



NAFCU's 2017 State of Risk Management Report

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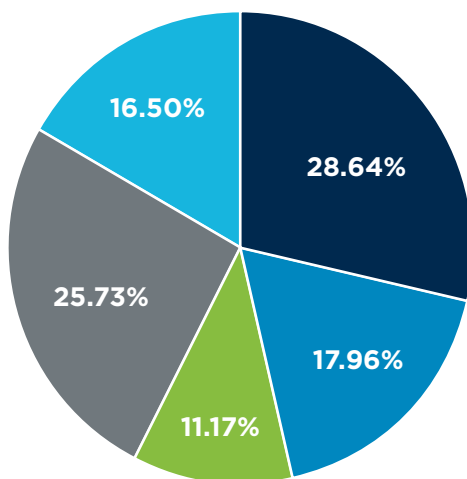


RISKS AND THE CREDIT UNION INDUSTRY

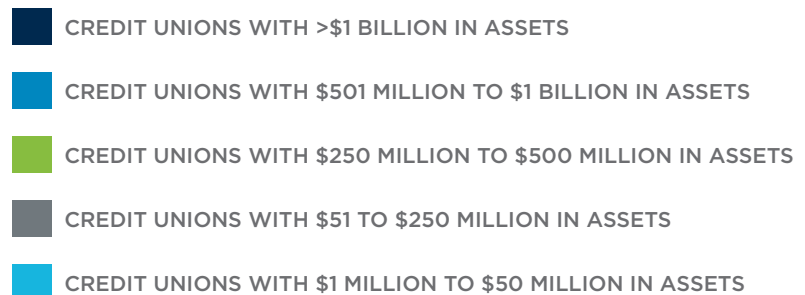
As part of our 2017 Risk Management Seminar, NAFCU conducted a wide-ranging survey on the current state of risk in credit unions. Our survey received feedback from 209 credit unions across all five of NCUA's regions. *It is important to note that this survey was conducted prior to NCUA's planned reshuffling of their regions.* In addition, the survey respondents represented a wide variety of asset levels. The largest volume of responses came from credit unions with more than \$1 billion in assets at 28.64%. However, we had excellent participation from all asset levels. 25.73% of the responses came from credit unions with between \$51 million to \$250 million in assets. The remainder of the responses came from credit unions with \$501 million to \$1 billion (17.96%), \$1 million to \$50 million (16.50%) and \$250 million to \$500 million (11.17%).

RISK

A probability or threat of damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through preemptive action.¹



THE CURRENT STATE OF RISK IN CREDIT UNIONS



The volume of responses across the various asset sizes, and the commonality of responses, suggests that risks are agnostic to asset size. You could say that we are in the risk business. From giving out loans to offering new products and services, credit unions are faced with a number of different risks.

The 2017 survey on the current state of risks for credit unions addressed the following issues, the results of which are explained on the following pages of this document:

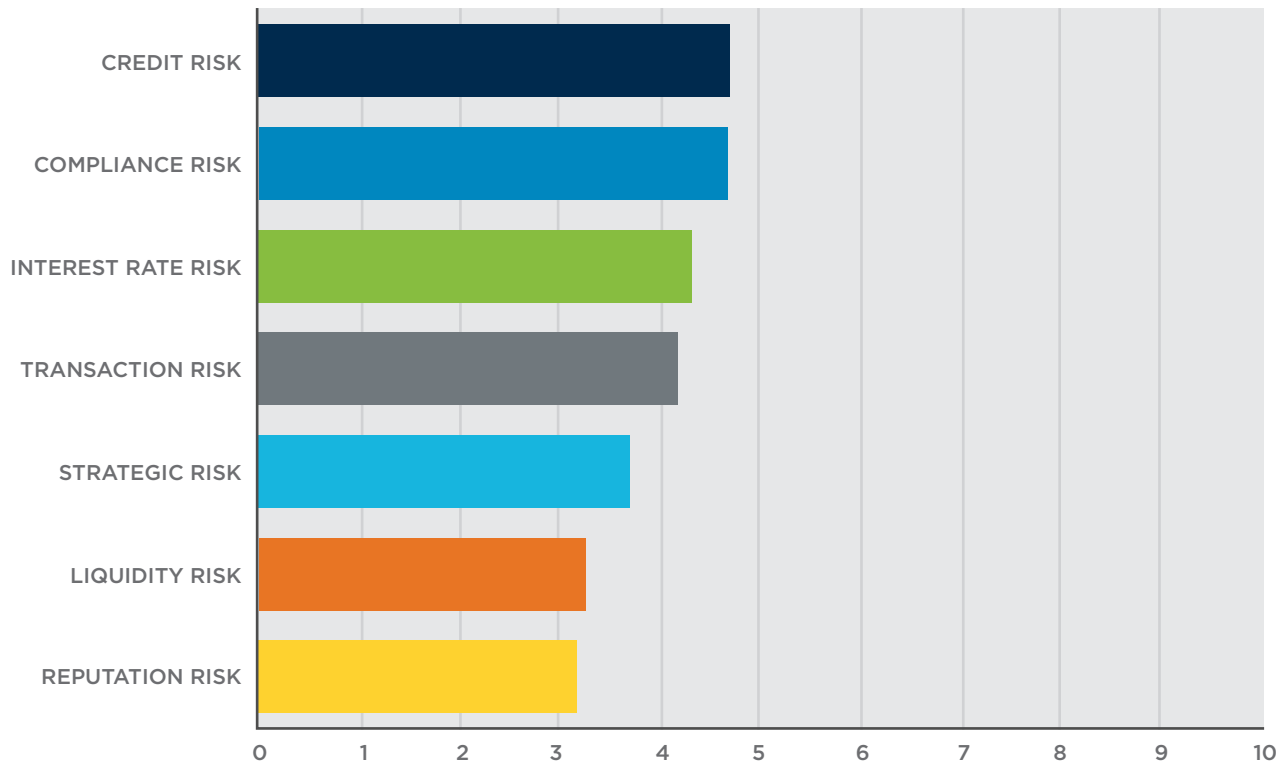
1. NCUA risks
2. Risk appetite statement
3. Enterprise Risk Management program
4. Significant future risks

¹<http://www.businessdictionary.com/definition/risk.html> Accessed on 8/22/2017

RANKING THE SEVEN CATEGORIES OF RISKS

In order to give credit unions a starting point to monitor and measure risk, [NCUA created seven categories of risk](#) that examiners will be thinking about when they look at your credit union. It is important to note that these risks can be present in any of the products and services provided by a credit union.

Survey Question #1: Rank NCUA risks according to your credit union's experience.

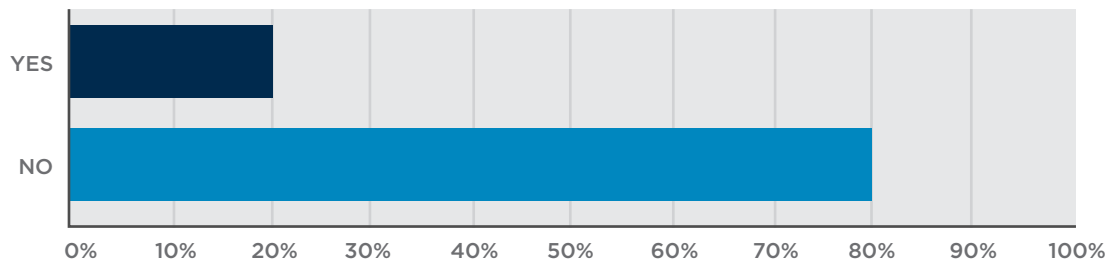


The survey results indicate that there is no clear-cut risk overpowering the other six risks.

Keep in mind that these risks are not mutually exclusive; a risk may fit into any number of the seven identified risk categories. For example, you may suffer a data breach of your core processor. The risk posed by the data breach could make your credit union susceptible to transaction risk by using the stolen data to perpetrate fraud. In addition, your credit union could suffer reputation risk by having the story of the data breach featured on the front page of a national newspaper or shared on social media.

COMMUNICATING RISK WITH A RISK APPETITE STATEMENT

Survey Question #2: Does your credit union have a written risk assessment statement?



In order to determine how credit unions are communicating risk within their institutions we asked if they have risk appetite statements. Eighty percent of credit unions surveyed said they do not have such a statement.

Risk appetite statement: *The amount of risk, on a broad level, an entity is willing to accept in pursuit of value. It reflects the entity's risk management philosophy, and in turn influences the entity's culture and operating style. Risk appetite guides resource allocation. Risk appetite assists the organization in aligning the organization, people, and processes in designing the infrastructure necessary to effectively respond to and monitor risks.²*

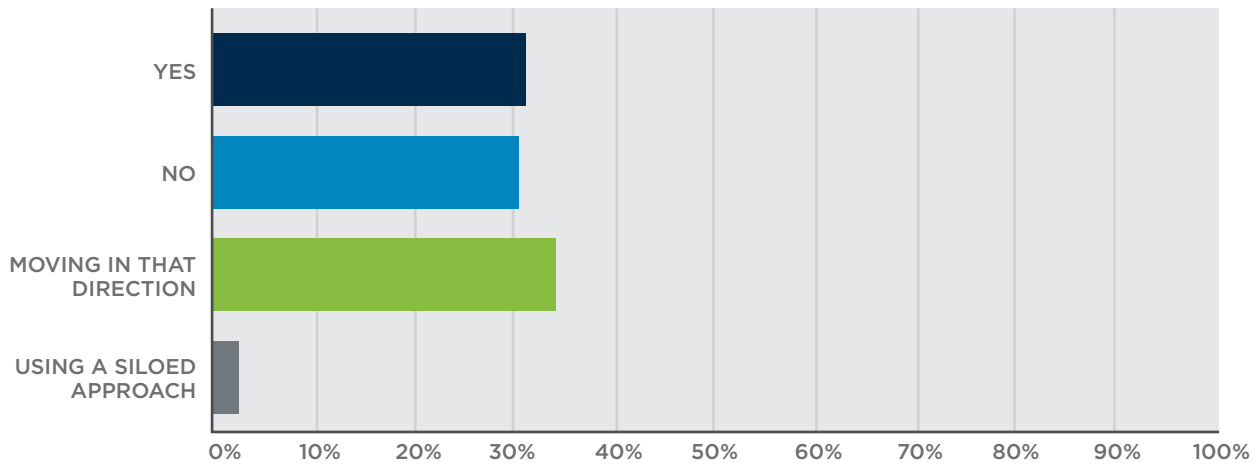
Identifying and mitigating risks successfully should begin with transparency around the risk tolerance or appetite of the organization. This leads to everyone in the organization speaking the same language when discussing risks.

From the provided definition, one can start to see the value and potential impact that a risk appetite statement provides. A well-drafted risk appetite statement can provide a sustainable structure in which to frame a risk management program for the credit union. It can be argued that without a risk appetite statement, any risk management program is missing a crucial element of success.

² *Enterprise Risk Management—Integrated Framework*, © Committee of Sponsoring Organizations of the Treadway Commission (COSO). All rights reserved. <https://erm.ncsu.edu/library/article/coso-erm-framework>

ENTERPRISE RISK MANAGEMENT AT CREDIT UNIONS

Survey Question #3: Does your credit union have a formalized ERM program?



In order to gauge how credit unions are monitoring risk in their respective institutions, we asked respondents if they have a formalized enterprise risk management (ERM) program.

ERM is not a regulatory requirement as of September 2017, which could be a large contributing factor in nearly a third of respondents not having an ERM program. However, the NCUA has stated in their supervisory guidance the value of an ERM program. The following two excerpts are from NCUA's [Supervisory Letter No.: 13-12 Enterprise Risk Management](#):

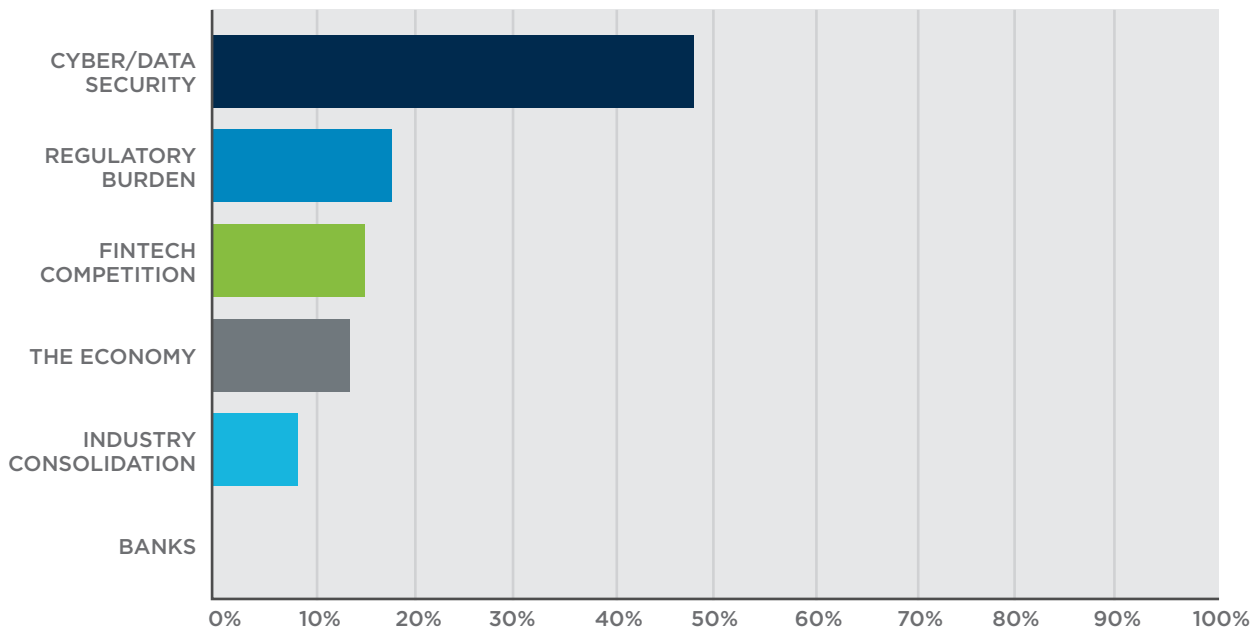
Enterprise risk management is a comprehensive risk-optimization process that integrates risk management across an organization. An organization's board of directors ultimately makes the decision to develop and implement an ERM framework, often with the goal of aligning risk with strategic objectives.

ERM is not a process to eliminate risk or to enforce risk limits, but rather to encourage organizations to take a broad look at all risk factors, understand the interrelationships among those factors, define an acceptable level of risk, and continuously monitor functional areas to ensure that the defined risk threshold is maintained.³

³ *Supervisory Letter No.: 13-12 Enterprise Risk Management* [11/07/2013] National Credit Union Administration (NCUA)

OUTLOOK ON RISKS AHEAD

Survey Question #4: Over the next two years, what do you view as the most significant risk to credit unions?



After we explored which risk categories our survey participants were concerned with and how they managed risk within their institutions, our final question was designed to gauge what risk(s) they were worried about in the future. It is not surprising that nearly half of respondents indicated that they consider cyber and data security the top risk they expect to face in coming years. This risk has been mentioned for the last two years on [NCUA's Supervisory Guidance](#). In addition, hardly a day goes by without news of a new data breach or cybersecurity attack. The economy and financial technology (fintech) were neck and neck with 13% and 14% respectively. Surprisingly, none of our respondents indicated that they expect banks to be a source of significant risk for credit unions within the next two years.

CONCLUSION

Credit unions both large and small face a wide variety of ever-changing risks. There is no one-size-fits-all risk management program that is perfect for every credit union. It is the job of all credit union employees to help manage risk. The results laid out in this paper are presented as a starting point to help you benchmark your program. We hope the responses and analysis provide food for thought as you develop your risk management program and help you prepare for the future. NAFCU will continue to provide risk management resources across a variety of channels, such as the upcoming [2018 Risk Management Seminar](#). If you ever have any questions, please feel free to [reach out to us](#).

Stay vigilant!

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