

# Risk Governance



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# Agenda

- ❖ What is Risk?
- ❖ What is Risk Governance?
- ❖ Risk Management Policy
- ❖ Risk Management Roles and Responsibilities
- ❖ Governance Structure and Controls
- ❖ The Risk Management Lifecycle
- ❖ Role and Focus of Treasury
- ❖ Risk Reporting and Communication
- ❖ Benchmarking Treasury Performance
- ❖ Lessons Learnt

# What is Risk ?

- Risk directly impacts on the main objective of business, because it manifests as the **chance of a loss** to the company due to adverse events and is made up of three components:
  - **Impact** of the loss (Monetary, reputational)
  - **Frequency** of the loss (Likelihood that the loss will occur)
  - **Risk Appetite** of the stakeholders (acceptability of the risk)
- Risk creates **uncertainty** in the outcome of our corporate objectives

# What is Risk Governance?

Risk governance is an integral part of corporate governance which focuses on the policies, structures and processes used in managing the risks faced by the business:

- The risk **philosophy** and **appetite** of the organisation
- Clearly defined risk management **policy**
- Clearly defined **roles** and **responsibilities** of the Board, management, and employees
- The **rules** and **process** for risk based decision making
- A sound system for internal control
- An appropriate **assurance** process

In summary, risk governance is the system for directing and controlling the management of risk within the organisation.

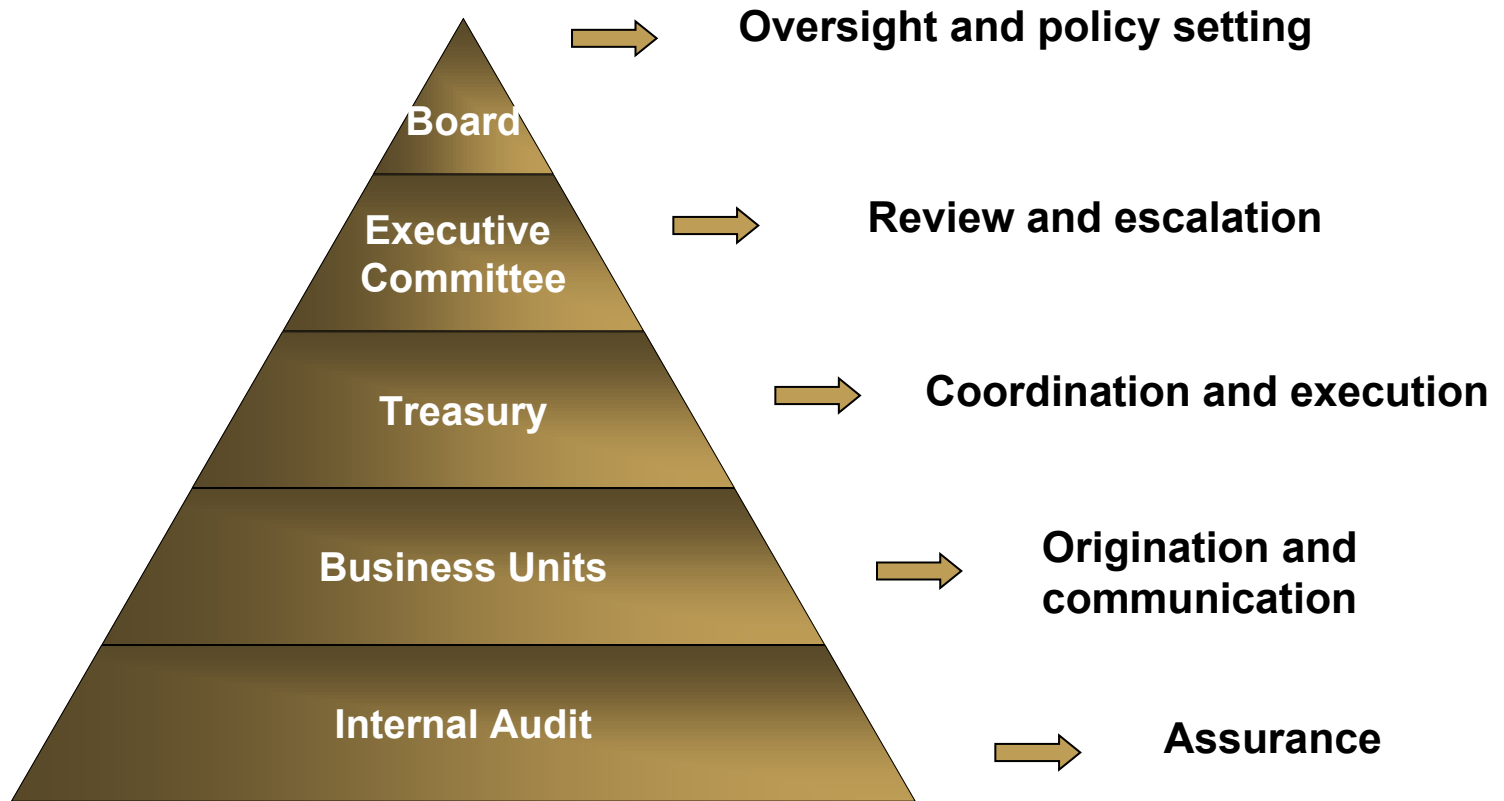
# Risk Management Policy

- **Risk Governance**
  - Who decides on/approves what?
  - Who can do what?
  - Risk Organisation
  - Which outside parties can we deal with?
- **Risk Exposures and Philosophy towards Risk**
  - What are our sources of risk? How do we measure it?
  - What is our attitude to the risk?
- **Risk Appetite and Objectives of Risk Management**
  - How much risk can we accept ?
  - What are we trying to achieve by managing risk
- **Role and Mandate of Treasury**
  - Cost/profit centre
  - Centralised vs. decentralised
  - Active/mechanistic
  - In- vs outsourced
- **Risk management limits**
  - How much should we hedge?
  - How far into the futures should we hedge?
  - What instruments can we use?
- **Performance Evaluation and Benchmarking**
  - Cash flow
  - Amount of exposure protected
  - Price protection achieved / target price levels
  - Impact on I/S, B/S and CF

# Risk Management Roles and Responsibilities

- **The Board** has the ultimate accountability for the risk and control environment, is responsible for approving and reviewing risk policies
- **The Executive Committee** is responsible for reviewing and challenging risk information produced by management and escalating issues to the Board
- **Treasury** is responsible for the facilitation, co-ordination, execution and administration of risk management activity across the organisation
- **Business Units** create risk through business activities and are responsible for providing updated data used in identifying, assessing, measuring, monitoring and reporting risk associated with their businesses or functions
- **Internal Audit** is responsible for independently assessing the effectiveness of risk management processes and practices and for providing timely objective assurance on the control of risk

# Risk Management Roles and Responsibilities

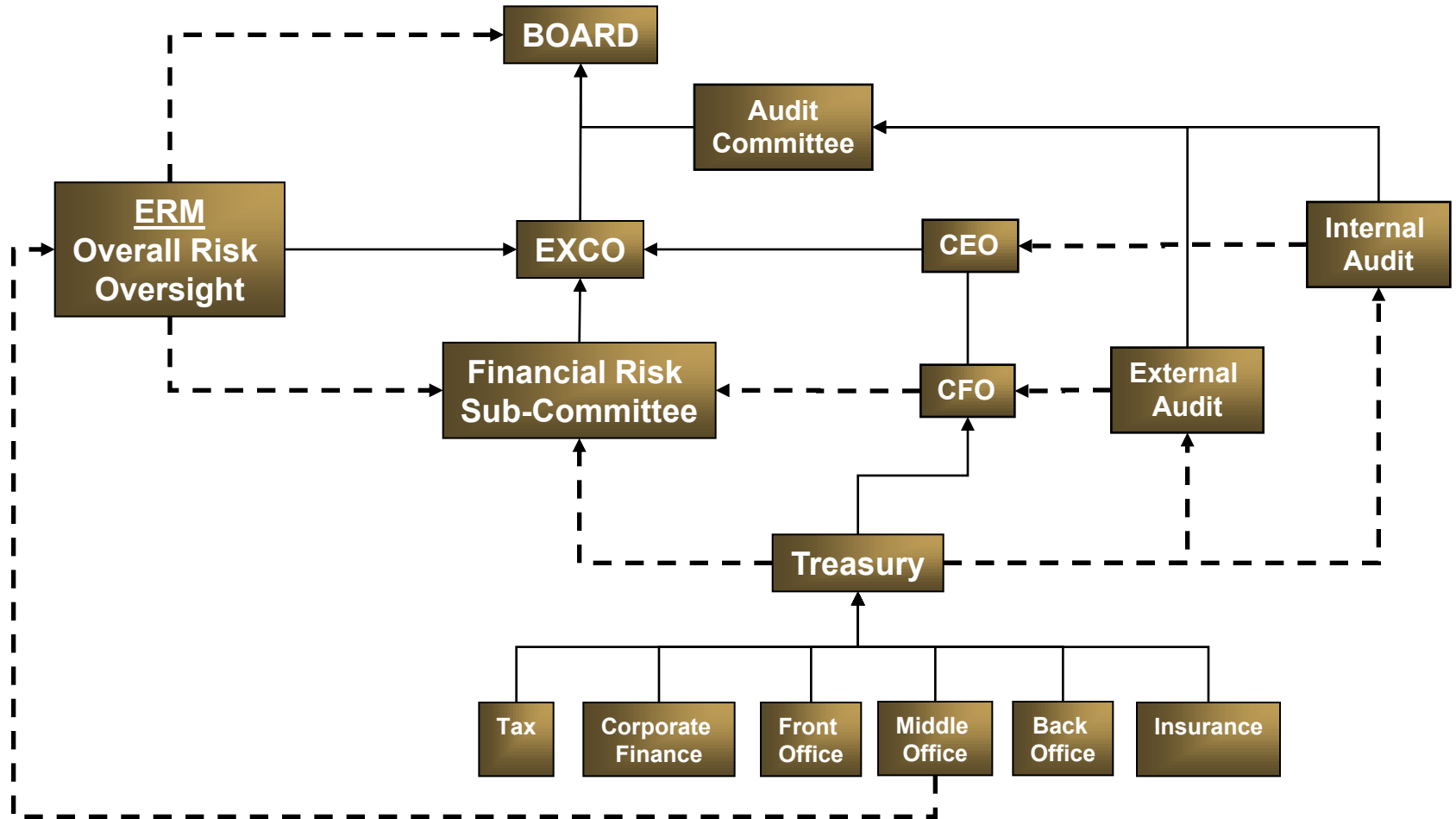


# Governance Structure and Controls

- **Roles** of Board, ALCO, EXCO, RiskCo, Treasury
- **Policy**, strategy, tactics, operational execution
- Effective **delegation** of authority
- Proper **resourcing** of treasury
  - The **right people** with compensation aligned with corporate treasury policies and risk philosophy
  - Right **structure** – reporting lines, controls, segregation of duties
  - Effective **systems** for business continuity and disaster recovery
- Regular **audits**
- **Compliance** with tax, audit, regulatory and legal standards



# Typical Governance Structure



# Risk Management Lifecycle



# Role and Focus of Treasury

- High degree of focus on **financial risk mitigation**
  - Liquidity - cash management and funding
  - Currency Risk (Transaction, Translation, Balance Sheet),
  - Commodity, Operational, Credit, Interest Rate
  - “Environmental” exposure e.g. carbon footprint
- **Expanding Role** –ERM, Strategic Planning
  - Focus on tactical and strategic, balanced with the operational
  - Input into long term corporate strategy and economic and business risk
  - Long term capital planning
  - Strategic projects & event risk (e.g. M+A)
- High degree of interaction with rest of business (**advisor role**)
- **Communication** - Stakeholder, Counterparty and Investor Relations Management
- **Projects** to improve operational performance, save cost and enhance revenues
  - Payment and card systems for T+E, loyalty programs
  - Credit card acquiring

# Risk Reporting and Communication

## Internal

- Daily/Weekly/Monthly reporting
  - Market perspective and impact on the business
  - Position, exposure, risk (Historic and projected)
  - Return, cost of debt/capital, cash flow (historic and projected)
- ALCO/RiskCo reporting
- Airtime at Board and Board Committee level
- Good understanding of role of treasury in organisation is vital
- Close relationship with:
  - Financial planning and accounting
  - Business units that generate significant financial exposure

## External

- Ratings Agency/Investor/counterparty/financial road shows

# Benchmarking Treasury Performance

- **Why?**

- Are risk management activities value adding?
- Determine performance against peers
- Enhance transparency and communication with business
- Segregate performance of risk management activities from performance of business operations

- **How?**

- Must be aligned with risk management objectives
- Should respect the list of instruments permitted in the risk management policy, provided that risk profiles have been identified appropriately
- A sound benchmark strategy must be replicable and its performance easily measurable

- **What?**

- Approach is different for each company
- Driven by risk philosophy, risk policy, forecasting/budgeting approach, mandate of treasury
- Usually a combination of measures are used
- Often based on benchmark/budget/forecast rates, hedge ratios, cash flows, accounting impact

# Lessons Learnt

- **Philosophy** towards risk and hedging **policy** is a **board decision**, enacted by management
- Hedging **policy** and the appropriate **control** and **measurement** structures are vital
- Primary objectives– **protect** cash flow, P/L, B/S through **reduced volatility**
- **No free lunches** – exposure to favorable price movements comes at a cost
- **Appropriateness** of hedging structure is critical – even simple structures carry risk
- Only transact in what you **understand**, can price and can risk manage
  - Ability to model and measure risk is key – pay for systems and expertise
- **Never over commit** by hedging more than your realistic levels of exposure, **even on a contingent basis**
- Never rely solely on one trading counterpart for strategies – **formulate own strategies**
- Never try to pick the top or bottom of the market – **averaging in** over time results in a more robust portfolio, whether in an up or down trend
- The **decision not to hedge** implies taking a **view** on future prices
- **Communication!**

# Thank You

## Questions?



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