Getting the Most from Your Risk Assessment

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The Changing Nature of Risk

- New Concepts in Risk Assessment and Management
- Terrorism
- Plastic Card Fraud
- Electronic Commerce
- Expectations of future members
- Business Failure
- Insurance

The Recent Evolution of Risk

- Economic Crisis of 2007 – 2008 - risk cannot be ignored as an element of safety and soundness and each institution must take individual responsibility for identifying, managing and monitoring elements of risk.
- Additional areas of risk continue to develop including (but not limited to)
  - litigation risk,
  - regulatory risk,
  - liquidity risk,
  - interest rate risk,
  - concentration risk,
  - credit risk, and;
  - operational risk.

The Recent Evolution of Risk

- Credit unions are susceptible to macroeconomic risks such as:
  - inflation and associated volatility,
  - shifting political environments, and
  - unemployment.

- Discrete or event-driven risks may instantly affect policies:
  - war,
  - market collapses,
  - theft,
  - malfeasance,
  - breach of fiduciary trust.
- Controlling and minimizing risks is a full time endeavor.
- Numerous components combating risk must work in sync with each other to help mitigate the risk.

NCUA and Risk Management

- NCUA Supervisory Letter 13-12, November 7, 2013, Enterprise Risk Management (ERM), Director of the Office of Examination & Insurance Larry Fazio stated, “Natural person credit unions are not required to implement a formal ERM framework. **However** credit unions are expected to have sound processes sufficient to manage the risk associated with their business model and strategies.” This letter further explains what examiners should consider when evaluating the overall effectiveness of a risk management program.
- NCUA Letter 16-CU-12, Chairman Rick Metsger advised “…NCUA will use risk-focused examination for larger credit unions…” Among the improvements Chairman Metsger mentions is “coordination of document requests tailored to a federally insured credit union’s risk profile and product offerings…”

Risk

Basic traditional risk took 4 forms:

- Compliance/Regulatory Risk
- Legal Risk (not providing legal advise or opinions)
- Reputational Risk
- Operational/Process Risk

We have seen numerous changes and enhancements to these risks.

Litigation Risk - Employment Risk

- Employment Risk – New Issues - CBD
- ADA - related
- Vendors/Contracts
- Licensing (ex., Remote Deposit Capture)

- Management/Mitigation
  - Insurance
  - Legal Counsel
  - Effective Policies – (ex., Due Diligence)
  - Compliance Resources

Liquidity/Interest Rate Risk - Asset Liability Management

- Interest Rate Risk
- Credit Risk
- Liquidity Risk

- ALM Management
  - Variable Factors
  - ALM Considerations
  - ALM Package Products

Operational Risk - Concentration Risk

- Asset classes (real estate, cars)
- Concentrations within a class of assets. Examples include, but are not limited to:
  - Residential Real Estate Loans
  - Member Business Loans (MBLs)
  - Loan Participations
  - Loans to one borrower or associated group of borrowers
  - Investments
- Liabilities
- Third-party providers
- Services provided to other parties (e.g. loan underwriting and/or servicing, insurance services, and investment consultation).

Reputational Risk – Media/Social Media

- Negative news/media releases
- Social Media Third-party providers

Management/Mitigation:

- Effective policies and procedures.
- Centralized control.
- Monitoring of news and social media.
- Staff training.

NCUA Letter 10-CU-03 Concentration Risk

Managing/Mitigating the risk:

- Addressed the need to identify, measure, monitor, and control concentration risk
- A complete program is needed to adhere to the letter.
- A “program” includes development of
  - Policies,
  - Procedures,
  - Assessment of Risk,
  - Adoption of Risk Limitations and Risk Mitigation,
  - Monitoring of the Risk level both at the granular level and at concentrated levels throughout the balance sheet

Systemic Risk - Internal Controls

Chief Areas

- Teller Operations
- Lending
- Electronic Data Processing
- Wires/ACH

Management/Mitigation

- Dual Controls
- Rotation of Duties
- Segregation of Duties
- Compulsory vacations

Regulatory Risk

- Violations/Penalties/Fines
- Areas of Concern
  - Liquidity/ALM
  - BSA/CIP/OFAC
  - Complaint Management
  - Disaster Recover/Business Resumption

Strategic Risk - Disaster Risk

- Natural Disaster
- Terrorism/Cyber-Terrorism
- Active Shooter

Management/Mitigation

- Who is Responsible?
- Creating a Plan
- The Planning Process
- Writing the Plan
- Testing the Plan

Risk Management - Purpose

The purpose of the Risk Management program is two-fold.

1) There is an increased scrutiny from the regulators about risk management and steps being taken. As a result credit unions are expected to provide various levels of risk assessment in addition to day-to-day services.
2) Credit unions are challenged to meet and be all-knowing to the areas of risk in the credit union.

Risk Management: Mitigation and Controls

Comprehensive risk assessment supports a conclusion that risks can be effectively mitigated, measured, and monitored; management should implement appropriate risk management policies.

Policies should establish

- risk tolerance levels;
- risk appetite;
- internal procedures and controls;
- risk transfer mechanisms where appropriate and available, and;
- well-designed contracts that meet risk management needs.

Risk Measuring and Monitoring establish

- operational performance metrics,
- benchmarks and standards,
- develop management reports to support oversight of RDC operations.

Risk Management: Measuring and Monitoring

- Establish key operational performance metrics that support accurate and timely monitoring of risk

- Information should be used to set operational benchmarks and standards, as well as to develop reports for monitoring results against the standards.

- Effective oversight
  - regularly reviewing reports
  - periodically conducting reviews and operational risk assessments.
  - ensures accurate reflection of current policies and procedures and sound practices.

Risk Assessment

"An effort to identify and measure the risk inherent in the institution's processes and determine the level of controls and monitoring mechanisms in place to sufficiently manage that risk."

- A risk assessment is performed using an initial assessment of the various risks associated with each significant concentration of risks in the balance sheet.
- Subsequently the risk mitigations associated with each risk are identified
- A modified risk rating is obtained for each risk concentration.

Risk Assessment - Management's duties

Risk Assessment - identify and assess all areas of risk and understand:

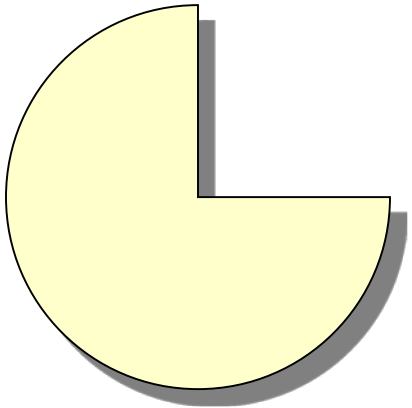
- Performing a risk assessment
- Interpreting the assessment
- Using the risk assessment

Risk Mitigation/Management and Controls

- Establish policies addressing
  - risk tolerance levels,
  - internal procedures and risk controls,
  - risk transfer mechanisms, and
  - contracts and agreements.

Enterprise Risk Management (ERM)

- Enterprise Risk Management Goals
- Categories of Risk
  - Strategic
  - Operational
  - Financial
  - Hazard
- Limitations of Enterprise Risk Management
- Risk Assessment Process
- Risk Identification Techniques
- Credit Union Risks
- Risk Assessment



Individual Risk Assessments and ERM

- What are the individual elements?
  - BSA/OFAC
  - ACH
  - FACTA ID Theft – Red Flags
  - Fair Lending
  - Concentration
  - Other
- ERM vs. Individual Assessments
- Results – how can we interpret these?

Getting Control of Risk

"We no longer mitigate risk – we <u>manage</u> it."

How we use our risk assessments:

- Recognize it – Determine all of the areas of risk (as we previously mentioned) as well as sub-areas of those elements.
- Analyze it – Look at these areas and determine why they represent risk. What elements of them are most/least risky? How much impact do they have on overall operations?
- Quantify it – Develop a system for gauging risk numerically. This can be as simple (1 – 10) or complex (1 – 100), based upon the size and complexity of your institution.
- Justify it – Compare the various elements and levels of risk and why they exist. How much risk can you accept? How much can you trade off? What is unacceptable?

Managing the Program

- Management must implement an effective program consisting of:
  - Comprehensive board policy:
    - Sets limits;
    - Demonstrates cohesiveness with the strategic plan;
    - Monitoring and due diligence;
    - Testing – incl. Scenario and Sensitivity analysis for changing economic conditions on asset quality, earnings, and net worth.
- Success or failure is determined by how well it is managed.
- The process is:
  - ongoing,
  - requires far-reaching knowledge of all operations, and
  - the ability to look beneath the surface.

Questions and Comments?

Thanks!!!

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