

Gartner Research

# Operationalizing Risk Appetite

## Operationalizing Risk Appetite

### Overview

Failure to convert high-level risk appetite statements into concrete guidance leaves an organization's diverse units, functions and risk owners unsure how to apply risk appetite to their regular decision making. This, in turn, leaves the organization unable to support its defined risk-taking posture and execute strategy in accordance with that posture.

Embedding risk appetite into metrics that business leaders can easily understand, and following this up with role-specific communication and training, transforms high-level risk appetite statements into guidance that the business can use. Following up this contextualization with a reporting process encourages entities in the business to continually track adherence to risk appetite in order to self-adjust how risks are addressed.

## Key Findings

- Organizations often struggle to integrate risk appetite statements and tolerance levels into business practices. Consequently, risk appetite is often abstract and difficult to apply.
- Contextualizing an organization's risk appetite for individual business unit (BU) and function leaders can be difficult, because each business area requires a different subset of information.
- Inadequate escalation processes for potential exceptions to the defined risk appetite can lead to static risk appetite statements that are misaligned with an organization's goals.

## Recommendations

To help business leaders make decisions informed by their organization's risk appetite, heads of enterprise risk management (ERM) should:

- Translate risk appetite statements into key risk indicators (KRIs) and/or risk tolerance levels. Embedding risk tolerance in policies and operational metrics converts high-level statements into specific, actionable guidance for BU and function leaders.
- Identify gaps in business leaders' understanding of risk appetite and communicate risk appetite by tailoring information to individual roles.
- Conduct scenario-based workshops to strengthen decision makers' ability to relate their organization's risk appetite to real-world events.
- Establish a reporting process for escalations and exceptions to track their organization's adherence to its stated risk appetite.

Once they have drafted risk appetite statements, heads of ERM face the challenge of getting business leaders to make risk-appetite-aligned decisions. Heads of ERM recognize that embedding risk appetite into business decision making is a top priority; 77% of the respondents to the Gartner Risk Agenda Poll Survey reported that it is an important problem for ERM leaders to solve.

To enable business leaders to apply risk appetite to their decision making, heads of ERM should simplify and contextualize risk appetite by taking the following four actions:

- Determine risk tolerance and embed it into actionable guidance.
- Assess knowledge gaps and communicate risk appetite to stakeholders.
- Reinforce risk appetite through training workshops.
- Establish a tolerance-focused risk-reporting process and track risk escalations.

## Determine Risk Tolerance and Embed It in Actionable Guidance

### Determine the Organization's Risk Tolerance

Although the terms “risk tolerance” and “risk appetite” are often used interchangeably, they describe distinct concepts. Risk appetite statements are made in qualitative terms, whereas risk tolerance is expressed quantitatively at a more granular level.

For organizations that use KRIs, the first step in determining risk tolerance is to select ones that align with their risk appetite statements. Once KRIs have been selected, heads of ERM can aggregate them to produce an overall risk tolerance level.

Some organizations may not use KRIs. Their heads of ERM and risk owners should collaborate to determine a specific tolerance level in the form of a single metric.

Both these methods determine risk tolerance and link qualitative risk-taking preferences to measurable outcomes. Mapping quantifiable metrics to qualitative risk appetite statements provides both a “floor” and a “ceiling” for monitoring the evolution of a risk and identifying when an organization is approaching an unacceptable risk level.

### Embed Risk Tolerance in Business-Level Guidance

After heads of ERM have determined the tolerance level, risk tolerance should be embedded in specific and actionable guidance. To begin, they should review business units' existing policies to ensure they align with the articulated risk appetite. By reviewing existing policies, they can identify and provide feedback on existing metrics, performance objectives and risk tolerance.

After reviewing existing policies, heads of ERM can embed risk tolerance in standardized day-to-day procedures. To embed risk appetite into metrics, organizations will have to rely on a combination of historical values, industry standards, and subject matter experts' judgment to establish thresholds.

## Case in Point: Translating Risk Appetite (ATB Financial)



To make risk appetite more actionable to BUs, the ERM team at ATB Financial — a financial institution headquartered in Edmonton, Alberta, Canada — partners with business leaders to translate the organization's enterprise-level risk appetite statement into BU-level-specific guidance. To begin with, the ERM team creates separate BU-level risk appetite statements. The team gathers key information on business practices and creates a draft version of guidance more applicable to BU operations. Next, the ERM team organizes a kickoff session for all BUs and gathers the information needed to understand the applicability of the enterprise-level risk appetite to business operations. After drafting guidance for BUs, the team meets with BU leaders for draft validation. The ERM team validates guidance with the business to make it more actionable, while ensuring it conforms to the enterprise-level risk appetite statement. By translating enterprise-level risk appetite statements into BU-specific guidance, BUs can easily apply risk information and independently implement controls to limit risk exposure while launching new products.

## Assess Knowledge Gaps and Communicate Risk Appetite to Stakeholders

### Assess Knowledge Gaps

Business leaders are less likely to consider risk appetite statements when making strategic decisions if they do not fully understand how risk appetite relates to their specific unit or function. Assessing business-level risk appetite knowledge can help heads of ERM understand how the business interprets risk appetite and where the ERM team needs to focus. A resource-conscious method of assessing risk appetite is to incorporate risk culture into existing forms of risk assessment. This can include adding questions about business leaders' understanding of risk appetite to an enterprise risk assessment survey or adding risk appetite scenarios to risk assessment workshops.

Embedding risk culture into the risk assessment process can identify leaders with the most significant knowledge gaps. On an organizational level, the survey can give heads of ERM a business-level view of risk appetite's relevance. If risk appetite is no longer relevant to BU or function leaders, heads of ERM should consider updating their organization's risk appetite to better reflect the business's changing needs or train business leaders on the organization's risk appetite.

## Communicate With Stakeholders Through Audience-Specific Messages

After identifying knowledge gaps, communicating appropriate and relevant information to business leaders can help fill those gaps. BU and function leaders, who apply risk appetite to routine decisions, require detailed information about their business domains. Members of boards and C-suites, on the other hand, require “the big picture” in order to ensure that the organization pursues a risk-informed strategy and governs overall risk sufficiently.

### Risk Appetite Details Communicated to Stakeholder Groups

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Source: Gartner (August 2018)

RISC182084

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Tailoring risk information to risk appetite’s primary stakeholders in concrete and manageable ways usually requires the following information:

#### For the board of directors:

- Summarized risk appetite documentation across all appetite statements
- Level of risk appetite effectiveness and adoption across the organization
- Critical updates on risk categories, appetite statements, metrics or tolerance levels

## For executive leaders:

- Documentation summarizing risk appetite and management-related information for top risks
- Trending risk exposure across all top risks
- Details about previous, current and future decisions and their potential impact across risk appetite categories

## For business leaders:

- Subset of risk appetite statements based on the area of business
- Detailed information on trending risk exposure across relevant risk categories
- Breakdown of metric calculations, if based on multiple sources

### Case in Point: In-Channel Sense-Making Support (St. James's Place)



ST. JAMES'S PLACE  
WEALTH MANAGEMENT

Communication between the ERM team and business leaders is detail-oriented and tailored to the specific needs of the business. However, the detailed nature of communication between business leaders can increase the frequency of questions to the ERM team. To communicate critical risk information to business leaders and encourage independent problem solving, the ERM team at St. James's

Place — an asset management company headquartered in Cirencester, England — created an easy-to-access risk information platform to help business leaders make real-time risk-informed decisions. The platform enables the ERM team to communicate critical risk information to business leaders, thus making risk appetite easier to understand and apply. The ERM team uses the platform, which includes a chatbox, to complement commonly shared abstract risk information with concrete, actionable guidance on how the business is expected to manage risks in line with risk appetite. The platform tailors communication by providing only relevant risk information to business leaders. The results are fewer high-priority actions from internal audits, an overall improvement in KRIs, and more self-identification of control and risk deficiencies.

## Reinforce Risk Appetite Through Training Workshops

Although communicating risk appetite focuses attention on the risk information that matters, business leaders may still be unsure what the application of risk appetite looks like in practice. To build their knowledge and confidence when applying risk appetite, the ERM team can conduct training workshops. These enable business leaders to practice applying risk information to a variety of real-world scenarios. For example, a workshop could include small groups working to respond to hypothetical decision scenarios. Groups could reference risk appetite statements to guide their decisions and then discuss the results with the wider group. Workshops enable participants to crowdsource knowledge and learn from the wider group; in a safe-to-fail environment, participants gain a solid foundation in how to apply risk information.

### Case in Point: Guided Sense-Making Workshop (CHS)



To ensure business leaders make risk-aware decisions without hands-on ERM assistance, the ERM team at CHS — an agriculture company headquartered in Inver Grove Heights, Minnesota, U.S. — created a training workshop that enables decision makers to practice applying risk appetite to realistic business decisions in a safe-to-fail environment. The ERM team designed a training workshop around an interactive decision-making simulation, teaching business leaders how to apply risk information to decision scenarios independently. This approach takes participants through an experimental learning journey that improves their ability to make sense of risk information by familiarizing them with key risk principles. The exercise is designed around a realistic scenario that requires participants to make a series of risk-informed decisions similar to those they might make in their day-to-day work. The simulation can be rerun multiple times with different outcomes. Exploring these outcomes encourages participants to consider the impacts and opportunities associated with each decision. The simulation provides a space where participants can feel comfortable taking risks and reevaluating their decision-making process. Ultimately, the experience trains decision makers and equips them with the tools to independently apply risk appetite to decision making.

## Establish a Tolerance-Focused Risk-Reporting Process and Track Risk Escalations

### Tolerance-Focused Risk Reporting

Once risk appetite is operationalized and business leaders have integrated it into their daily practices, it can be difficult to stay up to date on the evolution of risks. Without tolerance-focused risk reporting, the ERM team and the broader organization are often unaware of the relationship between risk management and risk tolerance. Implementing tolerance-focused risk reporting enables an organization to continue to see the effects of decision making on risk tolerance. Visualizing and tracking residual risk against risk tolerance enables stakeholders to track whether they are staying within the risk tolerance level and to self-adjust if their decisions are increasing overall risk.

#### Case in Point: Strategic Risk Reporting Template (Cenitex)

**cenitex**

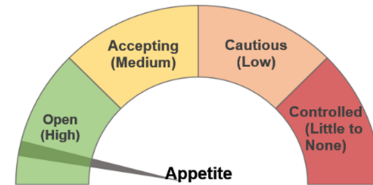
Heads of ERM often find it challenging to ensure their organization consistently stays within the articulated risk appetite. To address this challenge, Cenitex — a government information and communications technology service provider headquartered in Melbourne, Australia — utilizes a strategic enterprise risk reporting template to track risks in relation to articulated risk appetite and tolerances. The template is rooted in Cenitex's risk report status and appetite visualization, which catches the reader's attention and grounds the conversation. Through the visualization, risk appetite is related to opportunity, and risk tolerance metrics are used to help stakeholders determine the right balance of risk taking. To help ground risk mitigation plans, Cenitex uses an easy-to-understand graphical representation of the mitigation timeline for improvement completion. The risk visualization displays magnitude, velocity and risk appetite, catching the reader's attention and providing an easy-to-follow action plan. The reporting template helps Cenitex's ERM team report top risks and ensure their organization remains within the articulated risk appetite.

## Cenitex Strategic Risk Dials

### Strategic Opportunity

#### Opportunity – A

Key Objective: Articulate Strategic Objective.



<b>Opportunity Owner</b>		<b>Opportunity Status</b>
		Activities in Progress
<b>Opportunity</b>		
<ul style="list-style-type: none"> <li>List of opportunities created by strategic objective.</li> </ul>		
<b>Opportunity Appetite Statement</b>		
Application of risk appetite to this opportunity.		
<b>Appetite Constraint</b>		
Appetite constraint considerations stakeholders should be aware of when analyzing the opportunity.		
<b>Key Success Indicators</b>		
<ul style="list-style-type: none"> <li>List of KPIs identified for the strategic objective.</li> </ul>		
<b>Current Activities</b>	<b>Timeframe</b>	<b>Accountable Division</b>
List activities related to achievement of objective.	Status	Activity Owner
<b>Status Commentary</b>		
<ul style="list-style-type: none"> <li>Pertinent Information related to the status of activities and outcomes to date.</li> </ul>		

Gartner.

Source: Cenitex

## Track Risk Escalations

A formal process for making exceptions helps heads of ERM in cases where an organization may need to operate outside a previously articulated risk appetite. The process should provide a standardized way for the ERM team to look back on risk appetite and decide whether:

- A one-off exception should be made
- A change in the organization's risk appetite should be recommended

Additionally, reporting and documenting risk escalations and exceptions enables an organization to track its adherence to risk appetite and can provide guidance on future revisions to risk appetite statements.

## Conclusion

Although drafting actionable risk appetite statements is important, these statements have little effect unless the organization applies them in practice. Encouraging business leaders to adopt risk appetite and make risk-informed decisions is essential for organizations, if they are to adhere to their risk appetite statements. Embedding risk appetite into relatable metrics and tailoring communication to individual roles ensures that business leaders understand risk appetite and receive only information critical to their role. Additionally, teaching business leaders how to apply risk appetite makes them comfortable with the task of incorporating it into daily decision making. These steps should be complemented by an ongoing reporting process, so that business leaders can self-adjust in response to changes to their organization's overall risk appetite. Together, these steps help heads of ERM put potentially abstract risk appetite statements into action by enabling business leaders to factor them into their daily operations.

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