RISK TREATMENT

Risk treatment decisions are based on the results of a risk assessment.

The assessment includes identifying and analyzing an organization's various risks. See the exhibit “Enterprise-Wide Risk Management Process Model.”

Available risk treatment techniques include these:

- Avoid the risk
- Modify the likelihood and/or impact of the risk
- Transfer the risk
- Retain the risk
- Exploit the risk

Risk Treatment Process

Risk treatment involves making decisions based on the outcome of the risk identification and analysis. For risks identified as needing treatment, specific
options must be selected to modify them. Treatment options will vary, and the negative or positive effects of the uncertainty on the organization should be considered. The goal of risk treatment is to modify identified risks to assist the organization in meeting its objectives.

The risk treatment process is continuous and entails examining each risk treatment option (or combination of options) in terms of whether it leads to a tolerable level of residual risk. It also involves selecting and implementing a risk treatment option or options, and measuring the effectiveness of each option selected.

Risk treatment techniques are not mutually exclusive, and many risks require a combination of techniques. The risk treatment plan should indicate risk priorities and the order in which chosen techniques will be implemented. Review of risk treatment plans as part of overall monitoring of the risk management process is important. Risks may change based on changes in the organization’s operation or on environmental factors, such as economic conditions or legal and regulatory requirements. Previous risk treatment decisions may no longer be valid, and implemented controls may no longer be effective. Furthermore, emerging risks—such as those arising from new technology or the acquisition of a new business unit—must be identified and assessed. The risk treatment process should also include a cost-benefit analysis to assess whether the benefits of the chosen treatment option outweigh the related costs.

The risk treatment plan should document the process and designate the chosen risk treatment options as well as people responsible for implementing the plan. The plan should also include a timetable for implementing the risk treatment options and for monitoring and reviewing the established plan.

**Risk Treatment Techniques**

Risk treatment techniques apply to hazard, operational, financial, and strategic risks. In general, available risk treatment options fall into the categories of avoidance, modification, transfer, retention, or exploitation. Because speculative risks can result in both negative and positive consequences, the organization must consider a range of risk treatment techniques or a combination of techniques to manage negative and positive outcomes. For pure risks, the focus of risk treatment is on managing negative outcomes.

For events that appear to have primarily positive potential outcomes, such as a major competitor leaving the market, treatment would focus on exploiting the risk by maximizing expected gains. Techniques would include modifying the likelihood of an event to increase the opportunity to meet objectives while also considering treatment options for potential negative outcomes.

In some cases, risk avoidance is an appropriate option; when considering it, organizations must take into account any opportunity costs of not accepting a particular risk. See the exhibit “Risk Treatment Techniques.”
Identified risks can also be treated by modifying the likelihood and/or impact of events resulting in positive or negative outcomes. For hazard risks, modifying the likelihood of events focuses on **loss prevention** efforts to reduce overall loss frequency. Techniques designed to modify the impact of events recognize that not all negative outcomes can be avoided, but that the financial consequences of these events can be decreased. Techniques such as sprinkler systems in buildings or driver training for commercial truck operators are **loss reduction** efforts aimed at reducing the severity of losses. An organization can use contingency plans to modify the consequences of an operational risk, such as a disruption in its supply chain resulting from a permanent or temporary loss of a major supplier of raw materials.

Risks can be transferred, or shared, through contractual arrangements or joint ventures with other organizations. Outsourcing is a method of risk sharing that can be used to transfer noncritical operations and their related risks to another organization. For hazard risks, insurance is the primary technique used to transfer risk. Contractual risk transfers (noninsurance), such as hedging or other contractual agreements, can be used to transfer financial consequences of risks to another party or organization.