The Board's Role in Risk Management

One of a board of directors' most important roles is to understand the risks their organization faces, and as part of their oversight responsibilities, ensure that management is taking proper steps to mitigate the risks. This is a complex task, given the range of both potential risks and potential mitigation approaches.

"Part of the directors' role is to evaluate risks facing the organization, the potential impact of those risks and then prioritize them," says Larry Lawson, Executive Vice President, Risk Management and Insurance Services. "From there, the board and management can explore appropriate mitigation strategies."

Risks in today's business environment range from cyber and reputational risk, to operational and financial risk, to liability, property and management risk. Farm Credit organizations also face interest rate risk and credit risk, among others. Boards need to understand not only the risks, but management's approach to mitigate them.

The first means of mitigating risks is to avoid them, often by changing processes, policies or procedures. As an example, a physical security risk could be avoided by installing key card access systems, undertaking employee training and/or hiring security guards.

Another way to mitigate risks is to transfer the risk to someone else. Contracts are a major solution in this regard – for example, a loan agreement can require the customer to carry insurance to cover losses on the collateral securing the loan.

"Insurance is a means to transfer risk by paying someone else – the insurance company – to take on your risk obligations," says Larry.

The Farm Credit System Association Captive Insurance Company (Captive) provides insurance to cover a wide range of risks and FCC Services purchases additional insurance for the System from commercial insurance companies, effectively covering any risk for which insurance can be purchased. System organizations can obtain specific information about their coverages through the Origami online platform, which every System entity can access. Both management and boards should understand what's covered through the Captive and the other insurance placed by FCC Services – and what isn't.

"It's also important to realize that not all risks are insurable or the cost to do so is prohibitive," says Larry. For example, a financial institution can buy insurance to obviate credit risk but the cost to do so is much higher than the risk avoided. When risk can't be avoided or transferred through contract or insurance, it should be financed by setting aside funds in case the risk situation occurs. Allowance for credit losses is a form of this financing, since insurance for credit loss is expensive. The Captive is another form of risk financing benefitting the entire System.

"It's important that boards obtain sufficient information on, and discuss, their organization's risk so they can understand the business and financial vulnerabilities," says Larry. "Some boards are taking risk seriously enough to appoint directors with expertise in risk management or insurance, others seek education through other means."

For more information about specific insurance coverages, visit Origami; for more general risk and insurance advisement, including board presentations, contact Larry Lawson at larry.lawson@fccservices.com.