SWOBODA RESEARCH CENTRE

The Reflections Series

Insights and experience from practitioners

Managing Risk in a Credit Union

Caroline Domanski

April 2022

No1 CopperPot CREDIT UNION

From the Reflections Series

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The Swoboda Research Centre

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The Centre is rooted in values of co-operation, participation, social and financial inclusion, transparency, integrity, and excellence. Much of its work is done in collaboration with Liverpool John Moores University.

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Caroline Domanski, MBE, MSc, is CEO of No1 CopperPot Credit Union since in 2015. No1 CopperPot is one of the largest credit unions in the UK, with over £165 million in assets and 36,000 members. As an executive director Caroline's main focus is on the strategic drivers of the business. Working alongside the board to drive change which ensures the credit union remains forward thinking with a member-centric approach. Caroline regularly represents credit unions throughout the wider mutual movement, and currently holds a representative seat at the Trade Bodies Round Table and newly formed Trade Associations Cyber Information Group.

Caroline was awarded the UK's National Young Leader of the Year Award in 2012 and awarded the World Council's Young Credit Union Person (WYCUP) scholarship in 2013 and has recently completed the Building Societies Association's MSc programme with Loughborough University.

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The Reflections Series: Most reports and papers from Swoboda are based on primary and / or secondary research, presented by subject matter experts, often academics. In this series, launched in 2022, Swoboda seeks to give a platform to the practitioners - executives, directors and staff – of community finance providers, to present their views and ideas. These papers are rooted in their own experience of organisational planning and delivery, rather than the study of others', and provide an insightful complement to traditional research papers.

Table of Contents

Foreword on The Swoboda Reflections Series

It is often said that 'learning through doing' is the most effective way to learn. Subjecting our own experience to rigorous reflection and analysis, thinking through our actions and approaches, considering what has worked well and what has not worked well and coming to clear conclusions often results in a growth in understanding that is long-lasting and practically relevant. It is the way that many credit union practitioners and activists have learnt and developed personally and professionally over the years.

The Swoboda Reflections Series of practical papers aims to capture the learning that CEOs, senior managers, and board members have generated through their own experience of credit union governance and management. By encouraging people to reflect upon and analyse their experience of tackling credit union issues and to explore their ideas in an accessible written format, Swoboda aims to assist credit union leaders to share what they have learnt with colleagues and activists throughout the Swoboda membership and the sector more generally.

Reflection Series papers are subject to rigorous peer review, in the same way as the academic papers published by Swoboda. But against different criteria. There is no requirement for academic referencing or for studies based on academic research. Rather the requirement is for a well-presented, self-reflective enquiry, written in clear English, and which contributes to the improvement of organisational or operational practice in managing and developing credit unions.

Through the sharing of ideas and approaches through these papers, the aim is to promote credit union thinking and reflection, and all practitioners are invited to submit ideas for papers based on their own experience and practice. We also invite practitioners to comment on and reply to the papers written by their colleagues in the sector, for it is through collaborative discussion and debate that new ideas and understandings emerge.

This paper on *Managing Risk in a Credit Union* by Caroline Domanski is the first paper in the Reflections Series. Caroline Domanski is the CEO of No1 CopperPot Credit Union, the largest police credit union in Britain and in this paper, she reflects, analyses, and describes her experience of developing a risk management framework for the credit union. As will be the case with all Reflections papers, Caroline's paper is not presented as the last word on the matter. It is not a manual or a guide. It is presented as her, and undoubtedly her colleagues', experiential learning in the management of risk in a large and busy credit union.

Information about the Swoboda Reflections Series can be found on the Swoboda website. All practitioners and activists are invited and encouraged to submit proposals for papers. Through the sharing of our learning and ideas, let us strengthen our credit union movement together.

Dr Paul A. Jones

Director of Research at the Swoboda Research Centre

1. Introduction

As CEO of a 36,000-member, £165 million asset credit union, I am keenly aware of the importance of a systematic and robust approach to risk management, at both board and operational level. Not only is it critical to the safety and soundness of the business, but it is fundamental to the protection of our members' funds. This has been stressed recently by the Central Bank of Ireland in its *"Thematic Review of Risk Management Maturity in Credit Unions*" (2021) in which it recognises the advances credit unions have made in this area but notes "*the identification of recurring issues with risk management in our supervisory engagements indicates a clear need for credit unions to further evolve and embed their risk management frameworks, to ensure that all of these elements are functioning effectively".* A similar concern surfaces in the British Prudential Regulatory Authority (PRA)'s annual assessments of the credit union sector[1].

In fact, the current PRA rulebook stresses that a credit union must agree and set its risk strategy and maintain a fully documented system of control, maintained under section 75 of the Co-operative and Community Benefit Societies Act 2014 or under article 40 of the Credit Unions (Northern Ireland) Order 1985.

In this paper, I aim to share my personal reflections, as CEO of No1 CopperPot Credit Union (No1 CopperPot), on working towards embedding a risk management framework (RMF) throughout the credit union. By RMF, I mean a coherent system of policies, processes and organisational design through which we identify existing and potential risks to the business and assess how to deal with them if they arise. Such a framework is based on a systematic approach to risk identification, risk measurement, mitigation, reporting and monitoring, and risk governance.

The paper considers things that I feel have worked well, those that have not worked so well and how the risk management framework has evolved, developed and been kept under review. I need to stress that this paper is not intended to provide a textbook approach to implementing a risk framework but rather is a reflection based on my own personal experience and learning.

No1 CopperPot, whose common bond is police officers and other police force staff in Great Britain, is governed by a board of seven non-executive directors (NEDs) and two executive directors (EDs). EDs are not common in British credit unions but are allowed in the legislation. In our case, it was decided by the board, in order to strengthen the board and embed accountability, that the Chief Executive Officer (author) and the Chief Finance Officer would become voting members of the board. As with NEDs, ED positions are subject to a triennial election (ratification) by the membership in the annual general meeting.

The board is accountable to the members and to the regulator for determining, approving and overseeing the approach to the management of risk (cf. CREDS 2020 Section 10). However, the authority for operationalising risk management is delegated to the CEO, that is to me. I have the responsibility for the operation of the RMF and

[1] https://www.bankofengland.co.uk/prudential-regulation/supervision/credit-unions

process within the parameters and policies set by the board. The way I see it is that effective risk management keeps the credit union on track strategically by balancing its propensity to take risk with the propensity to exercise control. In a sense, I consider that at the strategic level we are proportionately more about taking risk than exercising control, while at the operational level the proportions are reversed.

At No1 CopperPot, we also have another committee which plays an important role within the RMF. Some years ago, as one of the very first British credit unions to do this, No1 CopperPot replaced the traditional Supervisory Committee with an Audit and Risk Committee which allowed for the recruitment of more highly skilled committee members. The Audit and Risk Committee operates within its own terms of reference set by the board and makes recommendations regarding the RMF and the control of risk to the board. To strengthen this committee, the credit union has engaged two independent advisors as chair and vice-chair, other members being directors. These advisors are appointed under a fixed period of engagement and are present at all board meetings. As appointees not elected by the membership, they have no vote at board meetings. Their role is to support the board and to offer greater risk management assurance.

2. Developing a risk management framework

The nature of a credit union means that all its activities involve some form of risk. The purpose of risk management is not to remove the risk, or to simply implement mitigating actions. Risk management seeks to understand and appropriately direct and control the risk. The rationale for implementing an RMF is primarily to assist the credit union to achieve its objectives through proactive management. Risk management helps to identify both opportunities and threats in order to establish a reliable basis for decision-making and planning. The risk management process allows us to improve operational effectiveness, identify the threat of risk throughout the organisation, improve loss prevention and incident management and build resilience. Ultimately through risk management we can enhance the health of the credit union, improving governance and stakeholder confidence.

There are various risk and control functions that exist within the credit union. The challenge is to assign specific roles to individuals or a committee, and effectively coordinate activities to ensure there are neither gaps nor unnecessary duplication of cover. At No1 CopperPot we have adopted and implemented the 'three lines of defence' model[2] as a control function within the RMF. It looks to establish clear responsibilities for each risk controller. The model is widely accepted in financial services and gains support of the regulators as a recognised approach to risk management, which is why it was considered and implemented as a suitable model for use at No1 CopperPot.

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[2] Taken from the IIA Position Paper (2013), *The Three Lines of Defense in Effective Risk Management and Control*, in which it was adapted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41

As CEO, I found that this model provided a simple and effective way to enhance risk management communications, by clarifying essential roles and duties. The simplicity of the model allows each role to be easily understood, along with the reporting channels. The model was agreed by the board and endorsed by the Audit and Risk Committee, both of which felt it reflected the credit union's aspirations for supporting a suitable RMF.

In the model:

- First line of defence – is general management controls and internal control measures
- Second line – is fulfilled by various controls and compliance oversight functions, established by management
- Third line - is the independent assurance.

Each of the defence lines play a distinct role within the wider RMF.

The model does not directly consider the board, the Audit and Risk Committee, or senior management as among the three lines of defence. However, each has an essential role in risk management and oversight and the model, when executed, offers assurance that the risk control framework is robust and fit for purpose.

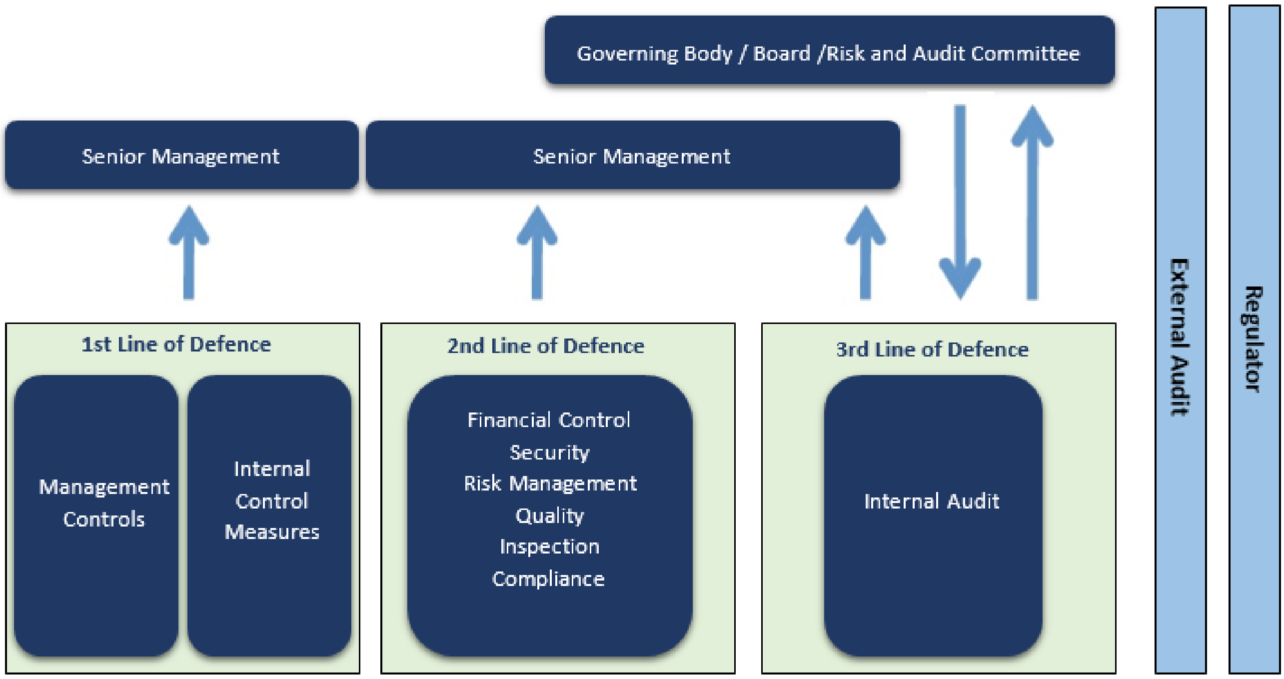

Figure 1 - The Three Lines of Defence Model (IIA, ibid.)

2.1. The First Line of Defence – Operational Management

In the first line of defence, at No1 CopperPot, it is the operational managers who own and manage risk, they are responsible for implementing corrective actions to address processes and control errors. Operational management is responsible for maintaining effective internal controls and managing risk control procedures on a day-to-day basis. In addition, operational managers are responsible for identifying, monitoring and reviewing risks in their areas providing information to the second line of defence via the risk register, which itemised all relevant risks and mitigations in the credit union (see 6 below). Quality assurance procedures also form part of the first line of defence.

First line responsibilities:

- Ensuring compliance with regulatory requirements
- Ensuring policies and procedures reflect changes to business practices and regulatory requirements
- Ensuring compliance with policies and procedures
- Maintaining an effective risk and control environment
- Recognising and reporting associated risks
- Ensuring ongoing compliance with risk frameworks and risk appetites
- Actively monitoring the risk profile of the credit union.

2.2. The Second Line of Defence - Risk Management and Compliance Functions

In this line, various risk management and compliance functions are established to help build and monitor the first line of defence.

The second line of defence should establish a level of independence from the day-to-day operations and is therefore ideally suited to a compliance role, in which operational duties are not undertaken.

Each process has some degree of independence from the first line, but by nature they remain management functions. Therefore, while the second line serves a vital purpose it cannot offer truly independent analysis to the governing body regarding risk management.

Second line responsibilities:

- Monitoring the effectiveness of the internal controls, accuracy and completeness of reporting, compliance with laws and regulations and remediation of errors
- Supporting management policies and managing implementation goals
- Identifying known and emerging issues and changing regulatory and risk scenarios
- Assisting managers to develop process controls
- Providing risk management frameworks
- Identifying shifts in organisational implementation of risk appetite
- Provide guidance and training of risk management processes.

2.3. The Third Line of Defence – Internal Audit

Internal auditors provide the governing body and senior managers with comprehensive assurance based on an independent view. This level of independence is not available within the second line of defence. The internal audit function provides assurance on effective governance, risk management and internal controls.

Third line responsibilities:

- Providing independent, objective assurance and consulting activities which add value and improve a credit union's operations
- Provide independent challenge, audit of key controls, formal reporting and assurance.

2.4. External Auditors and Regulators

External auditors and regulators outside of a credit union's structure also have an important role to play. External auditors provide assurances to a credit union's members, governing body and senior management. The regulators set requirements that are intended to strengthen the controls of the credit union. These are considered through regulatory returns, and often, as in the case of No1 CopperPot Credit Union, through an annual PRA supervisory visit.

2.5. Embedding the Lines of Defence Model

The three lines of defence model is designed to build assurances and provides greater independence within the organisation. As a widely recognised management tool, it provides assurance to both the board and CEO. Implementation of the three lines of defence model allows improved coordination between defence responsibilities associated with the control environment.

	First Line of Defence	Second Line of Defence	Third Line of Defence
	Risk Owners/Managers	Risk Control and Compliance	Risk Assurance
Application within the credit union	• Line Managers • Risk Owner	• Compliance Manager • Independent Role	• Internal Audit • Audit and Risk Committee • Penetration testing
Underlying responsibility	• Operational management	• Limited independence • Reports primarily to management	• Greater independence • Reports to governing body

Figure 2 - Evaluating the Three Lines of Defence Positions within No1 CopperPot[3]

[3] Extract from No1 CopperPot Risk Management Policy document

Embedding such a framework into the risk management plan means assigning roles and responsibilities to individuals within the business. This often requires people mobilisation to increase independence, in particular there is a need to focus on operations which have to be independently tested and sampled. For example, the responsibility of any second line testing on member withdrawals cannot be undertaken by anyone who actions or oversees this process. This testing may be quarterly sampling. First line testing in this scenario could be performed by a line manager by the way of daily checks. Once the structure is assigned increased monitoring can be implemented and true second line defence reporting can be established.

The second line I have found to be the most challenging to fulfil while maintaining full independence within a credit union. Credit unions are often smaller than other financial services providers and are restricted by limited resources. This often results in the responsibility for compliance forming part of another function or role within the business. For example, a customer service manager may also have responsibility for compliance. This combination compromises the independence required for any second line testing within the parameters of the model.

To overcome challenges with independence within the second line function, at No1 CopperPot we have collaborated with a peer credit union to provide second line services. This means we have engaged compliance services from another credit union to provide aspects of second line testing. Collaboration of this nature has provided a good challenge and the opportunity to share best practice through recommendations.

While the three lines of defence framework may seem extensive, and perhaps even daunting or complicated, as a credit union grows in size and complexity, I have found that it provides a good level of assurance to not only the board, as the governing body, but also to me as CEO. In this role, as the credit union has grown, I have found that I have become more distant from day-to-day operations and the model offers assurances on multiple levels.

3. The risks faced by No1 CopperPot Credit Union

When designing and implementing a risk management framework, consideration should be given to both internal and external factors that may affect a credit union's ability to deliver its objectives. External factors include the social, cultural, political, legal and regulatory environments and frameworks within which the credit union operates. Technological advances and challenges, and the economic and competitive environment also feature in the external risk landscape. There may also be external risks associated with stakeholders. External risk generally includes all factors which affect a credit union that are beyond the immediate scope of control.

Internal risks include factors such as governance, organisation structure and responsibilities, objectives and strategies, capabilities, IT systems and culture. These risks are all integral to a credit union and there is often a much greater degree of control to mitigate the risks.

At No1 CopperPot, we found that it was useful to categorise the risks in a way that allowed for similar risks to be grouped together. It is easier to manage if linked risks were considered simultaneously. No1 CopperPot categorises its risk into four key areas which we feel are the most relevant to the business, these are:

1) Business and strategic risks

2) Market and liquidity risks

3) Credit risk and operational risk

4) Conduct risk.

Within each category, we identified a number of sub-categories to assist in defining the risks. These are shown in Figure 3 below.

Category	**Sub-category**
Business and Strategic Risks	Business Strategy Products and Services Competition Performance and viability
Market and Liquidity Risks	Liquidity and funding Investment rate
Credit Risk	Concentration risk Default risk
Operational and Conduct Risks	Conduct risk Compliance Process Outsourcing and IT Key persons and people Business continuity Governance

Figure 3 – Risk Categories at No1 CopperPot

Understanding the nature of the risk is fundamental to business planning. The risks should be assessed when the credit union is setting its business objectives, considering each area. This piece of work is central to producing a detailed risk register (discussed in 6 below). There is not a definitive or standard list of risks for a credit union. Each credit union may produce its own set of categories and sub-categories dependent on its business strategy and market. For example, a credit union may consider concentration risk if a large number of members live in the same area, whereas for a national credit union like No1 CopperPot that is less of a risk factor. Another example specific to our common bond is that by law police officers cannot be made redundant, so this removes the risk of redundancy to the business to this group of members. This may be a different position entirely if the credit union is operating in a different sector.

4. Understanding the risk appetite

A broad definition of risk appetite is the amount and type of risk that an organisation is prepared to seek, accept or tolerate. It is the responsibility of the board to set the risk appetite and tolerance levels for risk. This process takes into account the upside of any risks, such as income derived from lending activities.

By determining the tolerance level and defining what is acceptable and what is not, the board sets clear boundaries for a credit union to operate in terms of its actions and conduct. This assists decision-making, especially where breaches could occur which are preventable or at least predictable and an outcome can be planned. Risks can also have a positive outcome and actually add value rather than simply costing the organisation. By setting the risk appetite the credit union facilitates that potential risk costs do not exceed the potential advantages gained. An example of this is a particular type of lending which may be considered higher risk, such as consolidation lending. It has a positive affect by generating income for the credit union and by also assisting members with debt issues. Through the risk appetite statement, a credit union can choose to accept this risk and consider the outcome of increased delinquency which may be experienced through this type of lending. By assessing the risk, the credit union can ensure that the advantages gained do not outweigh any potential costs.

It is important to articulate the risks we face in a risk appetite statement. This develops understanding and links the risks the business is willing to take with the overall mission and aims of the credit union. I have found that it is very easy to focus on the operational aspect of mitigating, rather than also considering accepting, risk. The use of risk appetite statements allows a board to focus on the strategic aspect of the amount of risk the business is prepared to take in pursuit of its objectives.

Risk appetite statements can be overarching such as:

> "In pursuit of our strategic objectives as a credit union we will not knowingly take risks that threaten the Credit Union's sustainability and the ability to meet the needs of both our existing and future members."

Alternatively, the statements might focus on subcategories of risk. The risk appetite for a subcategory might sound something like, in response to reputational risk:

> "In pursuit of our strategic objectives, we are not prepared to knowingly or willingly take unnecessary risks that will impact the Credit Union's reputation within its common bond and affect the Credit Union's sustainability".

Other subcategories which might be considered are credit risk and liquidity risk.

I view the risk appetite statements as a high-level summary of the credit union's attitude to risk in line with its strategic aims. From this point it is then easier to define the risk tolerance the business is willing to accept in pursuit of its goals.

The example in Figure 4 provides a definition of willingness to accept risk. The accepted risk can be linked to a result in reputational damage, financial loss or exposure, major breakdown in information systems or information integrity, incidents of regulatory non-compliance, potential risk of injury to staff and members. Later, we look at designing the impact framework where this can be further defined.

It is important to note that this example is based on four levels of risk and lends itself to well to a four-by-four risk matrix. Five-by-five frameworks are also commonly seen and in that case a credit union may wish to use a five-level risk tolerance framework at this stage.

Risk Appetite	Risk Description	Risk Band Score
Zero Risk	This is where a credit union is not willing to accept risks under any circumstances.	1-2
Low Risk	A credit union is not willing to accept risks in most circumstances.	3-4
Medium Risk	A credit union is willing to accept some risks in most circumstances.	6-9
High Risk	This is when the credit union accepts opportunities that have an inherent high risk.	10-16

Figure 4 – The Risk Tolerances Scoring Matrix as used at No1 CopperPot

In the four risk categories outlined, the board is able to discuss and define their tolerance level based on the risk appetite statements. Using the risk tolerance scoring matrix (Fig. 4, above), the board can assess each of their risk categories in an easier way than if this was done through an open discussion without parameters to work from (Fig. 5, below). Once the risk appetite scores have been defined the credit union can start to build its risk register. Risk appetite statements should be re-visited on a regular basis to ensure they are current and reflect the strategic direction of the business.

Risk Category	Risk Appetite
Business & Strategic	Low
Market & Liquidity	Medium
Credit Risk	Medium
Operational & Conduct	Low

Figure 5 – Sample Risk Appetite Tolerance by Category

5. The identification and assessment of risk

The risk management framework involves a process of identifying and documenting individual risks.

It is usually the risk owner, an individual delegated to oversee and manage a particular risk, who identifies and describes the risk, determining its category. The context and nature of the risk or cause and its impact would then be evaluated.

A standard approach is to assess the inherent risk. That is the risk without any controls in place. This is followed by the residual risk assessment, which is the assessment that takes place after the control measures or mitigations have been applied.

Assessing the risk considers both the impact if the risk came to fruition and the likelihood of it happening. The ‘impact’, or ‘consequence’ is the outcome of an event which has an effect on objectives. A single event can generate a range of impacts which can have both positive and negative effects on objectives. Initial impacts can also escalate through knock-on effects. Likelihood is the chance that something might happen. Likelihood can be defined, determined, or measured objectively or subjectively and can be expressed either qualitatively or quantitatively.

An easy example to understand is the default of a banking institution with which a credit union holds a deposit. The impact is the maximum loss likely, should the bank fail to honour the deposit. We can then ask ourselves, is that a significant loss? and what is the likelihood it will happen? What may be a significant loss to one credit union could be quite minor to another, so this needs to be an individual assessment based on the impact or consequence of the risk.

An assessment of the impact of risks at No1 CopperPot is outlined in Figure 6 below. This assessment is individual to each credit union, dependent on the level of possible severity of impact. This can be recognised through the financial loss impact levels, whereby No1 CopperPot could stand to lose up to £200,000 before it is considered significant to the stability of the organisation. For another credit union a loss of that nature may have a major or even fatal impact, highlighting the importance of setting relevant impact levels. It is important that the board discuss and articulate what different impact levels look like as this will assist with not only setting the risk appetite but categorising each risk easily. This is reviewed on an annual basis as levels of tolerance can change, and in particular the level of financial tolerance is likely to increase with growth.

1 Insignificant	Reputation: Internal review, not at fault. Business Process & Systems: Minor errors in systems or processes requiring corrective action, or minor delay without impact on overall schedule. Non-compliance: Innocent procedural breach, evidence of good faith. Financial: £0 to £49,999
2 Minor	Reputation: Non-headline exposure, clear fault, scrutiny required by internal committees or internal audit to prevent escalation. Business Process & Systems: Services occasionally not provided, or services do not fully meet needs. Non-compliance: Breach, objection/complaint lodged – minor harm with investigation. Financial: £50,000 to £199,999
3 Significant	Reputation: Scrutiny required by external agencies, authorities or regulators, repeated non-headline exposure – slow resolution. Business Process & Systems: One or more key accountability requirements. not met, material delays, marginal under achievement of target performance. Non-compliance: negligent breach, lack of good faith evident – performance review initiated. Financial: £200,000 to £499,999
4 Major	Reputation: Intense public, political and media scrutiny e.g., headline/ profile, repeated exposure – at fault or unresolved complexities. Business Process & Systems: Prolonged suspension of work, additional resources required, performance significantly under target. Non-compliance: Deliberate breach or gross negligence, formal investigation, disciplinary action. Financial: Greater than £500,000

Figure 6 – Impact Assessment at No1 CopperPot Credit Union

The likelihood assessment, as in Figure 7 below, provides support in defining the likelihood of a risk coming to fruition. This approach benefits from a percentage change of likelihood supported by some narrative to assist in describing the probability.

1 Low	May only occur in exceptional circumstances (0-20% chance of occurring); simple process; no previous incidence of non-compliance.
2 Medium	Could occur at some time (21- 50% chance of occurring); non-complex process and/or existence of checks and balances.
3 Likely	Will probably occur in most circumstances (51-80% chance of occurring); complex process with some checks and balances influencing factors outside the control of the credit union.
4 Almost Certain	Can be expected to occur in most circumstances (81-100% chance of occurring); complex process with minimal checks and balances; influencing factors outside the control of the credit union.

Figure 7 – Likelihood Assessment at No1 CopperPot Credit Union

6. Recording risks in a register

The risk register allows risks to be formally recorded and monitored. There are numerous software packages available for recording risks, but at No1 CopperPot we use a simple Excel spreadsheet, which can be just as effective. Within the risk register the following sample headings provide a good level of information to assist with monitoring and control. However, a credit union may develop its own headings and required information which assist in the management of the risk.

Number	**Category**	**Sub-Category**	**Description**	**Arising From**	**Owner**
Useful for reference and discussions	Allows the risk to be monitored against risk appetite	Additional categorisation	Brief description of the risk	Detail of issues the risk can arise from	The person responsible for the risk area

Inherent Risk Score	Mitigating Actions	Residual Risk Score	Trend	Management Action	Key Risk
This is the risk score before any control measurers	All control measures are listed in mitigating actions	Resulting score following the mitigating actions.	Used to demonstrate if the risk is trending up or down	Indicates in an action plan is required to control the risk	Used to indicate if the risk is considered significant or requires a higher level of monitoring

Figure 8 - Sample of Risk Register Headings
(Note that these columns would normally be presented in landscape view across a page)

The key focus is to ensure that risks are within the set risk appetite for each risk identified. Mitigating actions attempt to reduce the likelihood of the risk occurring or the impact of the risk if it does occur or both. The risk may well be outside of risk appetite without any mitigating actions, but it is the residual risk that should be within risk appetite. The Register forms part of the systems and controls and should be regularly reviewed by the board to monitor its progress towards reducing any risks outside of appetite and monitor changing risk trends. By way of example, the full risk register is reviewed annually by the board at No1 CopperPot. However, risk is a standing agenda item at board meetings and the significant risks are reviewed on a monthly basis. The Audit and Risk Committee also undertakes a rolling quarterly review of the register.

Common mistakes I have seen within the risk register include ill-defined risk descriptions and incorrect consideration of the residual risk score following the mitigating actions. This could be where the actions do not reduce the impact, they only reduce the likelihood, and the impact score has been reduced and vice versa.

A residual risk rating map or heat map can be used to build a picture of a credit union's risk profile following the implementation of mitigating actions. The map summarises each risk and allows a single glance overview of the risk profile. Within No1 CopperPot the rating map is used to assess if there are large numbers of risks falling into the higher categories. Generally, where a risk is falls into the higher category action should be taken. The example map in Figure 9 below shows a large number of risks at the higher ratings which would be concerning to a CEO reviewing this.

Likelihood	**4 – Almost Certain**	4	8	12	16
	3 - Likely	3	6	9	12
	2 – Medium	2	4	6	8
	1 - Low	1	2	3	4
		1 - Insignificant	**2 - Minor**	**3 - Significant**	**4- Major**
		Impact			

Figure 9 – Sample Residual Risk Rating Map

At No1 CopperPot, both senior leaders and NEDs regularly challenge the risk register and consider when a risk is more prevalent. For example, the Bank of England's Monetary Policy Committee has in the past noted that negative interest rates are a tool which could be used to control spending in the economy. This led to consideration of the impact on the Credit Union's cash reserves and if any action should be taken. The important thing to consider is the risk register is not a box ticking exercise; it documents risks, and strategies for dealing with such risks. It is a living, working document which by design encourages planning and control of business risks.

7. Becoming a 'risk intelligent' organisation

Our vision at No1 CopperPot is to become a 'risk intelligent' organisation[4], in which we consider risk in relation to all aspects of the business and endeavour to comply with a robust RMF. Understanding our attitude towards risk leads to continually making risk-based decisions in line with the risk profile of the business. Put simply risk is considered by design.

A risk intelligent organisation depends on each employee understanding and considering risk in every aspect of their role in the organisation. However, it is ultimately the board that is responsible for the oversight of the risk function.

Beyond this there are risk owners allowing each individual risk to be controlled and monitored. Risk owners tend to be an operational member of staff within the business, who is accountable for managing the risk on a day-to-day basis.

[4] Deloitte (accessed December 2021), Cultivating a risk intelligent culture in the financial services industry, https://www2.deloitte.com/bd/en/pages/financial-services/articles/cultivating-a-risk-intelligent-culture-in-fsi.html

Central to becoming risk intelligent, is ensuring that consideration is given to all possible treatment options and the actions to reduce or control the likelihood of the risk, these include:

1. Transfer the risk - shift all or part of the risk responsibility to another party who is best able to control it. This could be through insurance options or by outsourcing performance criteria and monitoring.
2. Avoid the risk and decide not to proceed with the activity or choose another way to achieve the same outcome.
3. Retain and accept the risk, deciding how to cover costs if a loss occurs.
4. Control or manage the risk, reducing either the likelihood of the risk occurring or the impact of the risk or both. This may be through:
    - Prudent limits on activity or transactions
    - Control by approval delegation to responsible and skilled persons
    - Maintaining effective compliance systems.

Examples on reducing the likelihood include but are not limited to:

- Implementing structured training and other programmes for educating colleagues within the credit union
- Establishing policies over effective transaction approval limits
- Documenting the procedures and internal controls to enhance awareness and application of the correct control procedures
- Introducing preventative controls through systems design to check data accuracy
- Ensuring organisational arrangements which allocate responsibility for approval of transactions or control checking to enhance segregation of duties
- Ensuring independent supervision of systems and control procedures (no conflicts)
- Implementing quality assurance, management and standards for processing transactions and database changes
- Introducing effective governance processes to reinforce the importance of the risk management and control systems
- Reviewing and amending compliance / internal audit programmes to higher risk areas
- Undertaking preventative risk audits by consultants in selected areas of expertise
- Research and development to enhance systems for detection and simplify processes to allow easier detection
- Ensuring preventative maintenance of equipment (to avoid/defer failure)
- Maintaining staff morale and motivation (remuneration, conditions, appreciation of effort, performance reviews, compliance culture reinforcement, linking performance measurement to risk management culture)
- Maintaining a whistleblowing policy for reporting breaches in procedures, or security.

Furthermore, actions can be taken to reduce or control impact. These include:

- Business continuity and disaster recovery plans
- Fraud control planning
- Preventative maintenance of equipment to minimise damage e.g., fire extinguishers
- Minimising exposure to sources of risk through limits on acceptable transactions
- Contract conditions with suppliers e.g., privacy; standards of performance
- Portfolio planning, risk review limits e.g., large exposures
- Separate activities and resources so as to avoid concentration in one person or location
- Diversification (membership, loan types, investments)
- Succession planning - to have back up of key staff or access to alternative staff resources
- Insurance cover
- Public relations planning to communicate effectively with the members

To be a truly risk intelligent organisation it is important that the risk and mitigating factors are considered by design. This will ensure consideration in all areas of the business from product design to operational resilience.

8. Stress testing

This leads us to consider what happens if an identified risk comes to fruition. Stress testing as part of the business planning stages allows a credit union to consider different or combined scenarios in which potential risk come to fruition. This scenario planning is an important tool which assists the formation of outcomes should a risk or combination of risks occur. A good example would be scenario planning for a global pandemic - if we can foresee the risk then plans and preparation can be implemented to reduce the impact or possible likelihood. Common scenario planning undertaken for a credit union would generally look at scenarios such as significant increases in delinquency or a reduction in lending, or these two factors occurring simultaneously. For a range of scenarios, we can map the impact on the credit union and prepare action plans to address key issues.

The comprehensive risk register will include actions to control and mitigate risk and allows challenge to the impact and likelihood levels on a regular basis. In my experience, the risks within the risk register will highlight areas where appropriate stress testing should take place, enabling the impact on the business to be understood and any necessary action plans considered.

9. Key challenges in risk management

Risk management practices are not without problems, particularly at the implementation phase. In this section we consider some of the likely areas of failure and remedies to address these.

Failure to use appropriate impact assessment

Consideration of risk impact to the business needs to be relevant to the credit union and enable risks to be categorised effectively. It is useful to break this down into key areas, and consideration of the financial implication helps to put losses into context. However, this should not be the only metric as there are other factors such as reputational risk which must be taken into account. It is useful to consider financial losses in relation to income and capital requirements to determine the level of significance.

Understanding and quantifying the financial impact has assisted defining risks at No1 CopperPot. By putting losses into context, we have been able to demonstrate that some losses which feel significant, such as a large loan loss, in isolation have little impact on the business. For an impact to be felt, loan losses would need to become systemic.

Mismeasurement of known risks

Risk managers sometimes make mistakes assessing the probability of losses. This is particularly true when assessing risks with hidden recovery costs which may not initially be apparent.

Mismeasurement of mitigating actions is also commonplace, and this is often seen when the mitigating actions only impacts either the likelihood of the risk occurring or the impact and yet both risk measures are considered to have reduced. When reviewing the risk register, I have found it useful to consider each set of mitigants and evaluate whether such actions reduce the likelihood of occurrence and/or the resulting impact to ensure correct reflection in the scoring.

Failure to take known risks into account

It can be very difficult to consider all the risks in a risk measurement system. It can also be costly and time consuming. It is also true that we cannot always foresee future events perfectly.

A classic example is the risk of a pandemic. Following the SARS outbreak in 2003 many businesses considered the impact of a global pandemic on their risk register, but many also failed to consider this is a bona fide risk. The impact was largely considered from a staffing level perspective whereby large numbers of employees would be unable to work due to sickness. The introduction of a national lockdown by the Government was in many cases an unforeseen risk.

Failure in communicating risk to serious levels or the credit union's board

Risk managers communicate information about the risk position to management and the board. The management and board use this information to determine the credit union's risk strategy. If a risk manager is unable to communicate this information effectively, the management or board may make decisions that are badly informed, or they may develop an overoptimistic perception of the risk position of the firm.

Failure in monitoring and managing risks

It is challenging for risk managers to capture all the changes in the risk characteristics. As a result, risk managers may fail to adequately monitor risks simply because the risk characteristics may change too quickly to allow them to manage the risk effectively.

10. Learning points and pitfalls

The implementation of a risk management framework does not come without its learning points, failures and pitfalls. In my personal experience over the years, I have learnt you must not be afraid to make changes to your framework. We often find that the implementation needs refining or that something doesn't quite work as anticipated. This may be re-assessing the impact framework, particularly as the credit union grows in size and can absorb greater losses with less impact. It could be re-defining risk appetites as a greater understanding of risk tolerance is developed.

I have found that risk management is a key board skill and does not appeal to everyone. It is useful to have a smaller more focused group, which at No1 CopperPot is the Audit and Risk Committee, whose members have a keen interest in risk. This is more successful than trying to implement a framework of this size with the whole board. However, once the framework has been defined it must be approved at board level as this responsibility cannot be devolved.

Challenge is the key to developing a strong risk framework. Do not be afraid to challenge and be challenged, this is how the framework evolves, improves and remains current. Take note of 'critical friends': you may find these in regulators, auditors and trade bodies. These stakeholders have experience and can provide a sounding board and best practice advice, so utilise these tools wherever possible.

Finally, if you do not have the right expertise on your board, seek it out. It could be in the form of an advisor or consultant, a secondment from another credit union or a new appointment. It is important that risk management is included in the credit union by design and runs through all aspects of strategy and operations, assisting in the development of a strong, stable, sustainable credit union for future members to benefit.

Appendix – Extract from No1 CopperPot risk register

Number	Risk category	Sub category	Description	Arising From	Mitigating Actions	Owner	Inherent Risk Score			Residual Risk Score			Trend	Intended Management	Key Risk
							Score	L	I	Score	L	I			
BSR1	Business & Strategic	Performance and viability	External pressure on reducing loan interest rates has a negative impact on loan income for the Credit Union.	Highly competitive current lending market. Failure to monitor loan rates in the market means that the Credit Union lending products become unprofitable.	Monthly ALCO meeting reviews competitor rates in the current loans market as well as monitoring loan demand from members. Loan performance reviewed at Board meetings as well as annual and interim strategy meetings.	CEO	12	4	3	3	1	3	↓	Maintain	Yes
CR1	Credit Risk	Default	Risk that commutation loans default arising from no formal charge on the member's pension.	Interest rate rises, economic conditions or poor underwriting could result in increased delinquency. Specific changes in circumstances for the member eg dismissal, ill health, pension legislation. The impact of COVID-19 may mean that police officers defer their retirement resulting in delays when settling Commutation Loans.	Board set limits on commutation for consolidation purposes. All commutation loans over £50,000 are approved by senior management and all loans over £25k are reviewed by a manager. Reduced term of Commutation Loan to 12 months due to potential changes in police pension legislation.	COO	9	3	3	9	3	3	↓	Reduce	Yes
CR2	Credit Risk	Concentration	The risk of failure of a counterparty deposit taker resulting in loss of Credit Union funds.	Failure to monitor the market and credit ratings of deposit takers used by the Credit Union. Balances on deposit are significant that failure could result in the Credit Union becoming insolvent.	Monies on deposit are managed in accordance with the Financial Risk policy which incorporates risk ratings is approved by the Board. An investment management organisation manages a significant portion of funds which spreads the counterparty risk as they have access to more counterparties. Use of Flagstone platform allows access to more counterparties for term deposits. New deposits are approved by ALCO.	CFO	8	2	4	2	1	2	↑	Maintain	Yes

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- **Great Western CU**, England
- **Heritage CU**, Ireland
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- **Just CU**, England
- **London Mutual CU***, England
- **Manchester CU**, England
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- **Palmerstown CU**, Ireland
- **Partners CU**, England
- **Penny Post CU**, England
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