

Group Risk Management

External References applicable to this Policy:

[APRA Prudential Standards](#)

International Standard IS 31000:2009

Group Risk Management Framework

Board strategic objectives

Board risk policies and all other policies and process

The obligations of this Policy:

1 Risk management objectives and definition

The Group is committed to adopting sound risk management principles and to manage risk in accordance with recognised best practice. In order to deliver this objective a consistent and systematic approach to managing risk is to be adopted by all staff in all areas of the Group activities. The principles outlined in the International Standard on Risk Management IS 31000:2009 will be adopted.

Risk is defined as the chance of something happening that will have an impact upon objectives – it is measured in terms of consequences and likelihood. Risk management is an iterative process consisting of well-defined steps which, if taken in sequence, support better decision-making by contributing a greater insight into risks and their impacts.

For the purposes of this Policy, the term 'risk' includes all existing and potential risk exposures facing the Group. Risk exposures are classified into four basic types, namely: liquidity risk, market risk, credit risk, operational risk.

The term 'key risk' is defined as a risk that meets one or more of the following criteria:

- a) inherent risk rating equal to Very High; or
- b) residual risk rating greater than or equal to High; or
- c) a risk that is determined by the Executive or Board as being a key risk.

All key risks are to be included within the *APS 310 Key Risk Profile*. Those risks that are not currently included in the *APS 310 Key Risk Profile* and satisfy one or more of the criteria are referred to the Executive for inclusion as part of the annual attestation by the CEO that is required under *APS 310 Audit and Related Matters*.

The main policy objectives of risk management are to:

- a) Maintain the highest possible integrity for services provided by the Group;
Safeguard Group assets (people, property, reputation and financial);
Create an environment where all Group employees assume responsibility for managing risk and identifying possible risks in their respective areas of control;
Ensure the Group can appropriately maximise its opportunities and minimise its threats;
Focus limited resources in critical areas and assist in decision making;
Ensure the risk of each Group operation does not have a contagion effect on the Group.

1 Policy Application

This policy recognises that Community CPS Australia Ltd (Community CPS) has a number of controlled entities. Collectively Community CPS and all the controlled entities shall hereinafter be referred to as the Group. This policy applies to all entities and operations of the Group and applicable laws, regulations and codes.

2 Risk Philosophy

As an Approved Deposit-taking Institution (ADI), Community CPS is a participant in the Australian financial system and aims to achieve best practice in its approach to risk management and thereby play its part in the continued soundness of the financial system. One objective of risk management within the Group is to promote an enterprise wide culture where all staff have an understanding of the reasons for, and benefits of, risk management and follow soundly based risk management practices.

The risk management approach at the Group involves the identification of risks, assessment of their consequences and application of adequate controls to mitigate those consequences, together with regular monitoring of compliance with those controls.

In order to achieve an effective and systematic risk management approach, a Board objective is to allocate adequate resources to the risk management function through an appropriate organisational structure, strategic direction, staff training, regular risk reviews and reporting of risk issues.

This Policy requires a consistent and structured approach to the identification and management of the range of risk exposures to the Group in undertaking its strategic direction.

The Group has a conservative culture in terms of its attitude towards managing risk. The risk appetite set by the Board has been set so that it is consistent with this conservative culture.

3 Risk Appetite (Tolerance)

Operating any trading entity – particularly a financial institution that largely trades in credit risk products – without some level of risk exposure is not possible. However, the Board approach is to ensure that its activities are compatible with its risk management strategies.

In determining this strategic approach, the Board will take into account the nature of its role (largely as a provider of financial services for domestic consumption) together with any relevant views expressed by APRA in relation to the risk profile of the Group. The Board will accept a level of risk that is considered appropriate to the Group's culture and operations and generally commensurate with similar institutions in Australia offering those financial services. In determining that level of risk, benchmarking will be adopted to compare the Group risk profile against similar ADIs in terms of loan mix, level of capital, large exposures, liquidity, loan provisions, delinquency and other appropriate measurable factors. The objective is to ensure that the risk exposure is reasonable at all times and the Group maintains a level of capital set by the Board, following a review of all the relevant factors.

The strategic direction of the Group is outlined in the annual Strategic Plan. The risk policy will be reviewed at least annually, following the setting of the strategy for the organisation to ensure that appropriate risk management practices are in place to meet the risk appetite set by the Board.

The Board has established, a risk appetite both in qualitative and quantitative terms utilising the residual risk assessments arising from the risk database and associated risk profiles.

Residual risks¹ assessed in qualitative terms as Very High or with a quantitative value in excess of 5% of the Group capital base will exceed the risk appetite set by the Board.

Residual risks assessed in qualitative terms as High or with a quantitative value exceeding 4% of the Group capital base are considered within the upper limit of the risk appetite. A residual risk with a rating at the upper limit of the risk appetite will only be tolerated where the Board has assessed that there is no practical treatment plan that can be implemented to reduce the residual

¹ The residual foreseeable loss given the probability of occurrence, degree of impact and any preventive and corrective controls in place work as expected.

risk rating. This will generally occur where there are no controls available or where the cost of implementing the control will exceed any reduction in the risk exposure.

Those risks that have a residual risk rating near or above the tolerance level will be recorded within the Key Risk Profile in the risk database for regular reporting and review by the Executive, Board Risk Committee and Board. In establishing appropriate tolerance levels, the Board recognises that each risk may be classified into one of three broad categories namely:

- **Within defined tolerance level** – the majority of residual risks should be within the Board determined tolerance level – risks assessed as High or with a quantitative value 5% of the Group capital base or lower;
- **Outside tolerance level (permanent)** – the Board recognises that some residual risks may be outside the determined tolerance level due to their nature and the inability of the Group alone to further reduce or transfer the residual risk. These risks are required to be identified within the Key Risk Profile and will be reviewed by the Executive and Board on an annual basis – risks assessed as Very High or with a quantitative value exceeding 5% of the Group capital base;
- **Outside tolerance level (temporary)** – some risks may have a determined residual risk that is outside the determined tolerance level but for which further mitigation action can be taken in a planned and structured way to bring the residual risk within the tolerance level over time. – risks assessed as Very High or with a quantitative value exceeding 5% of the Group capital base where the rating is able to be reduced over time. These risks are required to be identified within the Key Risk Profile and will be reviewed by the Executive and Board on an annual basis until the residual ratings are returned within the defined tolerance level.

4 Risk and Capital

In broad terms, the risk management process is characterised by the identification of four basic risk elements and these are:

- **Credit Risk** - the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms. This risk applies to all credit risk assets both on and off balance sheet.
- **Operational risk** – incorporates a range of risk exposures inherent in the trading activities of an entity. These risks include fraud, employee conduct, risks associated with products and services, legal actions, compliance obligations and natural disasters.
- **Liquidity risk** – the risk that insufficient funds will be available on a day-to-day basis to meet the operational and funding needs of the Group both in a normal and an adverse operating environment.
- **Market risk** – the risk of losses in positions arising from movements in market prices. From a credit union perspective, this translates to the risk to movements in Net Interest Income (NII) and operating profit as a result of a mismatch of asset and liability repricing structures and the variation in the market values of assets. Interest rate or market risk includes basis risk (where rate movements do not change equally for all assets and liabilities) and pricing risk (where assets are priced according to rules that preclude the elimination of interest rate risk).

All of these risks have an ultimate relationship to the **capital adequacy** of the organisation and one aim of the risk management process is to maintain a level of capital that is consistent with the risks to which the Group is exposed from its operations and the overall risk appetite.

Capital provides a buffer to absorb unanticipated losses from trading activities and, in the event of problems, enables the Group to continue operating while those problems are addressed and resolved.

Each of the risk categories identified above are to be supported, where appropriate, by specific policies, systems, procedures, strategies, contingency plans and other measures that will facilitate the risk identification, quantification of the exposure amount, and management of those risks consistent with the level of capital maintained.

5 Risk management and responsibilities

The Board is ultimately responsible for ensuring an appropriate risk management process is in place. The oversight of risk management is assigned to the Board Risk Committee and Board Audit and Finance Committee in accordance with the Charters of those Committees.

The Chief Executive Officer has responsibility for implementing actions and decisions of the Board Committees and the day to day management of risk. Appropriate management committees will review and assess risk and compliance issues on a regular basis and provide recommendations for risk mitigation to the Chief Executive.

The Group Risk and Compliance Department will maintain the Group risk database, provide assistance to operational areas in relation to risk and compliance matters, provide information and recommendations on risk mitigation approaches, assist in identifying potential future or pending risks and their appropriate mitigation, and co-ordinate risk management reporting.

Management and staff are required to be familiar and competent with the application of the risk management policy and accountable for the delivery of the policy within their areas of responsibility. This is facilitated through the requirement for Business Unit Managers to identify and manage the key risks applicable to their business unit. These risks are then subject to a bi-annual review as part of the business planning cycle. Staff are responsible for risk management matters directly relating to their roles and functions and these risk management responsibilities will be incorporated into staff job descriptions and as a component of the review of staff performance.

6 Risk Assessment and Internal Audit

The Group Internal Audit team will undertake a key role in the risk management process through:

- Reviewing the qualitative and quantitative assessment of identified risks, consequences and controls and providing recommendations as considered necessary for modifications to those assessments based on the results of related audit reviews;
- Utilisation of an appropriate risk based audit methodology, which incorporates a risk assessment component, to evaluate internal controls;
- Providing information to Managers on potential or existing risks that have not been previously identified and assessed;
- Provision of advice on additional internal controls, or variations to existing controls, that might be appropriate to lower residual risk;
- Undertaking an independent risk assessment annually, and examining the risk information from the Group risk database, to assist in formulating the annual Internal Audit Plan.

7 Methodology

The risk management process will, as far as is feasible, follow the generic risk framework set out in the International Standard IS 31000-2009. Accordingly, the process should involve a methodology to establish the strategic, organisational and risk management context in which the rest of the process will take place. The major elements of the process should include the **identification** of the risks, **analysis** of the risks (through the consequence and likelihood in the context of controls), **evaluation** of the risks (comparison of risk levels to established risk criteria)

and **treatment** of the risks (examining the range of options available to mitigate the risks identified).

For the purpose of identification, risks will be classified into the four categories discussed under section 5 above.

The risk management process should also include a method to **monitor and review** risks and **communicate** risk information to both internal and external stakeholders.

The Group Strategic Plan is to take into account the objectives of risk management as set out in this policy.

8 Risk Database

To facilitate the process to identify risks and assess their impact and mitigation, and to assess the qualitative and quantitative residual risk to which the Group is exposed, the Group will acquire and maintain a risk management software tool. The software should enable the development and maintenance of a comprehensive risk database and risk profiling capability within the framework of IS 31000-2009.

9 Business Continuity Management

As a specified component of the risk management process, this policy requires the development and maintenance of a Business Continuity Management policy and a Business Continuity Plan (BCP). The Plan will identify the key material business continuity risks that may impact on the Group and include strategies to manage those risks should they occur. The Plan is to be formulated on a whole of business basis to critical business functions, resources and infrastructure that would have a material impact if subject to failure or disruption.

The BCP must be reviewed by the Crisis Management Team at least annually and any material changes referred to the Board Risk Committee for approval. Where possible and appropriate, key elements of the Plan are to be tested to ensure the suitability of the response strategies identified in the Plan. The Plan will conform to the key requirements established in Prudential Standard *APS 232 Business Continuity Management*.

10 Capital Management

As a consequence of the strategic approach and risk appetite adopted by the Board from time to time, an appropriate capital adequacy assessment process will be implemented and maintained in accordance with the APRA Basel II Framework and specifically the Internal Capital Adequacy Assessment Process (ICAAP) as part of that framework. The capital adequacy assessment process will provide the basis for:

- Senior management and Board oversight;
- Sound capital assessment;
- Comprehensive assessment of risks;
- Appropriate monitoring and reporting;
- Internal control review.

The APRA Prudential Standards specify a minimum level of capital expressed as a percentage of risk-adjusted assets that must be maintained at all times. The calculation of capital and the minimum level are based on the adoption of International standards for banking institutions recommended by the Basel Committee on Banking Supervision, or any adjusted minimum level that may be applied by APRA.

The risk management approach of the Group will be to develop relevant statistical and other measures to quantify a minimum policy level of capital that is considered appropriate from time to time in accordance with an ongoing assessment of its risk exposure. This ratio may be referred to as the **minimum policy capital ratio**.

In view of the difficulty of accurately quantifying certain risk exposures and determining a specific ratio, the Group, through the Board Risk Committee, may adopt an acceptable range within which its optimum capital ratio should remain.

The determined range and the current capital adequacy ratio are to be reported to the Board on a monthly basis.

11 Risk Reporting Framework

A document will be developed and maintained to provide further detail on the requirements outlined in this policy and the risk management framework in place for the Group. The risk management framework is to include the establishment of appropriate management committees charged with the responsibility for managing risks within the broad risk categories identified above.

The risk reporting framework will be comprised of the following elements:

- The key principles adopted by the Group in the risk management process including commitment to risk management, resources, risk objectives and targets, a structure to facilitate risk management, and staff training and knowledge;
- Details of the approach adopted to meet the 7 key principles for risk management outlined in IS 31000:2009;
- Monitoring and reporting of risk issues including:
 - A method to facilitate the ability of staff to report identified risk issues;
 - A key risk profile report (for inclusion as part of the annual APS 310 attestation);
 - Regular reporting of key risk issues to the Board Risk Committee and other management committees;
 - Risk profiles of key risk areas.

Key Risk Indicators (KRI) will be developed and identified, where possible, against relevant risks to assist in the reporting process and management of risks generally. The risk database will record, where applicable, the relevant primary KRI established for a particular risk.

12 Review

This policy is to be reviewed at least on an annual basis by the Board Audit and Finance Committee for its effectiveness in terms of APS 510, and by the Board Risk Committee as part of its role in formulating risk strategy. More frequent reviews may be required to incorporate material changes to the risk management process adopted by the Board.

Any proposed changes to subordinate risk management policies that materially affect the risk appetite of the Group must be first submitted to the Board, via the Board Risk Committee, for approval.

Acceptable Deviations to this Policy:

There are no acceptable deviations to this policy unless otherwise approved and documented by the Board.
