Managing Risk in Strategy:

The Role of ERM

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Credit unions have traditionally treated enterprise risk management (ERM) as a largely static entity, focused inward on the institution's internal operational controls. However, with market volatility, complex new regulations and increasing demand for technology and collaboration with fintech, ERM is proving to be an ever-changing process. As risks change and evolve, so too must a credit union's ERM.

THE OPPORTUNITY

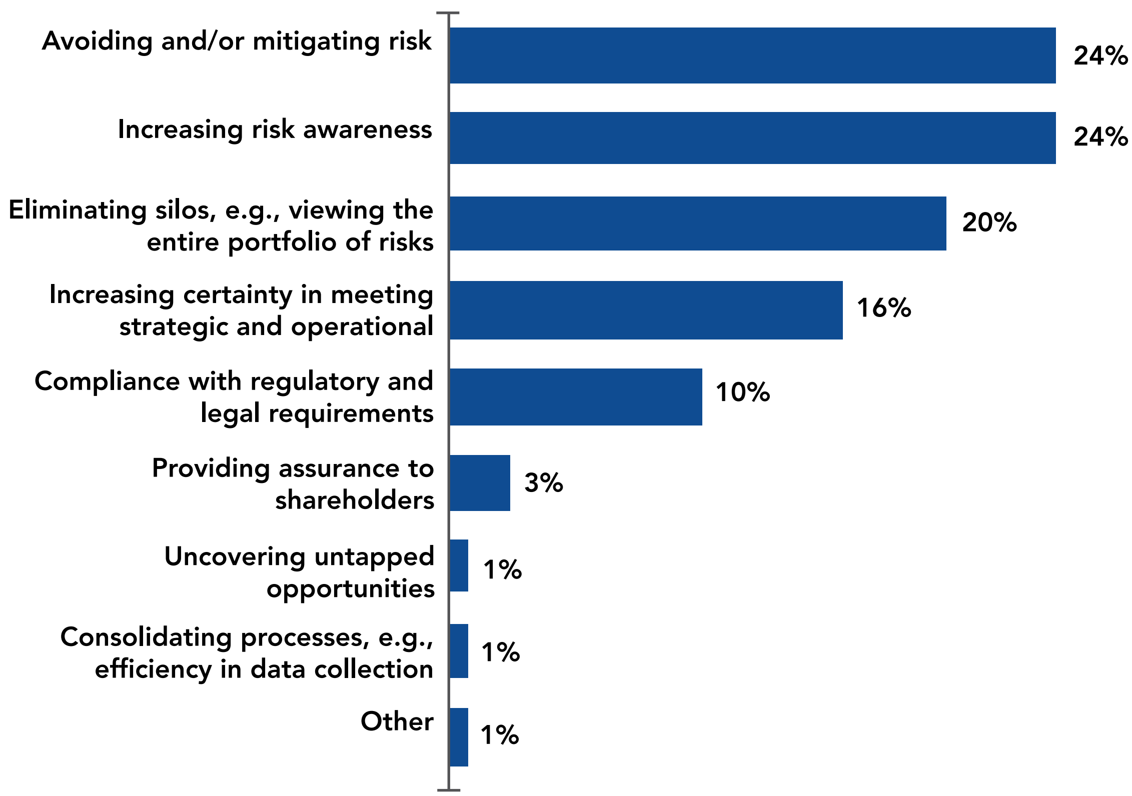
What is an ERM program and how does it benefit credit unions?

ERM programs are the process through which credit unions assess their risk appetites, identify present and future risks, proactively work to address those risks, protect and create value for the credit union and its members.

Benefits of an effective ERM program:

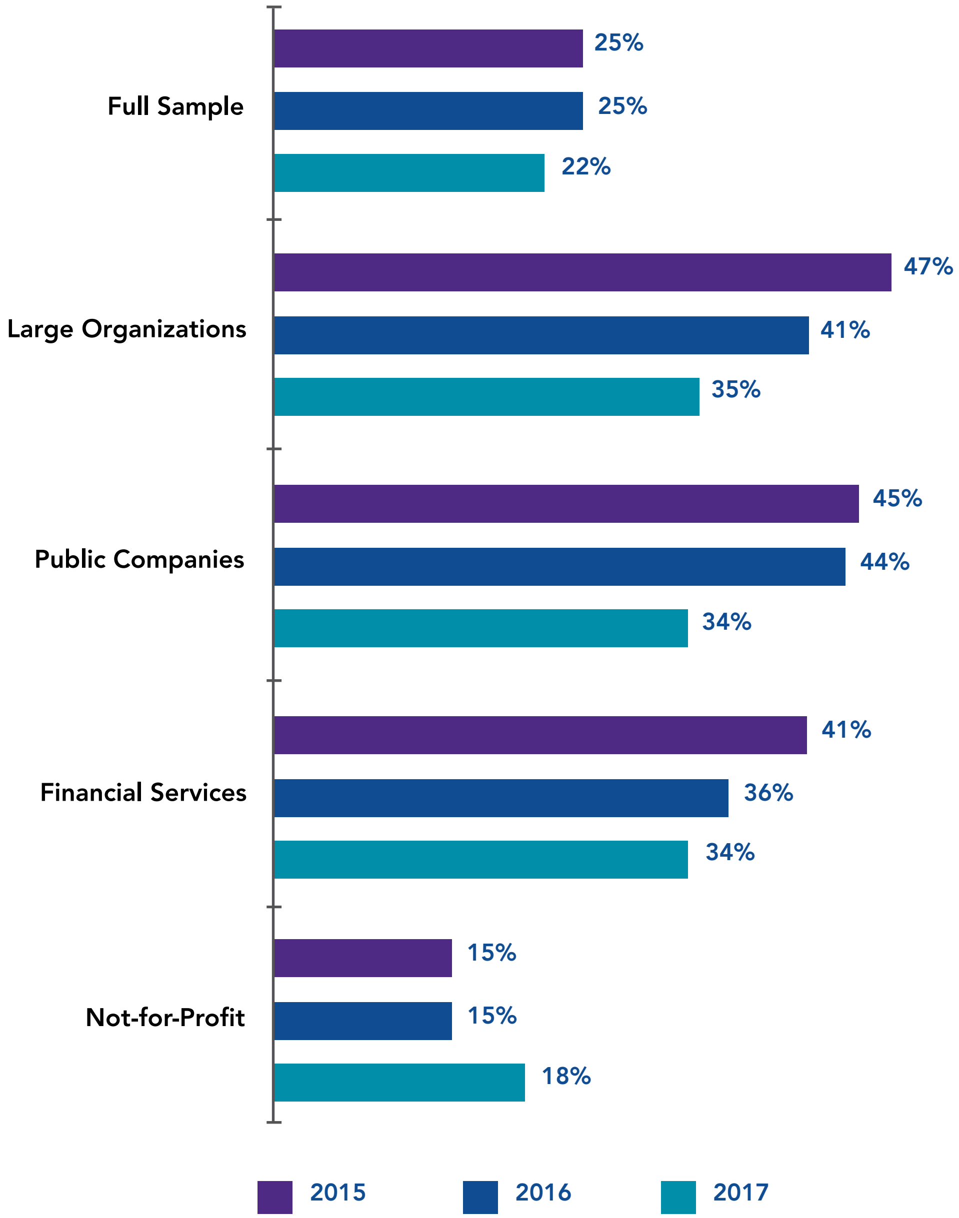
- Early detection of compliance issues, leading to lower compliance or auditing costs
- Increased awareness of the risks the credit union faces, leading to proactive measures as opposed to reactive measures
- Lower likelihood of operational loss
- Increased confidence with strategic planning
- Overall, an increase in the effectiveness of capital and resources

Primary value gained from ERM programs



Source: RIMS 2017 Enterprise Risk Management Benchmark Survey

Companies with “mature” or “robust” risk management oversight



Source: AICPA The State of Risk Oversight 2018

The type of risk

All products and services offered by a credit union carry a risk.

There are seven types of risk categories defined by the NCUA. At the very minimum, an ERM program must cover all of these.

Institution risks:

- ***Strategic risk*** - the risk of a credit union making poor business decisions or improperly executing on its strategy.
- ***Compliance risk*** - the risk of violating current regulations, which exposes the credit union to fines and other penalties.
- ***Reputation risk*** - the risk of a credit union garnering a negative public perception, which impacts its ability to continue servicing existing relationships or establishing new relationships.
- ***Transaction risk*** - the risk of fraud or errors impacting the credit union's ability to deliver products and services.

Market risks:

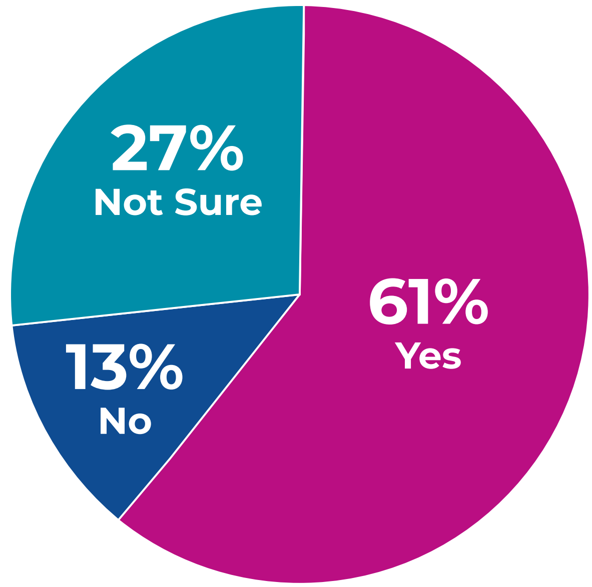
- ***Credit risk*** - the risk from a third party failing to meet the terms of a contract with the credit union, such as member loan
- ***Interest risk*** - the risk arising from changes in market rates that could affect a credit union's net worth and earnings
- ***Liquidity risk*** - the risk of a credit union not being able to meet obligations with its liquid funding sources

ERM programs are the process through which credit unions assess their risk appetites, identify present and future risks, proactively work to address those risks, protect and create value for the credit union and its members.

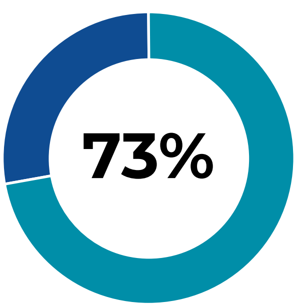
The role of ERM in strategic planning

The primary goal of ERM is to provide a clear process for identifying and managing risks so that organizations may better pursue their business goals. An ERM process not only informs strategic planning, but also takes into account risks to and from the strategic plan itself. By combining ERM with strategic planning processes, credit unions can create strategies that are not only resilient, but proactive in nature — as plans and objectives are created with potential obstacles in mind. Additionally, an ERM process may help credit unions more effectively prioritize between the different types of risks they may encounter and set up early warning systems and proactive response measures, as well as investigate risks that may otherwise be unnoticed.

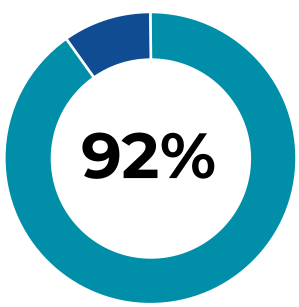
Are insights from your organization's ERM program being used to inform and influence corporate strategy?



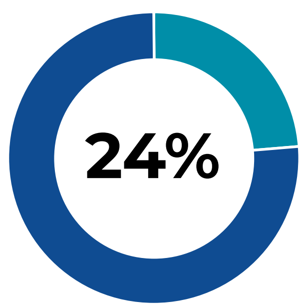
Source: RIMS 2017 Enterprise Risk Management Benchmark Survey



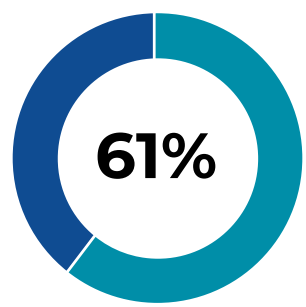
...report either having fully or partially integrated ERM programs in operation.



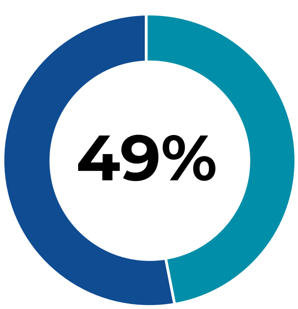
...of financial institutions have fully or partially integrated ERM programs.



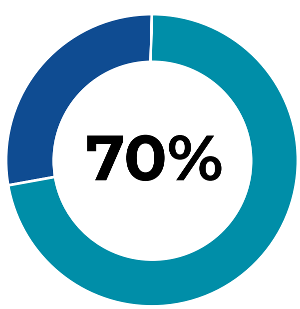
...report having a fully integrated ERM program in 2017. In 2013, it was 21%.



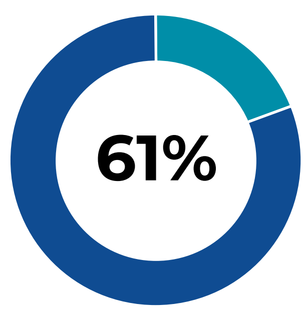
...say that ERM is being used to inform and influence strategy.



...do not have risk appetite and risk tolerance statements



...of financial institutions have a broad-level risk committee that reviews outputs



...say their program does not follow a particular standard or framework.

Source: RIMS 2017 Enterprise Risk Management Benchmark Survey

Three phases of risk in strategic plan

- *Risks that adjust the strategic plan*
  These are usually the risks recognized before the development of a strategic plan and can lead to adjustments to objectives before the plan is finalized.

- *Risks to the strategic plan*
  These are risks that endanger an element of the strategic plan, possibly preventing objectives from being completed.

- *Risks from the strategic plan*
  These are risks that arise from the strategic plan itself, including when new objectives result in unintended consequences.

How credit unions can use ERM to inform their strategic planning

Build resilient strategies
Resilience is the capability to respond quickly and effectively to an evolving environment — words to live by for any modern organization. Building resilience into a strategic plan requires that leaders understand current and future risks, understand the scenarios in which those risks can affect their organization, then draft strategies that not only anticipate those risks, but are also adaptable.

Increase awareness of risks as well as opportunity
ERM is not solely focused on downside risk, but also works to increase awareness of possible opportunities, which could in turn affect a strategic plan. Credit unions should consider how their current risk assessment process deals with:

- Identifying risk
- Communicating risk
- Developing mitigation responses
- Risk ownership and roles
- Normalizing risk tolerance

Combine risk awareness with planning sessions
The risk assessment process is a cyclical one. Risks must be identified and analyzed before preparing mitigation plans. Then credit unions can formulate a strategic plan around that risk.

Keys to success

Now that a credit union has decided that an ERM process is necessary, where should they start? Like all processes, it should be important to note that change is not immediate and neither are results. ERM is not only a shift in how an organization identifies and approaches risk, but also a shift in how every level of the organization perceives risk. Before implementation, credit unions need to establish realistic expectations for ERM.

Where to start

- *Gain buy-in from the leadership and board*
  Every large change at a credit union should ideally be discussed and approved at the top. After all, the board and management will play a large role in risk management, and ERM inherently affects the culture of an organization. Buy-in is oftentimes the biggest factor in how successful an ERM vision is.

- *Review the strategic plan*
  ERM is always linked to an organization's strategic plan, and the vision for ERM should be one that complements and informs the strategic plan.

- *Identify risks*
  Conduct a simple risk assessment: what are known, unknown but knowable, or unknown but unknowable risks? What does the board think the greatest risks to the credit union are? How much of a priority are these risks?

The primary goal of ERM is to provide a clear process for identifying and managing risks so that organizations may better pursue their business goals.

- *Draft reporting structure*
  What does the reporting structure look like? Draft a simple, top-level summary of risks, the timeframe and likelihood of those risks occurring, policies and prepared response actions, as well as how these policies can be improved.

- *Define the credit union's risk appetite*
  What are qualitative and quantitative ways to define risk? What is the credit union's current risk profile and risk capacity? What is the amount of risk that the credit union is willing to take on?

- *Determine who is taking the lead on ERM*
  Hiring on or promoting a chief risk officer is not always the best choice for every credit union, but someone needs to spearhead the ERM initiative and gather the necessary information, resources and support for the process.

Roles and responsibilities

ERM is a process shared between the Board of Directors and management, so credit unions need a clear distinction between what each group is responsible for. The lack of clear role definitions can lead to cases of miscommunication.

Is a CRO needed?

Many companies now prefer the establishment of a chief risk officer over, or in addition to, a risk committee, signifying a formal integration of risk management into the c-suite. Chief risk officers take the lead in carrying out processes that mitigate operational risks — which can include anything from

compliance to business continuity, IT security, adapting to market volatility, fraud and auditing. Chief risk officers are sometimes referred to as "change agents" because of the large impact they may have in the direction of a credit union. Perhaps most importantly, it is the duty of the chief risk officer to create a culture of risk awareness at all levels of the organization. Of course, not all credit unions can justify opening a new c-suite position or find it effective. In many cases, the responsibilities of a chief risk officer are distributed across operational areas along with the compliance department. Risk committees are also becoming more common, and some credit unions are finding that board engagement provides a more holistic approach to risk management.

Division of roles

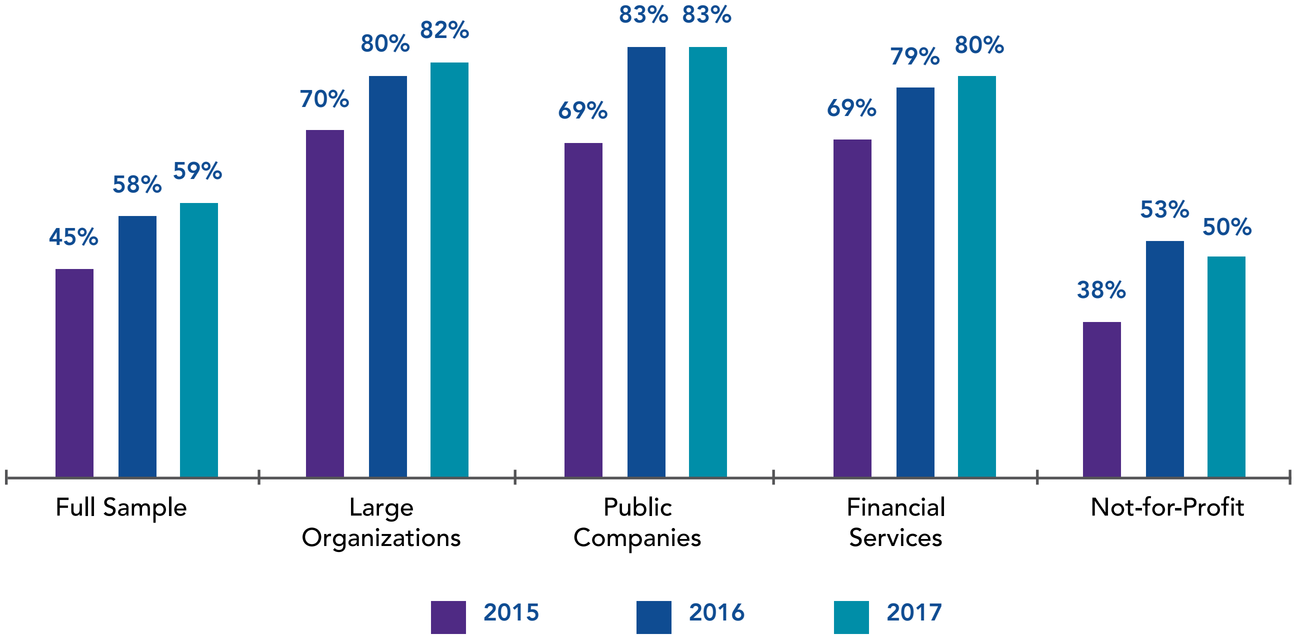
Management

- Develops the infrastructure and processes for ERM, including new hires
- Oversees implementation of ERM
- Determines risk tolerance
- Breaks risks into sub-categories and assigns to internal stakeholders
- Reports key information to the board, including both current and future risks
- Monitors and manages risk responses

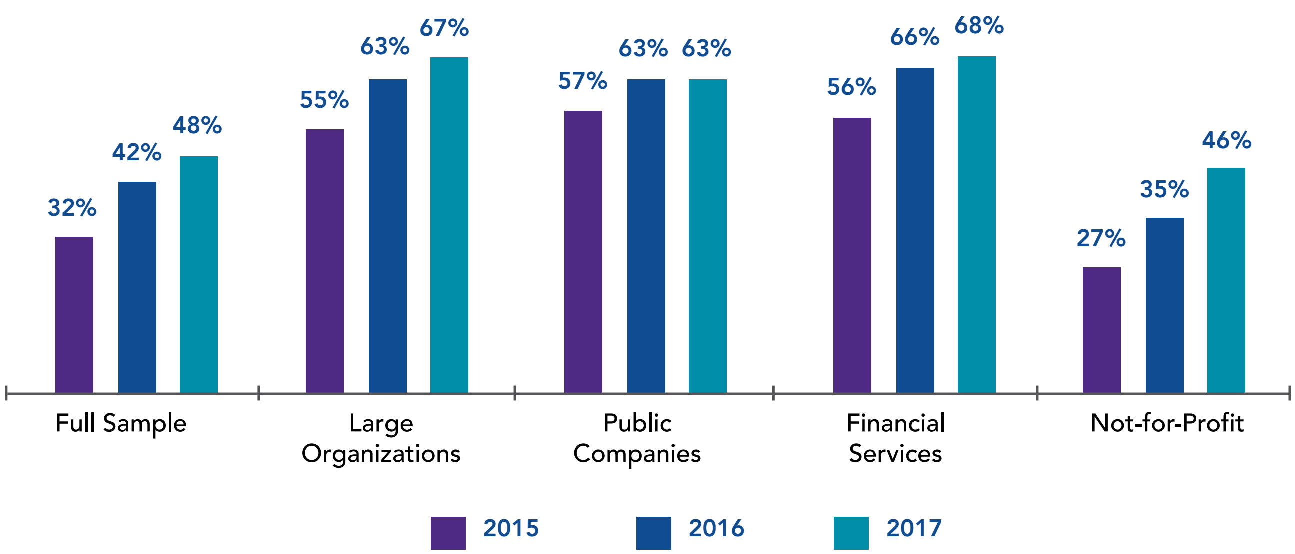
Board

- Scans the environment for emerging trends and brings them to the attention of management
- Approves the acceptance of risks
- Creates governance policies and processes that suit the credit union's risk tolerance
- Increases risk awareness

Percentage of organizations with management-level risk committees



Percentage of organizations designating individual as CRO or equivalent



Source: AICPA The State of Risk Oversight 2018

SMALL CREDIT UNION PERSPECTIVES

Smaller credit unions may not face the same amount of risks as larger institutions, so there may not be a dedicated risk management team or department in place. Smaller institutions have to delicately balance staff resources and cost, with most of their efforts going towards making sure they are meeting minimum regulatory compliance requirements related to risk. As such, they may not have the luxury of taking a step back and evaluate risk across their organization at a wholistic level.

Fortunately, with the assistance of modern, automated technology, smaller credit unions may be able to use tools to shore up their risk blind spots. Enterprise risk management software may be an affordable, convenient way for budget-tight credit unions to upgrade their risk management processes.

HOW CU SOLUTIONS GROUP CAN HELP

Our Strategic Advisory Solutions division provides guidance to effectively integrate compliance and risk initiatives across your organization, bridging the gap between credit unions and the evolving regulatory environment.

STRATEGIC ADVISORY

We partner with your credit union to build a risk management plan that encompasses all areas of organizational risk exposure, including financial, operational, reporting, compliance, governance, strategic and reputational risk. We also help credit unions align risk with their strategic objectives. Our custom structured process looks at all risk factors, associated interrelationships and acceptable levels of monitoring to help you enhance controls and increase performance.

How we can assist:

- Offer effective risk management for credit unions of all sizes.
- Provide an effective way for credit unions to increase efficiency, profitability and financial performance by mitigating and managing decision-making and risk.
- Assimilate the tools, systems and consulting to help CUs with risk management.

Read more in CU TrendScan

CUTrendScan.com

CU TrendScan is a quarterly digital publication that explores trends within the credit union industry. Focusing specifically on the areas of technology, marketing, HR performance and strategy, CU TrendScan takes a closer look at the issues that drive the industry forward.

More about Strategic Advisory Solutions

CUSolutionsGroup.com/Strat

Our advisors are long-tenured subject-matter experts who collaborate with credit unions to help drive change, make tough decisions and implement key development strategies. We go beyond the limits of consulting, so you can achieve your desired outcomes and strengthen bottom-line growth.

We assess your goals, risks and programs to craft strategy, modernize governance and measure ROI through a results-driven approach. We design an actionable plan that ensures your credit union's culture aligns with strategic initiatives. We focus on reducing staff turnover through employee engagement and provide executive coaching and HR performance tools to create and sustain a culture committed to innovation, reinvention and fulfilling your credit union's vision.

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