122
61
31
15
8
4
2
1

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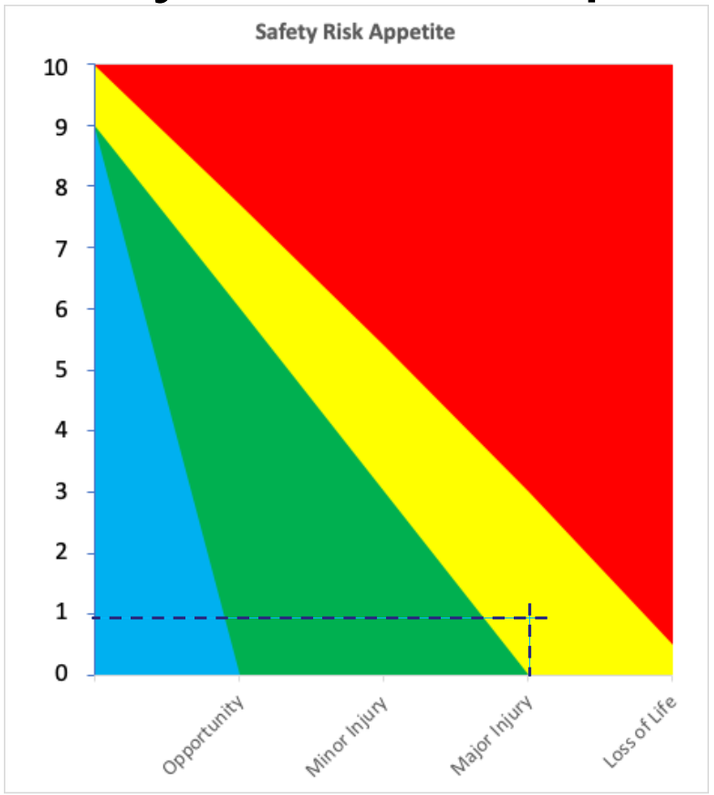
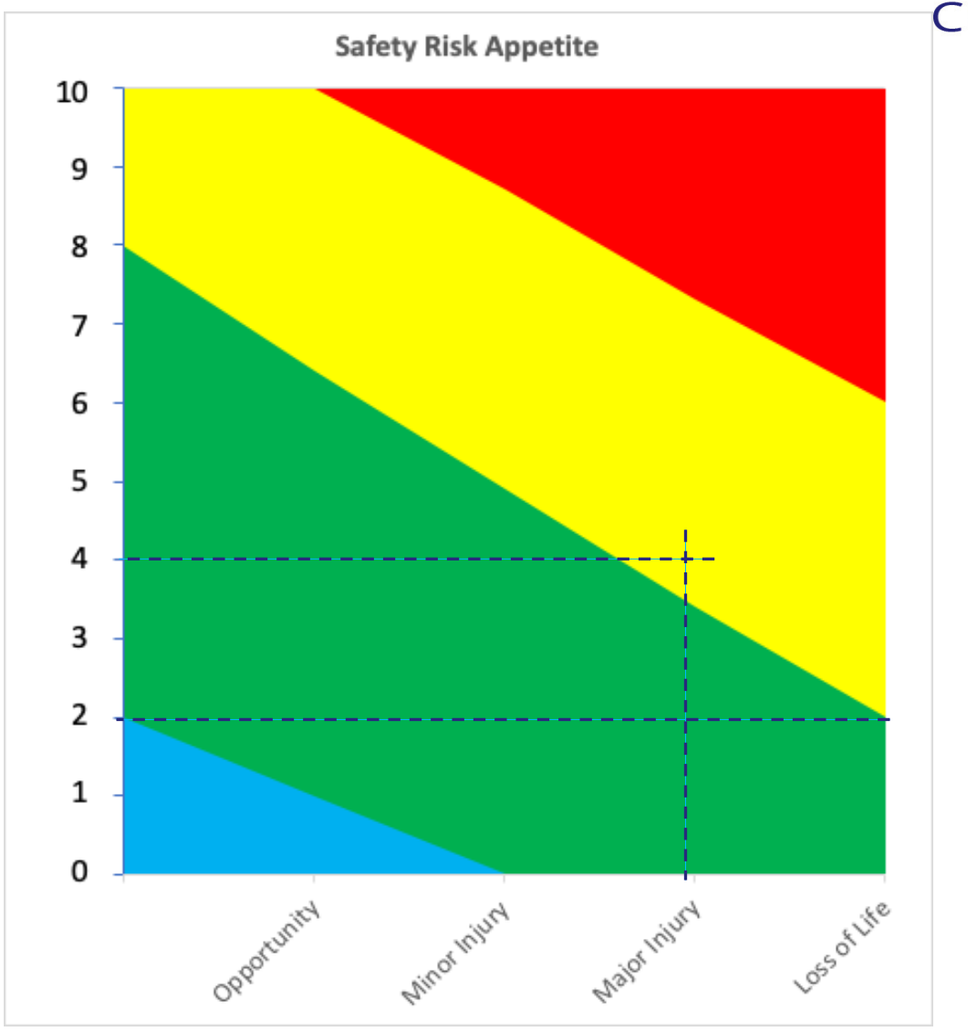
Eliciting Risk Appetite and Tolerance

- Safety Risk Example





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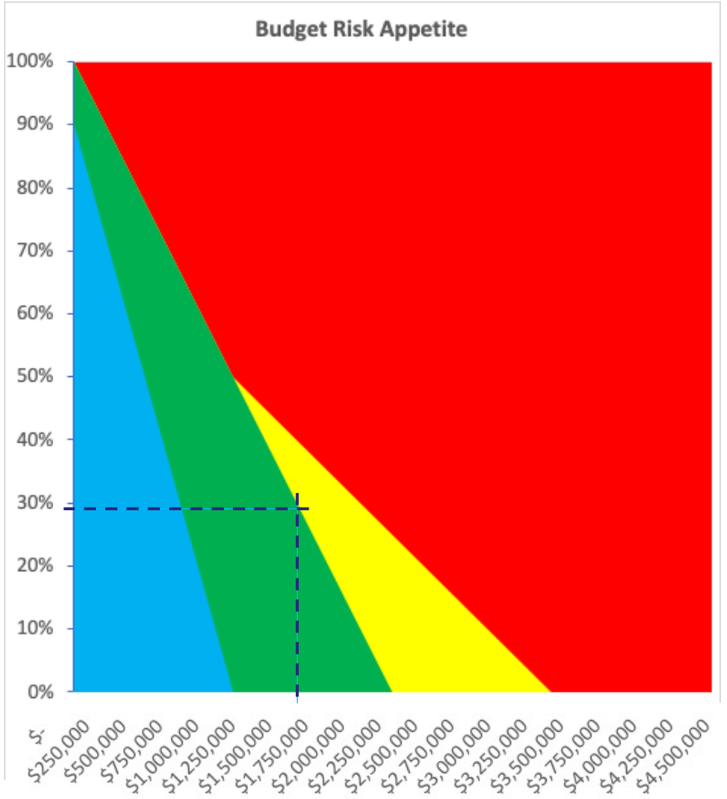
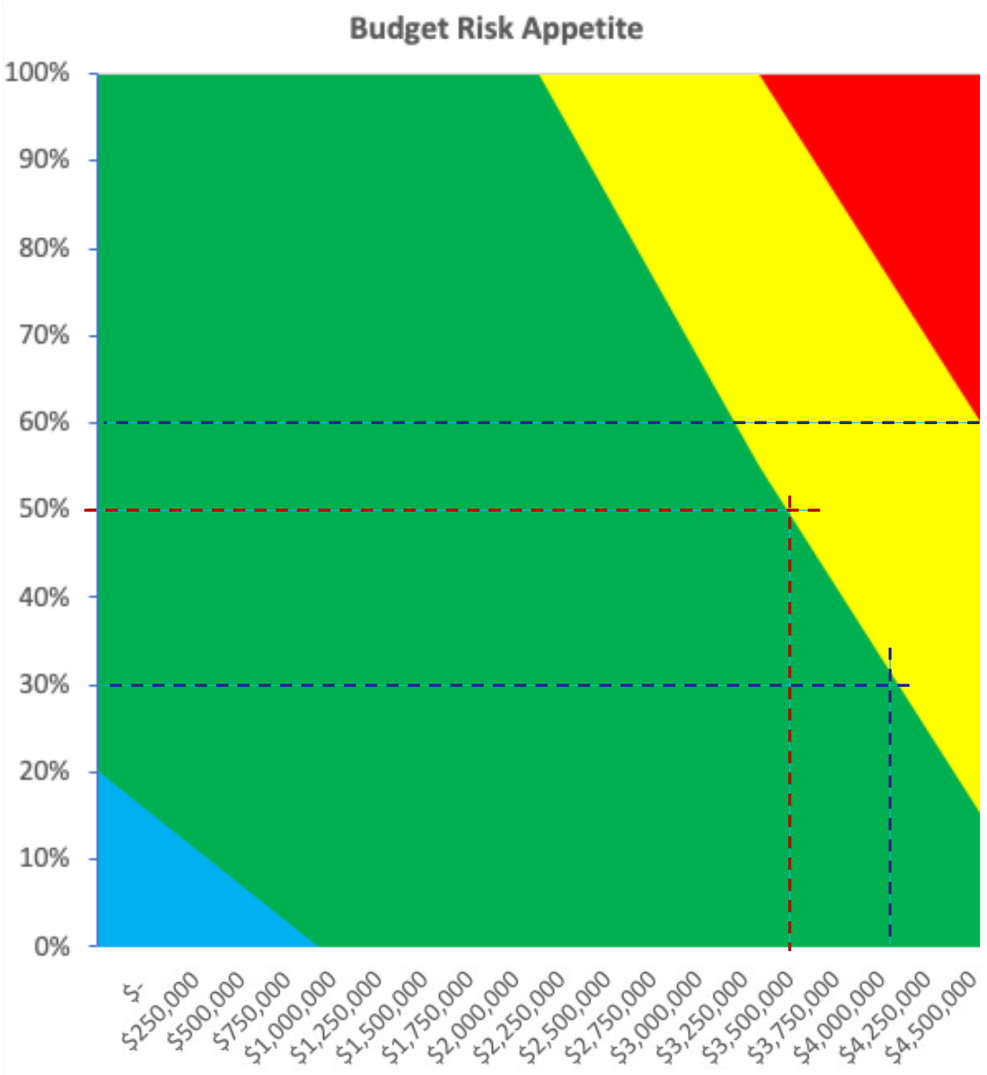
Eliciting Risk Appetite and Tolerance

- Budget Risk Example





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Risk Policy

At a minimum, Risk Policy must clearly communicate the following:

- Rationale for managing risk
- Risk appetite and tolerance linked with organizational goals
- Risk governance
  - Roles and responsibilities
  - Conflict resolution
- How risk management is measured and reported
- Tolerance thresholds between projects and the Enterprise

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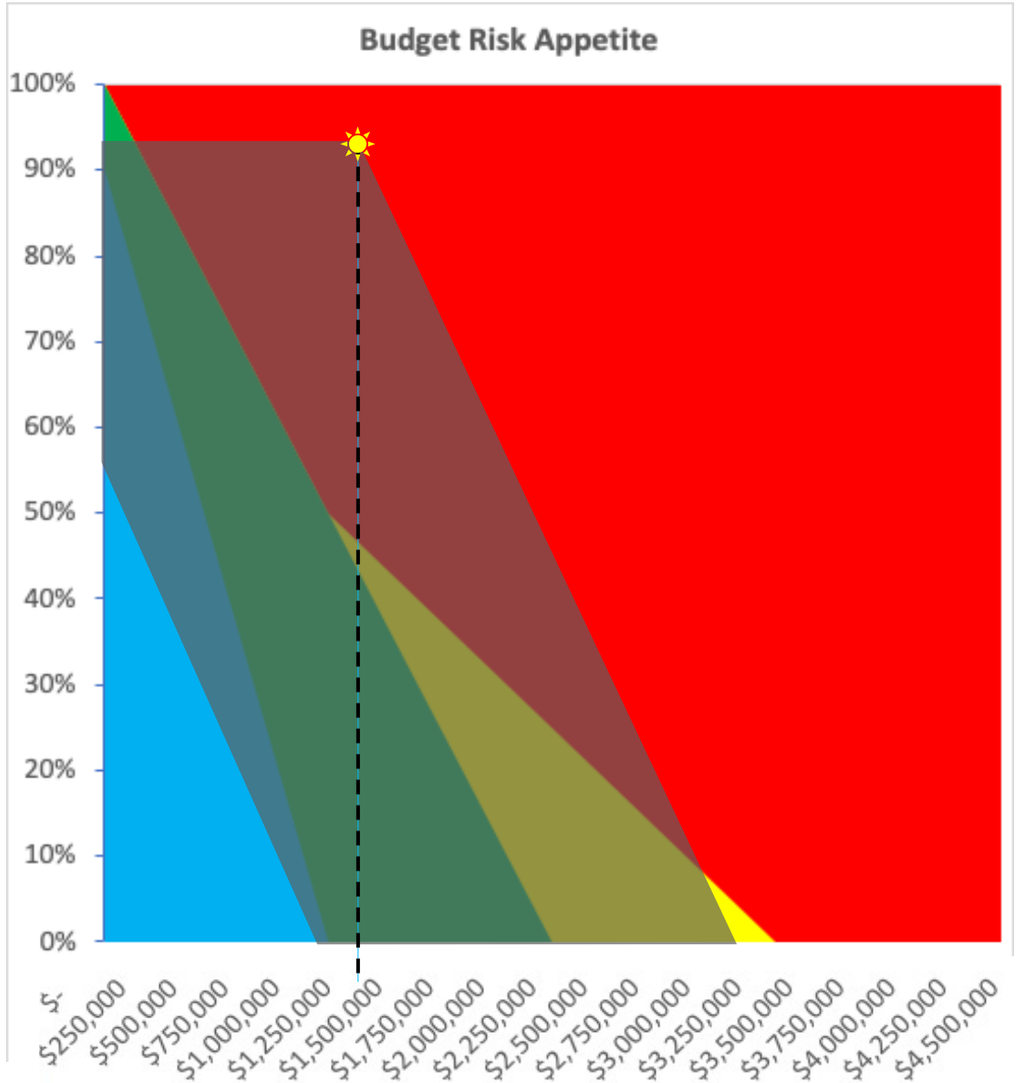
Risk Policy



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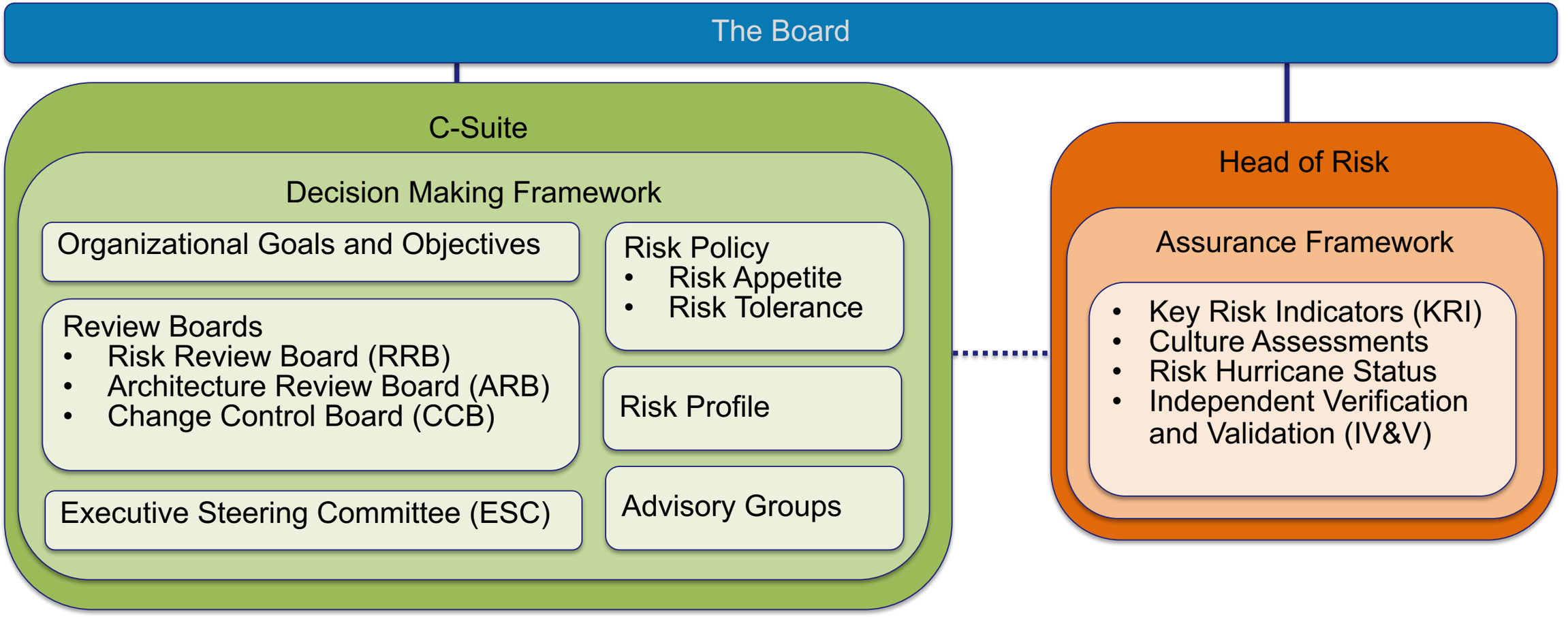
A Proposed Organizational Structure



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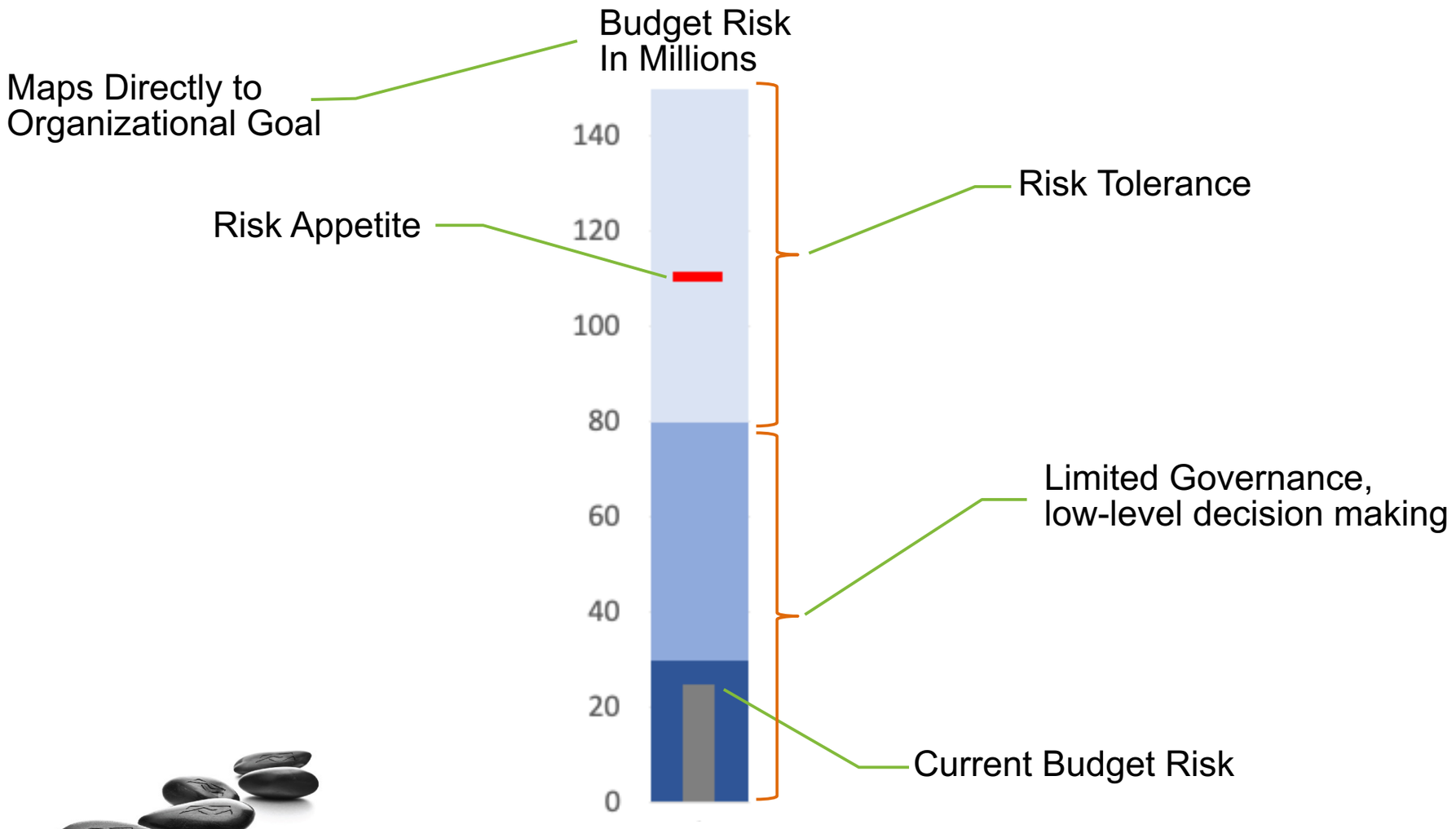
Reporting Appetite and Tolerance



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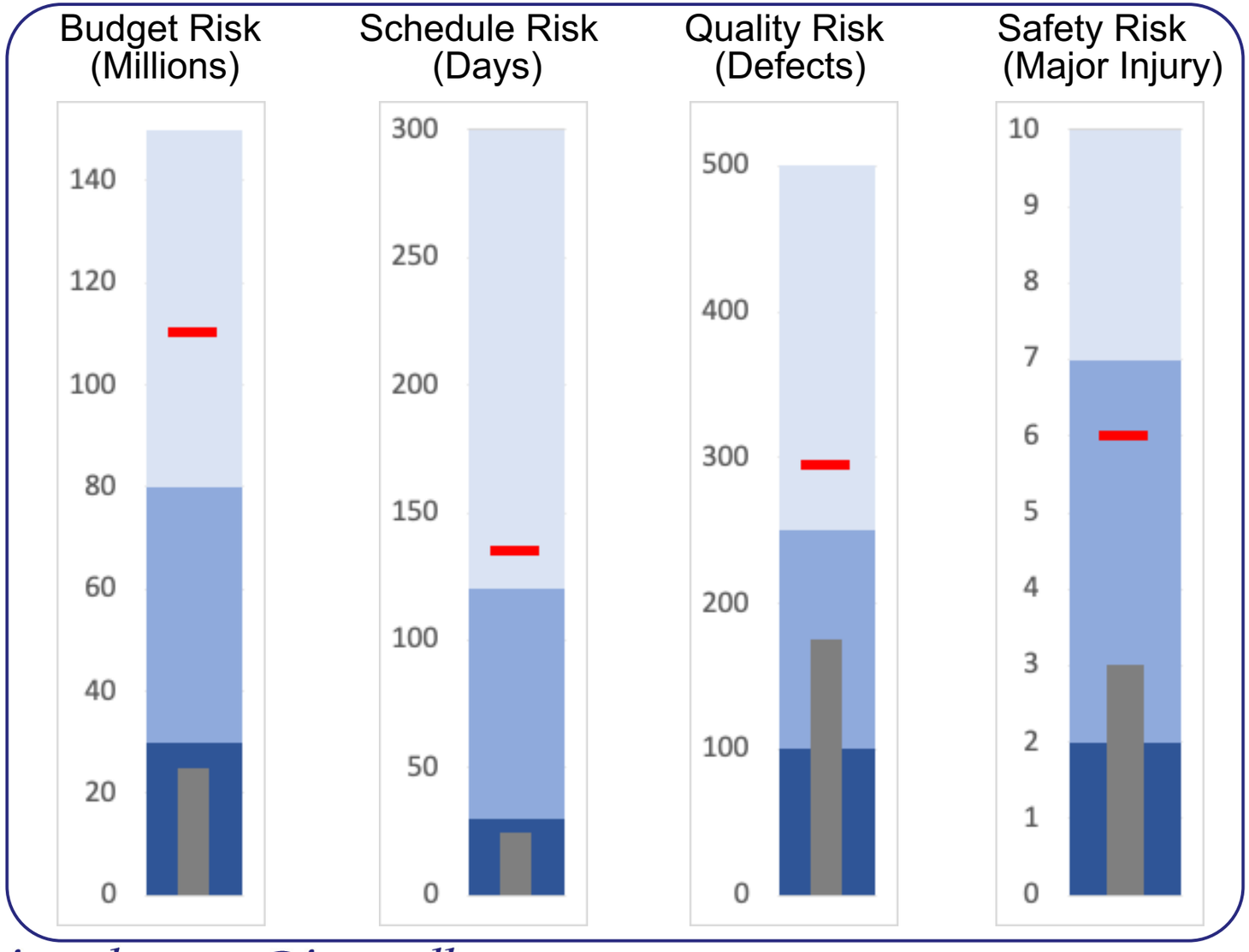

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Thank You!

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