IDENTIFYING PAYMENT SYSTEM RISK

THE HOLY GRAIL OF RISK ASSESSMENTS

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AGENDA

- Definition of Risk
- Identifying Risk
- Objectives
- Barriers to Identifying Risk
- Mitigating Risks
- Internal Controls
- Emerging Risks vs. Evolving Risk

RISK

What is Risk?

The possibility that an event will occur and adversely affect the achievement of objectives

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What is Risk

- Why does risk matter?
  - Risks can keep an entity from achieving their goals
  - Identifying risk allows the entity to design internal controls to mitigate the risk
  - Improper identification of risk could also keep the entity from achieving their goals

What is Risk

- There are no wrong answers when evaluating risk
- Risk evaluation, management and acceptance is unique to every entity

Inherent Risk vs. Residual Risk

- Inherent Risk
  - "..the risk to the achievement of entity objectives in the absence of any actions management might take to alter either the risks' likelihood or impact."

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Inherent Risk vs. Residual Risk

- Residual Risk
  - "..the risk to the achievement of objectives that remains after management's responses have been developed and implemented."

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IDENTIFYING RISK

Identifying Risk

- How do you identify risk?
  - Brainstorming
  - Experience
  - Education
  - Best practices
- What is missing from these practices?
  - Objectives (Goals)!

Identifying Risk

- By definition, risks are defined as barriers to achieving an objective (goal)
  - How can you identify a risk correctly if you do not have an objective?
- How do you establish objectives?
  - More importantly, what is an objective?

Objectives

What an entity strives to achieve

Objectives

- Objectives
  - Processing transactions with zero errors
  - Balancing to the penny
  - Having zero losses
  - Migrating wires from in-person acceptance to online acceptance
  - Increased deposits through enhanced service offerings

Objectives

- Matching Objectives to Risk
  - Objective
    - Processing transactions with zero errors
  - Risks
    - Checks encoding errors
    - ACH exception items
    - Wires misreading wire instructions
    - Mobile app does not identify foreign item

Objectives

- ❑Matching Objectives to Risk
  - Objective
    - Migrating wires from in-person acceptance to online acceptance
  - Risks
    - Barriers to entry (onboarding process)
    - Client has insufficient knowledge of technology
    - Clients prefer face-to-face interactions

Objectives

- ❑Matching Objectives to Risk
  - Objective
    - Increased deposits through enhanced service offerings
  - Risks
    - Barriers to entry (onboarding process)
    - Clients prefer face-to-face interactions
    - Solution provider is not sufficiently knowledgeable of risks

Objectives

- ❑What happens if you objectives in one department do not match objectives in another?
  - Conflicting objectives can result in conflicting risks
  - What happens when conflicting risks collide?

Barriers to Identifying Risk

- Strategic decisions may impact objectives
  - Changes in objectives impact risk
  - May increase or decrease risk depending on objectives chosen
  - May create conflicting risks to different departments

Barriers to Identifying Risk

- Using controls to identify risks
  - Creates a narrow focus and may not appropriately identify risks
- Poorly communicated objectives
  - Identifying risks is difficult without clearly defined objectives

Barriers to Identifying Risk

- Unachievable Objectives
  - Processing transactions with zero errors
  - Balancing to the penny
  - Having zero losses

MITIGATING RISK

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Mitigating Risk

- Methods for controlling/mitigating risk
  - Implement controls
  - Accept the risk
  - Avoid the risk
  - Outsource the risk

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Mitigating Risk

- Implement controls
  - Utilize risk assessment to Identify controls
  - Design controls to mitigate risks to objectives
  - Develop objectives at sufficiently high level to minimize conflicting risks

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Mitigating Risk

- Accept the risk
  - Take no action to mitigate the risk
- Avoid the risk
  - Do not offer the service/product so inherent risk is avoided
- Outsource the risk
  - Purchase insurance

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INTERNAL CONTROLS

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Internal Controls

"…is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance."

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Internal Controls

- Internal control components
  - Control environment
  - Risk assessment
  - Control activities
  - Information & communication
  - Monitoring activities

Internal Controls

- Identifying risks is critical to almost every component of internal control
  - Risk assessment
  - Control activities
  - Information & communication
  - Monitoring activities

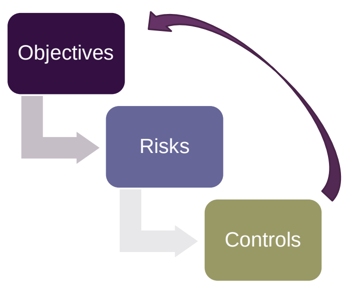
Internal Controls

- Identifying the entity's objectives is critical to identifying risks
- Without objectives, you cannot identify risks

Internal Controls

- Without identifying risks, you cannot identify controls
- Without controls, you cannot mitigate risk
- Without mitigating risk, you cannot achieve your objectives

Internal Controls



PAYMENT SYSTEM RISK MANAGEMENT

Payment System Risk Management

- Payment system strategies
  - Critical to include payment systems in the entity's strategic plans
  - Lack of clear strategy can increase the change of mismatched objectives and risks
  - Allows for alignment of internal controls with risks to ensure objectives are met

EMERGING VS. EVOLVING RISKS

Emerging Risks

- New risks that have not been seen before
  - Fintech banking charter
  - Fintech start ups

Evolving Risks

- Risks that change/evolve over time
  - Corporate Account Takeover (CAT)
  - Settlement Risk for Same-Day ACH

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