ISLE OF MAN
FINANCIAL SERVICES AUTHORITY

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The Isle of Man
Financial Services Authority's
Enterprise Risk Appetite Statement

What is the purpose of this document?

This document explains how the Authority's risk appetite is embedded into its overall framework for risk management and decision-making.

Understanding how the Authority approaches risk is important for all regulated entities, collective investment schemes, retirement benefit schemes and designated businesses which are subject to the Authority's supervision, regulation or oversight.

The Authority's risk appetite is reviewed on an annual basis and when there are significant changes to its operating environment; any changes arising out of those reviews will be reflected in updates to this document.

A. INTRODUCTION

The Isle of Man Financial Services Authority ("the Authority") is a statutory board with three regulatory objectives which are set out in statute. These are –

> ***(a) securing an appropriate degree of protection for policyholders, members of retirement benefits schemes and the customers of persons carrying on a regulated activity;***
>
> ***(b) the reduction of financial crime; and***
>
> ***(c) the maintenance of confidence in the Island's financial services, insurance and pensions industries through effective regulation, thereby supporting the Island's economy and its development as an international financial centre.***

The Authority also has four long term goals which underpin the regulatory objectives and which are as follows –

- *Continue to review and enhance frameworks so that:-*
  - *Users of financial services are appropriately protected and can make informed decisions; and*
  - *Financial crime is effectively deterred.*
- *Ensure effectiveness of our regulatory, supervisory and enforcement approaches.*
- *Work in partnership with stakeholders to embrace innovation within a dynamic, appropriately regulated, international financial sector.*
- *Preserve our independence and build our resilience while remaining accountable and transparent.*

The Authority's Enterprise Risk Appetite Statement ("ERAS") provides a framework for it to identify and assess significant risks to the achievement of its regulatory objectives and long term goals and articulates the level of risk the Authority is prepared to accept in doing so.

While the Authority aims to achieve its objectives and goals to the maximum extent possible, doing so will involve a level of risk. It is not feasible or desirable for it to eliminate all risks to the financial system and its users. In operating its Enterprise Risk Management framework ("ERM") framework the Authority seeks to use its available resources to reduce risk as far as it can, or should, in the areas that matter most. The Authority employs sound ERM principles, including identifying, measuring, monitoring and controlling risk; transparent decision making; effective communication; and prioritisation of risk.

B. GENERAL STATEMENT OF RISK APPETITE

As a regulator, the Authority is naturally risk averse. It does not, however, have the desire or ability to avert risk completely. While the Authority's supervision will reduce the likelihood that regulated entities and collective investment schemes will fail, for example, it is recognised that such entities operate in a competitive environment and need to take reasonable risks, which could lead to financial stresses and in some cases, ultimately their failure. Similarly, notwithstanding the Authority's best efforts, there will always remain risks to the achievement of its other objectives. The focus of the Authority is to recognise these risks to its objectives and use its resources in the most effective way to reduce them to an acceptable level. In practice, this means that risks need to be identified and their relative importance calibrated. The Authority then needs to deploy its resources to mitigate risk (in terms of both the likelihood of risks crystallising and the impact if they do) in the most effective and efficient way.

Proportionality is an important concept for the Authority as a regulator and one of its key principles is that any action should be commensurate with the resulting benefits. In setting its risk appetite levels, therefore, it considers what is the greatest threat to it achieving its regulatory objectives and where is the greatest harm possible; those are the areas for which it has least appetite.

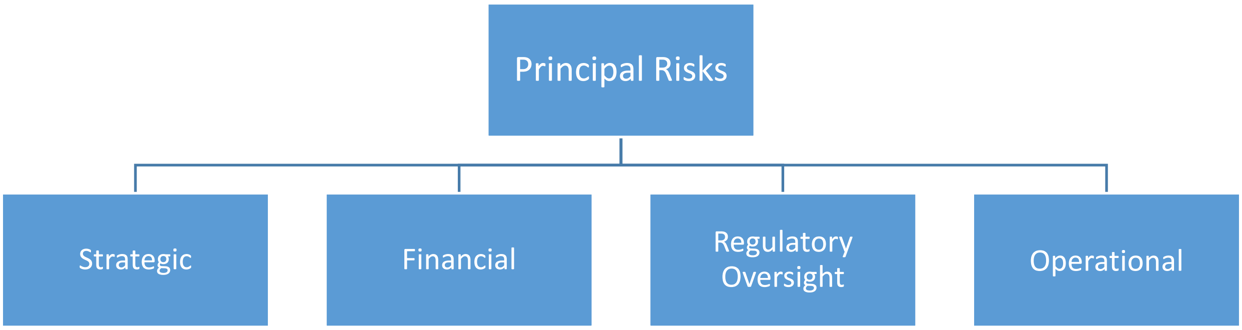
As a regulator in a small jurisdiction, the Authority cannot ignore the impact of its own actions on the Island's economy and in setting its risk appetite it must consider "the need for its regulatory, supervisory and registration regimes to be effective, responsive to commercial developments and proportionate to the benefits which are expected to result from the imposition of any regulatory burden."[1] As such, commercial implications figure among the many other factors the Authority considers when developing its framework.

The Authority has an interest in providing a framework which facilitates and encourages innovation, with one of its long term goals being to "work in partnership with stakeholders to embrace innovation within a dynamic, appropriately regulated, international financial sector". There is an acceptance that a certain level of risk is critical to innovation, subject to efforts being made to manage and control the risk appropriately.

[1] Schedule 1 to the Financial Services Act 2008.

C. RISK CATEGORIES

In terms of the Authority's ERM framework, risks are categorised under four Principal risk headings as follows:



D. RISK APPETITE LEVELS

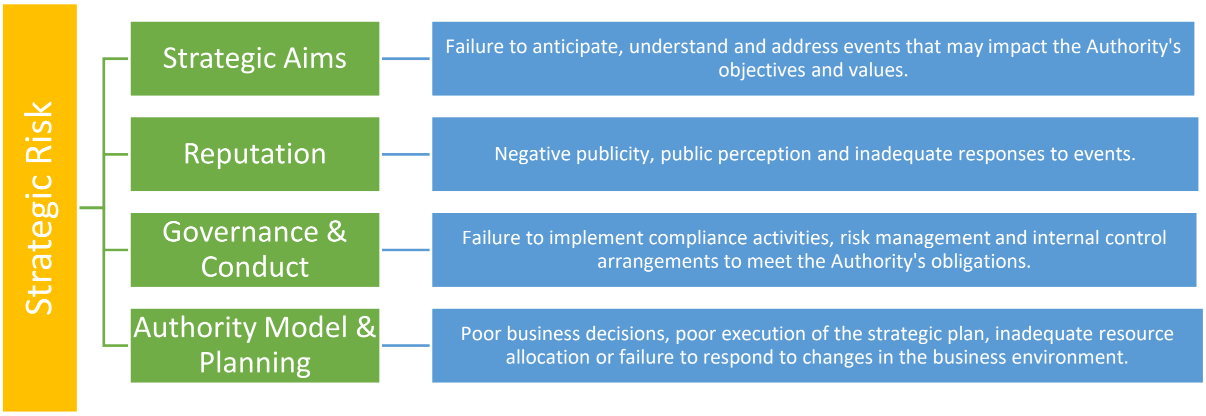
There are 4 levels of appetite. Risks for which the Authority has zero or low appetite are the main focus of attention and drive the prioritisation of the Authority's work. This does not mean that the Authority is indifferent to other risks; merely that these realistically have a different priority and are generally likely to receive less focus and resource.

Appetite	***Description***
zero	A risk which the Authority seeks to avoid and to which it will attach a very high priority in the allocation of its resources to address such risks, should they materialise.
low	A risk which the Authority seeks to avoid wherever possible. Appropriate resource will be applied in seeking to ensure that residual risks in this category are very low.
moderate	A risk which the Authority will take steps to mitigate but will accept that there is likely to be some residual risk. There would not normally be a case for allocating further resources to reduce the risk further.
high	There is little or no mitigation possible or appropriate such that both inherent and residual risk are the same. Due to the nature of the risk, the Authority chooses to tolerate the risk or accepts that it is outside of its control.

The broad appetite levels established for each category of risk, described below, are *guidance* appetite levels which have reference to what might be considered the most likely scenarios and might change depending on specific situations

Strategic risk

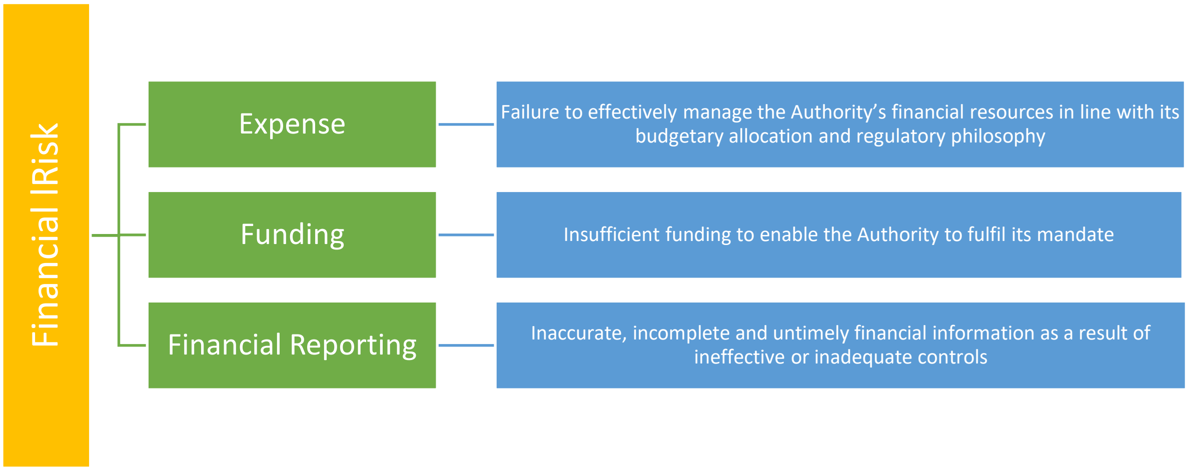
The risk that the Authority's strategy and implementation of it compromises the achievement of the Authority's goals and objectives.



The Authority has a generally low appetite to risk across these areas although a slightly higher appetite for the risks arising from the trade off between the Authority's statutory objectives and the need to consider the commercial impact, albeit along with a number of other factors. Equally, the Authority has an interest in providing a framework which facilitates and encourages innovation, with one of its long term goals being to "work in partnership with stakeholders to embrace innovation within a dynamic, appropriately regulated, international financial sector", however, it accepts that a certain level of risk is critical to innovation, subject to efforts being made to manage and control the risk appropriately.

Financial risk

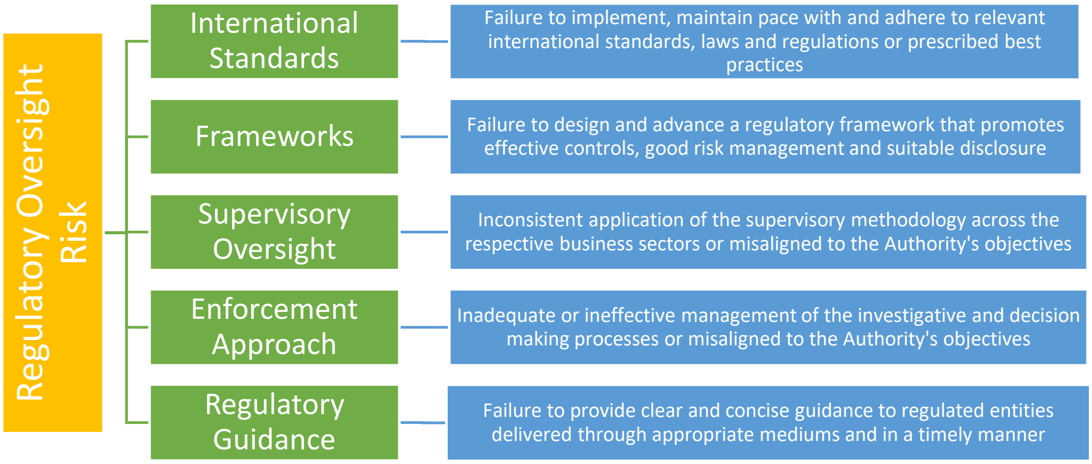
The risk that the Authority’s financial resources will be impaired because of adverse economic conditions, reduction in entities under supervision, inefficient financial resource utilisation, or increasing expenditure, reducing the ability to successfully achieve the Authority’s regulatory and strategic objectives.



The Authority has a generally low appetite to risk across these areas, but has a moderate risk appetite for items such as adverse economic conditions impacting financial resources.

Regulatory Oversight Risk

Risk that the Authority's supervisory and enforcement frameworks and processes are not relevant and up to date, and do not identify significant risks in supervised sectors; that we do not direct resources and implement protocols such that those sectors mitigate the risks, and do not make sure that effective supervisory intervention and / or enforcement action is taken as appropriate.



The Authority has a generally low appetite to risk across these areas, but notes that sometimes any changes required to frameworks can take time.

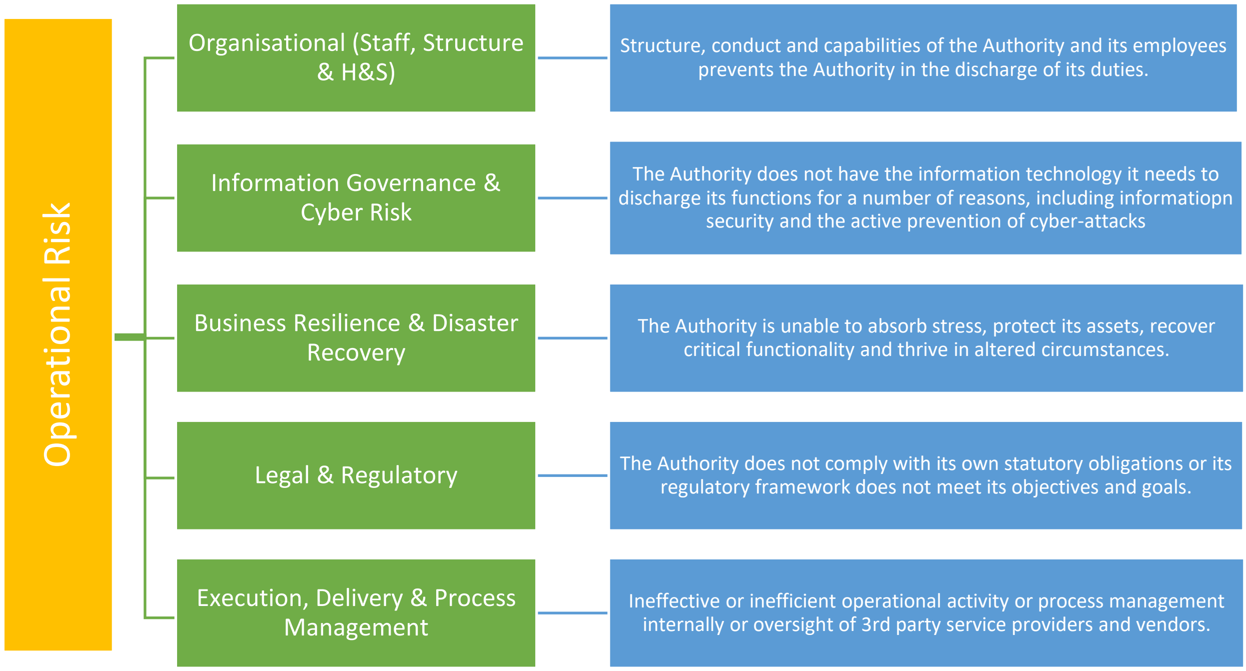
One of the Authority's key principles is that "Regulated entities are responsible for managing the risks within their business. Our job is to design and advance a regulatory framework that promotes effective controls, good risk management and suitable disclosure; this is how we contribute to the soundness of our industry."

It is accepted, therefore, that the entity's board of directors is ultimately responsible and accountable for the affairs of a regulated entity, designated business or collective investment scheme. The Authority's role is not to interfere in the direction and management of those entities unless there is a clear potential for their actions (or lack of them) to impact its regulatory objectives adversely, in which case it has the powers and tools to take action.

In relation to understanding and assessing risk (to the Authority's objectives) of individual regulated entities and designated businesses, the Authority's approach, and thus its risk appetite, is described in its Supervisory Methodology Framework.

Operational Risk

Risk that people, processes, systems, or external events impede the Authority's ability to meet its objectives.



The Authority generally has a low risk appetite to operational risk. However, there are scenarios for which there would be zero appetite (e.g. physical harm of employees) or a moderate appetite (e.g. Short term staff capacity risks).

E. REVIEW

The Statement is reviewed annually or where there is significant change to the Authority's operating environment.