The Basics of Risk Assessment

CUNA
Credit Union National Association

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The fact is we live in a risky world. Your credit union faces many risks and any one of them could have a serious impact on your credit union and its ability to serve members.

Objectives

- Understand the concepts of risk and enterprise risk management (ERM);
- Learn how to identify risks;
- Develop a risk assessment and categorize risk using a risk map
- Evaluate methods of controlling risk; and
- Establish priorities for the supervisory committee.

What is Risk?

Risk is the potential that events, both those you anticipate and those that are completely unexpected, may have an adverse effect upon the credit union's net worth and earnings.

Too much risk can impact the credit union's ability to meet its goals and objectives.

The amount of risk that a credit union is willing to accept is largely determined by the board of directors. This is called the **risk tolerance**. The board defines its risk tolerance through strategic planning and by setting goals and policies for the credit union.

An important point to keep in mind is **that the credit union simply cannot eliminate all risk.** Every time you open a new branch, add a new service or hire a new employee, there is an inherent risk that comes along with that.

The key is being able to identify these risks and appropriately control them to bring them within an acceptable level for your credit union. This is often referred to as mitigating the risk.

Risk Management Responsibilities

Responsibility for risk management at your credit union starts at the top with the board of directors and senior management. Members of the board of directors define the credit union's **appetite for risk**, with the decisions that they make and the emphasis that they place on good controls within the credit union. Senior management has the responsibility for implementing the risk management program and communicating the importance of good risk management identification and procedures to the employees.

Board of Directors—establishes appetite for risk.

Senior Management—implements risk management program and communicates importance of good risk management identification and procedures to employees.

Employees—are responsible for controlling risk within their areas.

Supervisory Committee—has oversight responsibility for ensuring that credit union assets are adequately protected.

The Changing Nature of Risk

Traditional Risk Management

Traditionally, credit unions have handled risk management on an exposure-by-exposure basis within a credit union's departments.

For example:

- The loan department evaluates credit risk;
- The controller analyses the risk associated with the investment before it is made;
- Operational management makes sure that tellers and other employees are well trained;
- The internal audit department audits internal controls to identify weaknesses; and
- The security department is responsible for physical protection.

And then executive management watches over all the areas and coordinates the entire risk management program.

The concept of risk management is changing in the post-Enron, Sarbanes-Oxley era. People have realized that **traditional risk management is simply not adequate.** Risk management weakness in one area of the credit union can severely impact another area and there are many factors influencing risk that did not previously exist.

Credit unions have always had to deal with the inherent risk of conducting credit union business (making loans, accepting deposits and maintaining branch offices to serve members) and this hasn't changed. But now, credit unions must consider risk from external sources, risks that are relatively new.

New Threats Affecting Risk

- **Terrorism**—threats from terrorism have impacted the way we handle money and enroll new members.
- **Plastic Card Fraud**—the explosion of plastic card fraud has forced credit unions to reexamine the ways that they administer these programs.
- **Internet Fraud**—different types of Internet fraud have forced credit unions to look at how they can control these risks and protect their members at the same time.
- **Technology**—has required credit unions to rethink some of their business models, their core strategies, their service delivery and their target markets.
- **Increasing Member Expectations**—members want more products and higher quality, and of course this leads to more risk. Not meeting members' expectations could have a significant impact on the credit union's viability.
- **Increased Accounting Scrutiny**—as a result of some of the business failures of few years ago; regulators have issued a lot of new regulations. We now have to deal with the