

2008 Credit Union Central Conference The Board's Role in Risk Management

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Answer a few questions

- Why the talk about Risk Management?
- What is the Board's Role?
- What methodology or tools should the Board ensure are in place at the Credit Union?





The Changing Environment

Northern Rock CEO, Directors
Step down (G & M) Nov 07)

\$60M credit union bailout
lambasted Mar 07

The biggest deposit in the
banking sector? Trust
(G&M Sept 07)

Credit Union Centrals of BC
and Ontario extend Merger
Closing to July 1, 2008
CUCBC website, Dec 2007

Apr 05 FICOM Dismisses
Board Chair and Audit
Committee Chair
VanTel/Safeway Credit Union

Commercial paper – what's
that? It's as easy as ABCD
(G&M Dec 2007)

Why the talk about Risk Management?

Risk is Core Business

- Credit Unions are in the risk taking business
- Using other people's money
- Money is made by taking risk; money is lost by not managing risks
- Need practices in place to ensure risk taken is explicitly identified, risk tolerance explicitly decided, and risk taken is governed and prudently managed



Who is interested?

- Depositor Members have keen interest in their deposits being safe and available
- Employees and other stakeholders want a strong sustainable credit union
- Regulators have keen interest in Credit Unions operating in sound and prudent manner
- Most of our provincial regulators have introduced standards of sound business
- All expect a foundation of Enterprise Risk Management in place at the credit union



Where does Risk come from?

- Risks from external environment

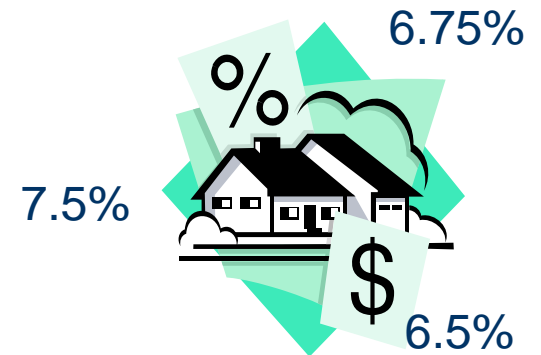
Political environment Economic factors
Regulations Competitors
Geography (natural disasters)

- Risks from internal factors

Products offered Method of delivering products
Change in organization Ethics and culture
Business strategies taken

What risks do Credit Unions have?

- Buckets of risks:
 - Credit risk
 - Market risk (interest rate risk)
 - Structural risk (asset/liability)
 - Liquidity risk
 - Operational risk (includes fiduciary, regulatory)
- Key risks within these buckets



Credit Risk



- Repayment from borrowers
- Impact from economic factors
- More focus on business lending – higher margin, higher risk
- Traditional risk

Market, Liquidity, Structural Risks



- Must have liquidity to fund the business
- Growth is dependent on having liquidity and capital
- Interest rate risk – adverse movements in interest rates; impact on margin
- Structural risk re assets and liabilities – duration of instruments

Operational Risk – Big Bucket



- Operational risk includes:
 - People risks
 - Process risks
 - Technology risks
 - Regulatory risks
 - Fiduciary product risk
 - Outsourcing risk
 - Strategic risk

What does operational risk look like?

- Dishonesty claims in 2006 approx \$8.5 million compared to \$2 million in 2005; average claim of \$670,000 in 2006 compared to \$300,000 in 2005
- Technology – our business is dependent on it – lots of technical risks, big impact – big dollars
- Process risk – not being people dependent
- Regulatory risk – new requirements continue at increasing speed
- Outsourcing – monitoring the providers; know who is doing what; no gaps in hand offs

What is the Board's Role?

Extract from Board Terms of Reference

- **Oversee Risk Management**
 - *The Board understands the principal risks of the business in which the credit union is engaged and strives to achieve a proper balance between risks incurred and potential returns*
 - *The Board establishes the proper policy framework for enterprise risk and specific areas of risk*
 - *The Board gains assurance that there are management policies and systems for an effective risk framework, and that risks are monitored and managed with a view to the long-term viability of the credit union*

Board understands the principle risks

- Effective oversight of risk management requires Board to be knowledgeable of organization's risk profile
- How to do that?
 - Orientation
 - Education
 - Risk workshop



The Board establishes the proper policy framework ...

- Establish a governing Enterprise Risk Policy
- Establish governing risk policies for specific risk areas – liquidity risk, outsourcing risk, credit risk, etc
- Also policies like compensation, code of conduct
- Establish capital policy to absorb riskiness of your credit union – greater than regulatory minimums
- Establish practices that will monitor for risks – strategic planning; enterprise risk management
- Board sets tone for code of ethics and conservative nature of credit union

Board gains assurance re management systems

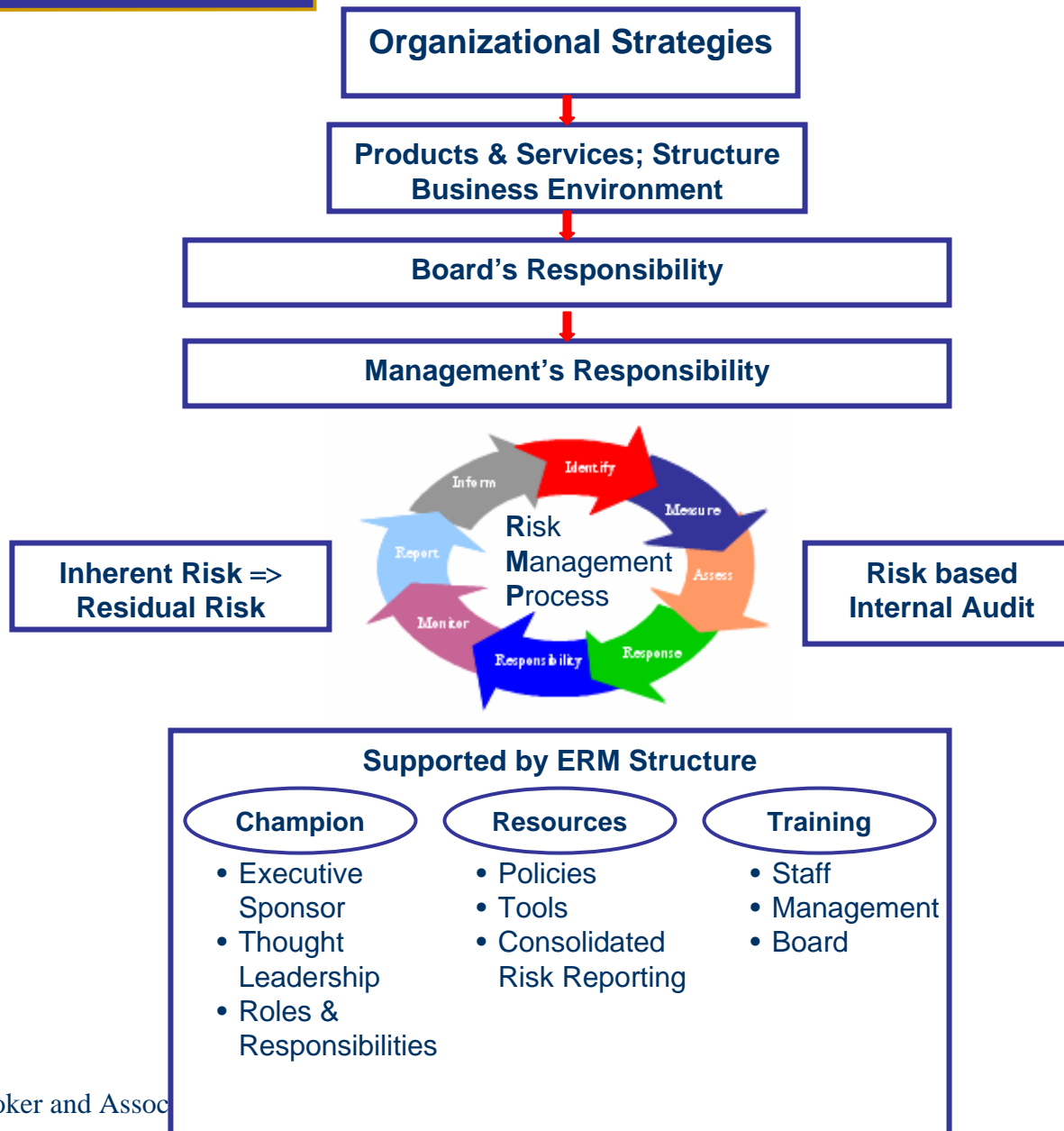
- Receiving the right reports from management to know if risks being appropriately managed
- Watch for emerging risks
 - Changes in external market; consider implications to credit union business; discuss at Board table with management
 - Changes within the credit union – implications
- Watch for shifts in risk profile



What tools do we need?

- Enterprise risk management methodology
- Reports

Elements of ERM Framework



10 Key Elements in framework

1. Establish policy
2. Risk awareness and training
3. Identify enterprise level risks
4. Risk owners – role and responsibilities
5. Risk responses – residual risk
6. Monitor level of known inherent risk and effectiveness of risk responses

cont'd

10 Key Elements in framework

7. Watch for unknown and emerging risks
8. Reports for executive and Board to monitor consolidated level of risk and emerging risks
9. Risk based Internal Audit plan and approach to audits
10. Business cases - analysis of inherent risk and risk responses

Governing & Managing Policy

Governing Policy: Enterprise Risk
The Board recognizes that in offering products and services to members and the means by which the products and services are offered, the credit union inherently assumes a variety of risks. The Board recognizes that it is an accountability of the credit union to its stakeholders to provide for the safety, soundness and good reputation of the credit union as a whole. This makes it necessary that the inherent risks of the credit union be recognized, and governed and managed....

Managing Policy: Enterprise Risk:
The Board has directed management to implement and maintain a comprehensive enterprise wide approach to the governing and managing of risks. Management recognizes that taking risk is required in operating the credit union. However, Management also recognizes that it is incumbent for the credit union and its staff for the benefit of its stakeholders (members, employees, community) to take action to minimize risk within acceptable costs. Management will

Risk awareness and training

- Curriculum of training
 - Board: Fundamentals of Governing Risk
 - Executive & Staff: Managing Risk is Everyone's Responsibilities
- On introduction of ERM
- In orientation program

Identify Enterprise Level Risk

- Process to identify risks
- Evaluate likelihood and impact of each risk = severity
- Create risk register



Risk Owners

- Ensure they understand their responsibilities
 - For inherent risk
 - For risk responses
 - Monitor residual risk
 - Emerging risks

Monitoring



- Monitor level of inherent risk – is it shifting?
- Monitor risk response – is it cost effective?
 - Need to take further action to reduce residual risk further?

Unknown and Emerging Risk

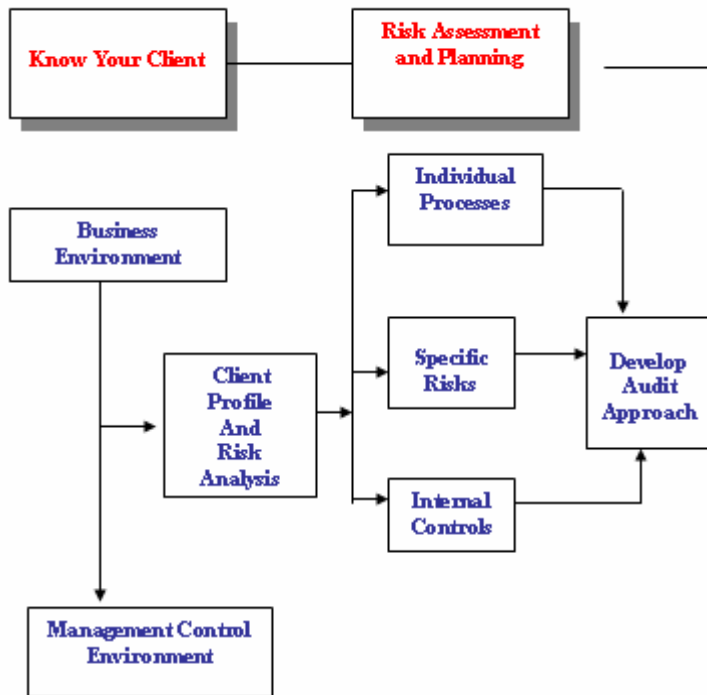
- Monitor for emerging risks
- Watch events in industry – consider applicability to your credit union
- Shifts in member preferences, employee preferences, product characteristics
- Internal and external

Reports for Board and Executive

2007 Enterprise-Wide Risk Control Dashboard

Actions	%	2006	2007		Risks
			Q1	Q2	
Stakeholder Perspective					
1. Meeting our legal obligations	60%				<ul style="list-style-type: none"> Obligations under administrative agreements not met Employees fail to comply with requirements of Safety Act
Customer Perspective					
2. Creating a level playing field for customers	50%				<ul style="list-style-type: none"> Lack of enforcement Poor service response
Business Process Perspective					
3. Encouraging duty holders to prevent accidents	55%				<ul style="list-style-type: none"> Boilers in high-risk locality may not meet safety requirements Owners may not perform elevator safety tests
4. Focusing employees' efforts to improve public safety.	20%				<ul style="list-style-type: none"> Performance of employees not effective due to absence of metrics and measurements to direct their efforts Inspection resources not allocated to high-risk installations
People Perspective					
	Good – Progressing well and control plan completed		Mixed – In progress but some aspects of risk control plan need substantial attention	!	Highly problematic – Risk control plan needs urgent and decisive action
	In Progress – On target to implementing risk control plan		Problematic – Some aspects of risk control plan need urgent and decisive action	%	Control Plan – Percentage (%) Completed

Internal Audit

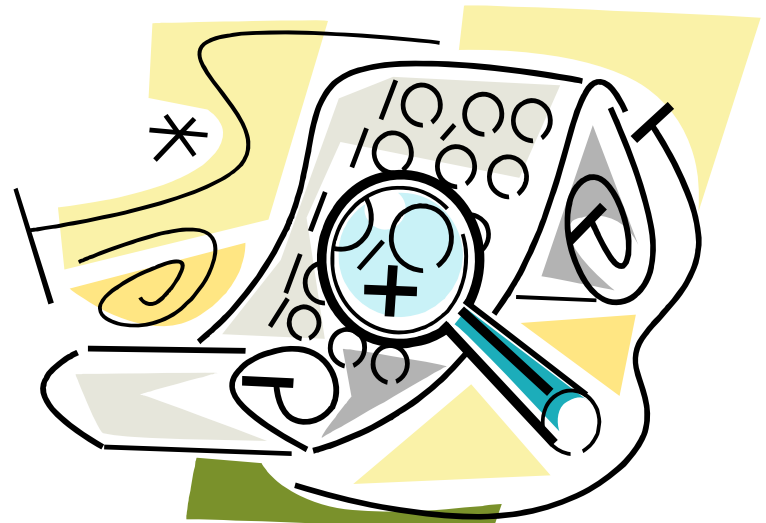


Need a risk based internal audit approach

- At enterprise level
- At business unit level

Risk Lens for Other Key Areas

- Business cases
 - Ensure there is a step for analyzing inherent risk
 - Identify risk responses that can be taken



Challenges in implementing ERM

- Lack of acceptance
- Lack of resources
- Lack of understanding the risk
- Lack of appreciation for potential chaos
- Seeing it as a project
- Underestimating impact
- Concern that ERM inhibits the business
- Misplaced responsibility
- Just paperwork

Lack of acceptance



Myth: this is simply a compliance exercise

Overcome it by:

- Provide education for Board, senior management, staff – today and as a refresher
- Training and material has to be relevant to the credit union's operations
- People leading the ERM implementation need to have the competence to do so – integrity, respect

Lack of resources

Myth: add it to the CFO or COO's job

- Starve it and it goes away
- For most organizations need dedicated resources
 - people, dollars, tools
- Need mandate, responsibilities



Lack of understanding

Myth: We already know the risks and operate our business effectively

- Implicit vs explicit awareness
- Shared understanding of the risks
- Shared understanding of severity of risks
- Clear ownership of risks and agreement on that ownership
- Involve staff

Lack of appreciation for potential chaos

Myth: We can handle whatever happens

- Clearly identifying the risk response
- Assessing effectiveness of risk response
- Is residual risk acceptable
- Explicit acceptance of residual risk in response to risk tolerance
- Are we in control?

Seeing ERM as a project

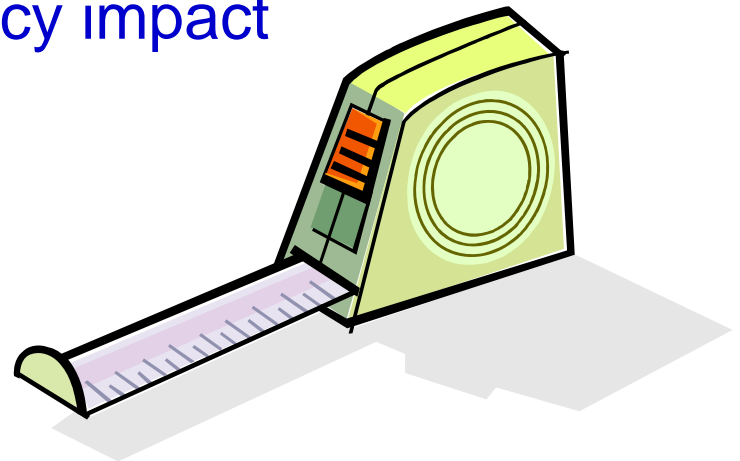
Myth: The exercise is done

- ERM is not an exercise
- Must be proactive in examining and considering risks
- Emerging risks – known in other organizations and unknown to us
- Changing business environment internally and externally
- Accountabilities and responsibilities are continuous
- It is a journey not a quick fix

Underestimating impact

Myth: Not all risks can be measured

- Can identify a measure for all risks
- Even those that are measured best in non-financial terms
- Reputation impact; efficiency impact



Concern that ERM inhibits business

Myth: This is going to stop business

- Decentralized vs centralized responsibilities
- Facilitator vs ownership
- Empowerment
- Clarity on who does what
- Demonstrate its value
- Being risk aware and determining acceptable level of risk

Misplaced responsibility

Myth: This is Internal Audit's responsibility

- Risk owners are business owners
- Subject matter experts
- Internal Audit needs to follow a risk based approach
- Can utilize management's assessment
- Being proactive vs reactive

Seeing it as paperwork

Myth: This is just paperwork

- Constructing informative reports
- Focusing on the severe risks
- Identifying emerging risks

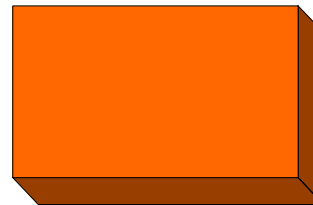
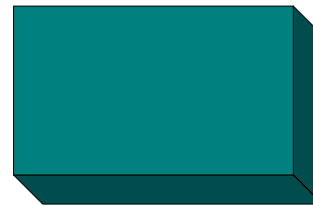


Who owns risk management

- Key responsibilities in a decentralized model
 - Risk Owners = business owners
 - Risk Services Department = facilitator
 - Management owns consolidated risk profile
 - Board owns oversight for long term sustainability of the credit union
- Everyone has a role

ERM - Who does it?

- An Integrated ERM framework engages all levels of the credit union
- If any one level not fulfilling the right role, then ERM framework will not be effective



Everyone needs to know their accountability



Enterprise Risk Management – Why Is It Important

- Given risk taking nature of credit union's business; **and**
- Credit Union's desire to be successful and have confidence of members; **and**
- Stewardship of member's savings; **and**
- Expectations of the regulators;
- ERM is methodology to assist management and the Board in their respective roles for the soundness of the credit union and its long term viability

Benefits of adopting ERM

- Organizations that choose to adopt ERM do it to be informed. By being informed, Board and senior management can be proactive in governing and managing risks
- Successfully implementing ERM should bring following benefits:
 - align risk appetite and strategy
 - Identify and manage risks that have traditionally been overlooked

Benefits of adopting ERM con't

Benefits (cont'd) ...

- minimize operational surprises and losses
- reduce costs by using risk information to streamline business processes
- make informed choices and decisions
- identify accountabilities for managing risk
- allocate greatest resources to greatest risks

The right practices for risk taking



- Board to drive and support having sound risk management process within the credit union
- Management to be focused on implementing good business practices including managing risk
- ERM is a tool to enable credit unions to be successful
- ERM allows CU to be in control, have structure, be organized, allows for business environment that is empowering, permits taking advantage of opportunities

The Board's Role in Risk Management

- Risks of a credit union are complex
- Requires Boards to have a solid understanding of the risks
- Boards are enabled in providing the right oversight by being properly informed and having the right tools in place

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