

Chapter 21

Risk control: additional guidance

21.1 Risk control: guidance on governance arrangements

Additional guidance on governance arrangements

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- (1) This chapter provides additional guidance on risk-centric governance arrangements for effective risk management. It expands upon the general organisational requirements in ■ SYSC 2, ■ SYSC 3, ■ SYSC 4, ■ SYSC 7 and ■ FUND 3.7, and so applies to the same extent as ■ SYSC 3.1.1 R (for *insurers, managing agents* and the *Society*), ■ SYSC 4.1.1 R (for every other *firm*) and ■ FUND 3.7 (for a *full-scope UK AIFM* of an *authorised AIF*).
- (2) *Firms* should, taking account of their size, nature and complexity, consider whether in order to fulfil the general organisational requirements in ■ SYSC 2, ■ SYSC 3, ■ SYSC 4, ■ SYSC 7 and (for a *full-scope UK AIFM* of an *authorised AIF*) ■ FUND 3.7 their risk control arrangements should include:
 - (a) appointing a Chief Risk Officer; and
 - (b) establishing a *governing body* risk committee.The functions of a Chief Risk Officer and *governing body* risk committee are explained further in this section.
- (3) The *FCA* considers that *banks* and *insurers* that are included in the FTSE 100 Index are examples of the types of *firm* that should structure their risk control arrangements in this way. However, this *guidance* will also be relevant to some similar sized *firms* (whether or not *listed*) and some smaller *firms*, by virtue of their risk profile or complexity.
- (4) For *Solvency II firms*, the PRA Rulebook: Solvency II firms: Senior Insurance Management Functions makes the chief risk function a *PRA controlled function*.
- (5) The chief risk function is having responsibility for overall management of the risk management system specified in PRA Rulebook: Solvency II firms: Conditions Governing Business, rule 3.
- (6) *Solvency II firms* may read references to Chief Risk Officer in ■ SYSC 21 as if it were a reference to the risk management function in the PRA Rulebook.

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Chief Risk Officer

- (1) A Chief Risk Officer should:
- (a) be accountable to the *firm's governing body* for oversight of *firm-wide* risk management;
 - (b) be fully independent of a *firm's* individual business units;
 - (c) have sufficient authority, stature and resources for the effective execution of his responsibilities;
 - (d) have unfettered access to any parts of the *firm's* business capable of having an impact on the *firm's* risk profile;
 - (e) ensure that the data used by the *firm* to assess its risks are fit for purpose in terms of quality, quantity and breadth;
 - (f) provide oversight and challenge of the *firm's* systems and controls in respect of risk management;
 - (g) provide oversight and validation of the *firm's* external reporting of risk;
 - (h) ensure the adequacy of risk information, risk analysis and risk training provided to members of the *firm's governing body*;
 - (i) report to the *firm's governing body* on the *firm's* risk exposures relative to its risk appetite and tolerance, and the extent to which the risks inherent in any proposed business strategy and plans are consistent with the *governing body's* risk appetite and tolerance. The Chief Risk Officer should also alert the *firm's governing body* to and provide challenge on, any business strategy or plans that exceed the *firm's* risk appetite and tolerance;
 - (j) provide risk-focused advice and information into the setting and individual application of the *firm's remuneration* policy (Where the *MIFIDPRU Remuneration Code* applies, see in particular ■ SYSC 19G.3.2G (2). Where the *dual-regulated firms Remuneration Code* applies, see in particular ■ SYSC 19D.3.16E. Where the remuneration part of the *PRA Rulebook* applies, see the *PRA's Supervisory Statement on Remuneration*).
- [Note: The *PRA's Supervisory Statement on remuneration* is available on the *PRA* website at <http://www.bankofengland.co.uk/pr/Pages/default.aspx>.]
- (2) *Firms* will need to seek the *FCA's* or *PRA's* (as appropriate) approval for a Chief Risk Officer to perform:
- (a) (for an *SMCR firm* that is a *PRA-authorised person*) the *PRA's* Chief Risk Function *controlled function*; or
 - (b) (for an *enhanced scope SMCR firm*) the *chief risk officer function*.
- (3) The *FCA* expects that where a *firm* is part of a *group* it will structure its arrangements so that a Chief Risk Officer at an appropriate level within the *group* will exercise functions in (1) taking into account *group-wide* risks.

Reporting lines of Chief Risk Officer

- 21.1.3 **G**
- (1) The Chief Risk Officer should be accountable to a *firm's governing body*.
 - (2) The *FCA* recognises that in addition to the Chief Risk Officers primary accountability to the *governing body*, an executive reporting line will be necessary for operational purposes. Accordingly, to the extent necessary for effective operational management, the Chief Risk Officer should report into a very senior executive level in the *firm*. In practice, the *FCA* expects this will be to the *chief executive*, the chief finance officer or to another executive *director*.

Appointment of Chief Risk Officer

- 21.1.4 **G**
- (1) *Firms* should ensure that a Chief Risk Officers *remuneration* is subject to approval by the *firm's governing body*, or an appropriate sub-committee.
 - (2) *Firms* should also ensure that the Chief Risk Officer may not be removed from that role without the approval of the *firm's governing body*.

- 21.1.4A **G**
- (1) This *guidance* is relevant to an *SMCR banking firm* that has appointed a chief risk officer.
 - (2) Taking account of the nature, scale and complexity of its activities, the *firm* should have appropriate procedures to ensure that the removal or any other disciplinary sanctioning of the chief risk officer does not undermine the independence of the chief risk officer.
 - (3) It will be appropriate, in many cases, for the procedures in (2) to include that any approval for the removal of the chief risk officer requires the approval of a majority of the *governing body*, including at least a majority of its members who do not perform any executive function in the *firm*.
 - (4) Similarly, it will also be appropriate, in many cases, for any other disciplinary sanctioning of the chief risk officer to require the approval of a majority of the *governing body*, including at least a majority of its members who do not perform any executive function in the *firm*.

Governing body risk committee

- 21.1.5 **G**
- (1) The *FCA* considers that, while the *firm's governing body* is ultimately responsible for risk governance throughout the business, *firms* should consider establishing a *governing body* risk committee to provide focused support and advice on risk governance.
 - (2) Where a *firm* has established a *governing body* risk committee, its responsibilities will typically include:
 - (a) providing advice to the *firm's governing body* on risk strategy, including the oversight of current risk exposures of the *firm*, with particular, but not exclusive, emphasis on prudential risks;

- (b) development of proposals for consideration by the *governing body* in respect of overall risk appetite and tolerance, as well as the metrics to be used to monitor the *firm's* risk management performance;
 - (c) oversight and challenge of the design and execution of stress and scenario testing;
 - (d) oversight and challenge of the day-to-day risk management and oversight arrangements of the executive;
 - (e) oversight and challenge of due diligence on risk issues relating to material transactions and strategic proposals that are subject to approval by the *governing body*;
 - (f) provide advice to the *firm's remuneration committee* on risk weightings to be applied to performance objectives incorporated in the incentive structure for the executive;
 - (g) providing advice, oversight and challenge necessary to embed and maintain a supportive risk culture throughout the *firm*.
- (3) Where a *governing body* risk committee is established, its chairman should be a *non-executive director*, and while its membership should predominantly be non-executive it may be appropriate to include senior executives such as the chief finance officer.

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