

Building your ERM Program

A Foundation that Takes you Forward



Berenice Villarreal, CPA Chief Risk Officer Randolph-Brooks Federal Credit Union

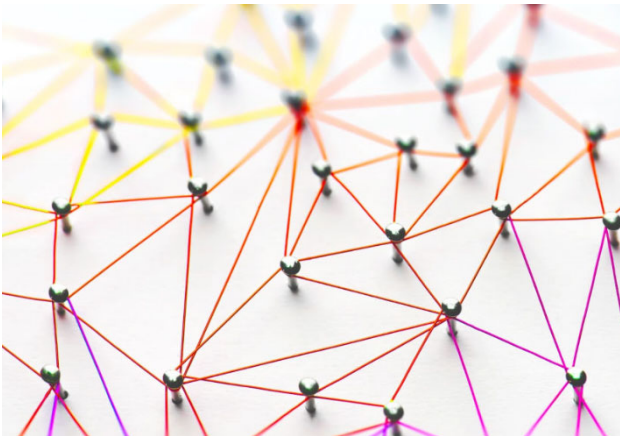
Berenice leads the compliance and risk functions for the credit union as RBFCU prepares to be under CFPB and NCUA ONES supervision. She has served credit unions for 17+ years holding several roles within RBFCU including leadership roles in Internal Audit, Consumer Lending, Business Services and Payments.

Berenice began her career in public accounting and auditing having worked at two San Antonio CPA firms. Berenice graduated from the University of Texas in San Antonio earning a Bachelor's in Business Administration with concentrations in both Accounting and Finance. She holds her certification in public accountancy in Texas as well as Credit Union designations in Enterprise Risk Management (CUERME) and Compliance (NCCO).



What is Enterprise Risk Management?

ERM is a comprehensive risk optimization process that integrates risk management across the Credit Union.



Before you Launch

Do you have:

- Executive commitment, including the CEO?
- A strong leader that understands your business?
- A clear vision aligned to your credit union culture?
- Someone that can devote the time to build the program?



Value Proposition

- View risk profile comprehensively, reducing siloes
- Improve risk / return relationship
- Increased communication and transparency
- Minimize surprises by highlighting key issues
- Enhanced alignment with strategic objectives



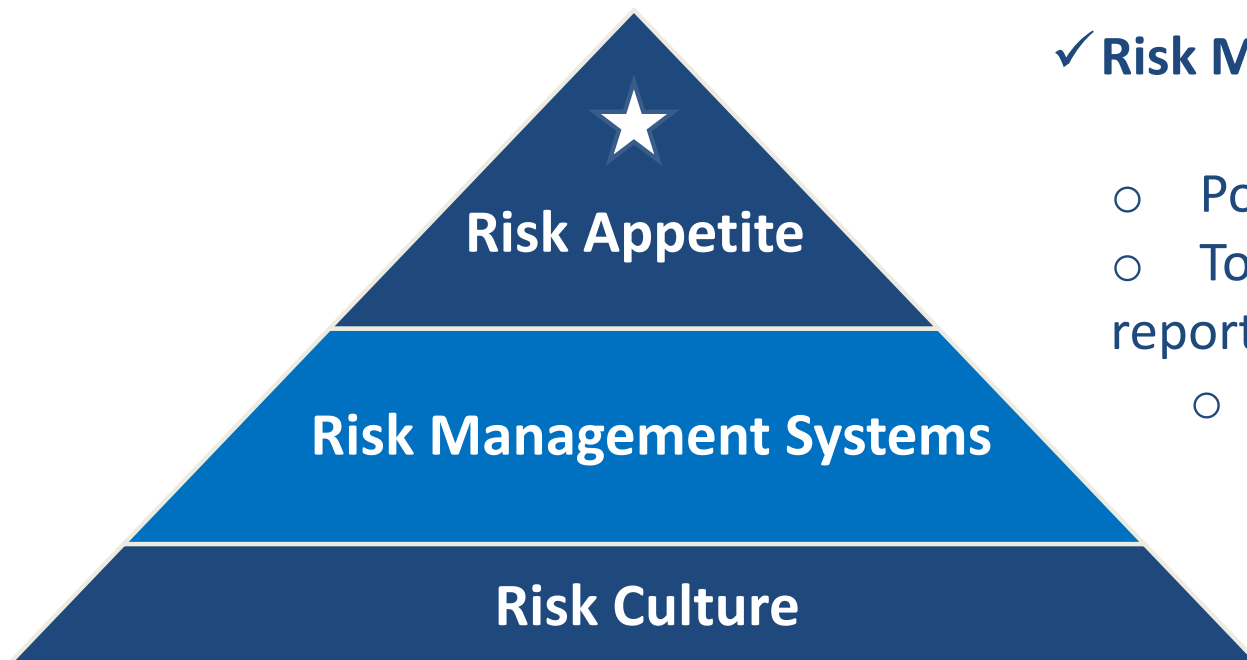
Elements of an Effective ERM Program



- ✓ *Board Risk Appetite Statements (by category)*
- ✓ *Tolerance Metrics (by category)*
- ❖ Establish the aggregate level of risk the Board is willing to assume
- ❖ Ensures Management operates within the Board's Risk Appetite



Elements of an Effective ERM Program



✓ Risk Management Systems include:

- Policies, processes and personnel
- To identify, measure, monitor, report and control risks.
 - RISK ASSESSMENTS



Elements of an Effective ERM Program

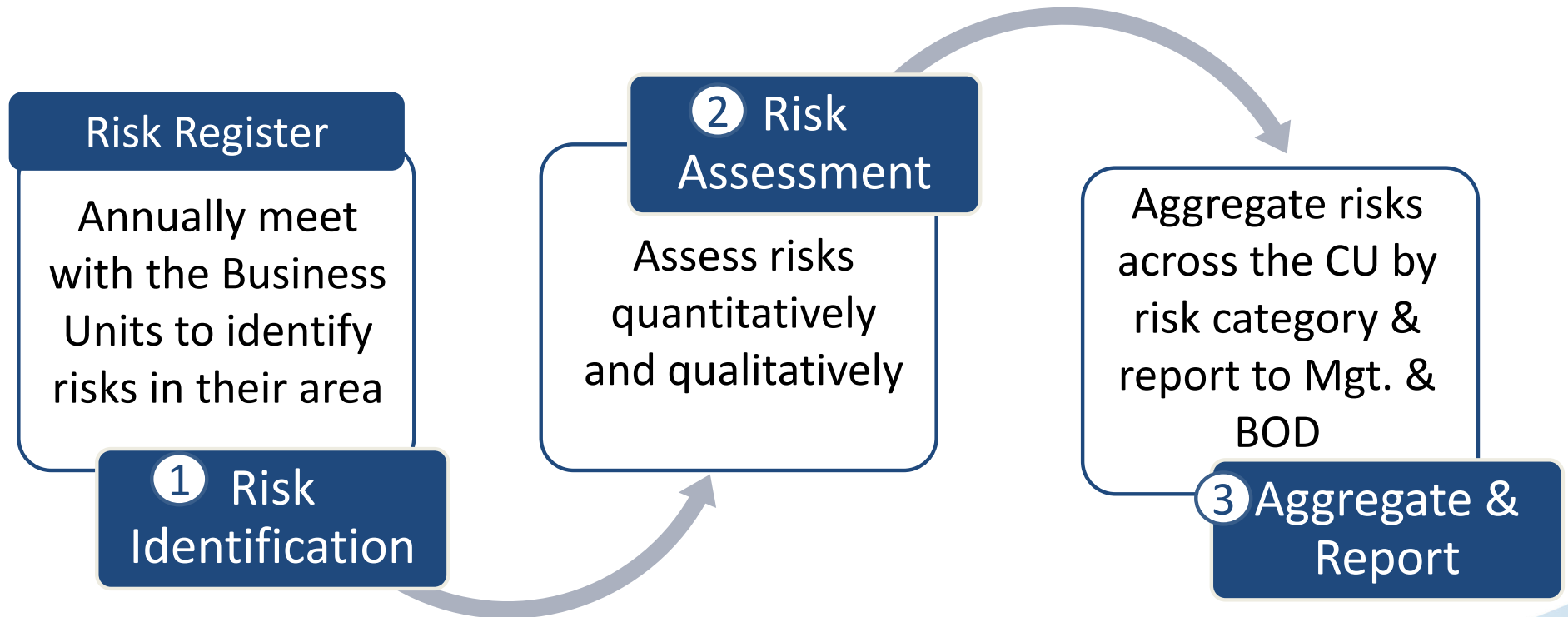


✓ **Risk Culture** sets the credit union's tone, reinforcing the importance of risk management

- Ethical values
- Desired behaviors
- Understanding of risk
- Set by senior management and the board



Risk Assessment Approach



Apogee IQ - System ERM utilizes to help manage credit union's risks



Business Unit Sessions

- Provide an overview of the ERM function
- Discuss key objectives for that business unit
- Recent changes impacting their function
- Get discussion to flow to help identify key risks
- Include a small group who understand their operations
- Management reports or metrics are helpful



Helpful Tip #1

- Before you start your sessions
 - ✓ The risk identification and assessment process should be simple, practical and easy to understand
 - ✓ Remember you are facilitating and leading, allow the participants to have dialogue and conversation
 - ✓ Avoid debates or confrontations



1 Risk Identification

- Identify the material events, having negative consequences, that can transpire within the functional area's responsibility:
 - Exposures, uncertainties and missed opportunities
- Consider internal and external factors:
 - External: economic trends, competition, natural disaster
 - Internal: employee fraud, people, processes, infrastructure
- Develop scenarios to demonstrate each risk



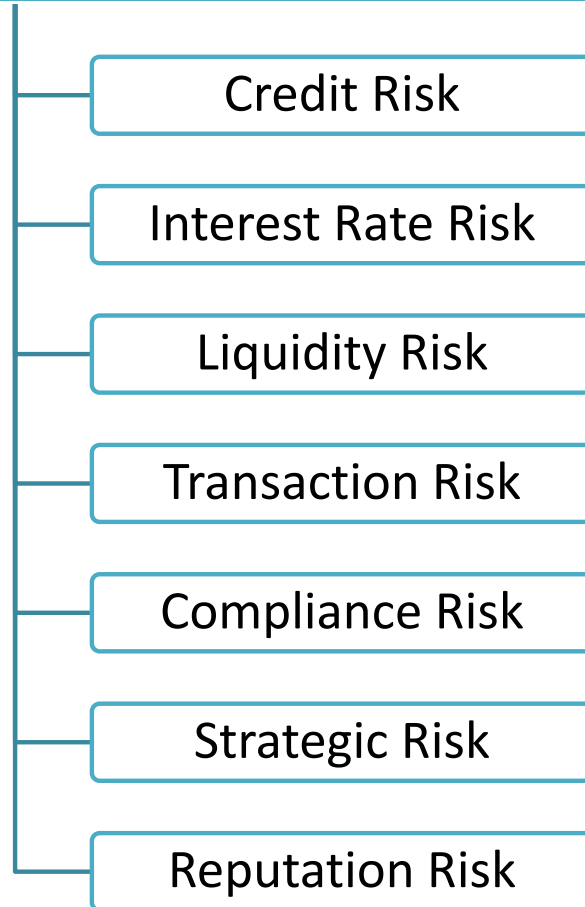
Risk Identification

Risk Unit	Short Desc	Complete Risk Description
Branch Management	Inadequate member educataion of products	The credit union could fail to properly educate the membership regarding available products and services. Leading to underutilization of products for members, lack of member engagement and loss of income for the credit union.
Branch Management	System delays	The credit union might experience delays in its systems or network connections that affect its ability to transact member business. This could result in member dissatisfaction and lost product revenue.
Branch Management	Employee theft or fraud	

ERM facilitates sessions with each Business Unit to identify risks in their areas and document in the Risk Register

Source: Apogee IQ Screenshot

NCUA Risk Categories



Helpful tip #2

As credit unions we're in the business of risk...

WE MANAGE RISK WE DON'T ELIMINATE RISK



② Risk Assessment

- ❖ **Impact** – Potential magnitude, in the absence of responses, measured against income and capital
- ❖ **Likelihood** – The probability an event will occur in a given time period, again in the absence of responses
- ❖ **Responses** – Actions the credit union takes to mitigate or manage risk exposures
- ❖ **Mitigation** – The degree to which the organization's responses manage down the impact or likelihood



Inherent Versus Residual Risk

❖ Inherent risk

- Potential exposure to the risk event within a year, **before** responses
- = **Impact * Likelihood**

❖ Residual risk

- This is the exposure **after** responses
- = **Inherent risk * [1 - completeness of mitigation]**

❖ The difference is the benefit of the responses



Risk Assessment Example

- ★ Assign a primary risk category, strategic objective category, and mitigation status

Risk Unit : Branch Management

Process Name : Process Selection

Short Description : System delays

Complete Risk Description : The credit union might experience delays in its systems or network connections that affect its ability to transact member business. This could result in member dissatisfaction and lost product revenue.

**** Apogee estimates the overall residual risk to earnings (net income at risk).**

- ★ Assess the impact and likelihood

Impact : 2 - \$70k to \$140k

Likelihood : 2 - 10% to 30%

- ★ Document how the Business Unit responds to the risk and determine how well the response mitigates the risk

Response : The credit union has offline procedures, which Branch personnel follows during system outages. In the event of network outages, personnel could be referred to other locations or alternate channels. Over the last few years, systems have been upgraded and outages are less frequent and shorter in length. Continued reporting and monitoring of IT issues through HUB and RVP notification.

Mitigation : 4 - 60% to 80%

Source: Apogee IQ Screenshots



Helpful tip #3

This is the business unit's risk assessment. **They own it.**

As risk management, we **facilitate** and enable productive discussion. We challenge only when we have metrics or information we can use as evidence



③ Aggregate & Report Risks

1. Export Risk Data from our system (Apogee)

2. Aggregate by Similar Risks & by Risk Category

Risk Unit	Short Desc	Complete Risk Description
Lending: Consumer	Human Error	Personnel could experience oversights or errors due to large application volumes, and fail to finalize or service loans consistently. This could result in the inability to repossess collateral or perfect lien in the event of defaults, increased charge offs, member dissatisfaction, and possible litigation.
IT: Applications	Human Error	There could be unintended consequences from IT departments not following or communicating instructions properly. This could result in data loss, inappropriate transactions, regulatory noncompliance, negative member impact or monetary losses.



③ Aggregate & Report Risks

3. Determine Risk Rating for Each Risk Category

NCUA Risk Category	Estimated Residual Risk Total (\$)	% Estimate	Risk Rating
Credit	\$	%	Moderate
Compliance	\$	%	Moderate
Interest Rate	\$	%	Low
Liquidity	\$	%	Low
Reputation	\$	%	Low
Strategic	\$	%	Low
Transaction	\$	%	Moderate

Risk Rating Scale

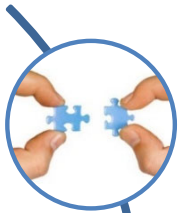
Residual Rating*	\$	% Scale
Low	Up to \$17 MM	0% - 15%
Moderate	Up to \$35 MM	16% - 32%
High	Up to \$65 MM	33% - 60%
Critical	> \$65 MM	> 61%

* Residual risk is calculated by qualitatively assessing potential earnings at risk and then shown as a % of net income



Developing Risk Appetite

Risk appetite is the amount of risk an organization is willing to accept in pursuit of its strategic objectives.



Risk Appetite links Enterprise Risk Management,
Strategic and Capital Planning



Helps guide strategic objectives, resource
allocation, alignment and decision making



Tool to improve organization performance and
represents a path to reach goals



Risk Appetite Statement - Example

Reputation Risk Appetite: LOW

Reputation Risk Appetite is **low** and the RBFCU brand is recognized for exceptional member service, quality products and services, trust, and the best place to work. Member feedback is handled timely and disaster recovery plans are documented and tested to ensure minimal member disruption or dissatisfaction. The credit union will evaluate strategies as necessary for the benefit of the entire membership. Net Promoter Score provides an insight into member satisfaction and the credit union strives to remain in the top echelon of financial institutions.

Examples-Actions Consistent with Risk Appetite

- ✓ Maintain disaster and recovery plans that are documented and tested
- ✓ Handle member feedback timely
- ✓ Maintain a culture that that results in low employee turnover
- ✓ Experience relatively low losses arising from litigation
- ✓ Monitor and manage the credit union's brand

Examples of Actions Inconsistent with Risk Appetite

- ✗ Maintain poor service
- ✗ Make decisions without considering or managing perceived reputation risk
- ✗ Significant exposure to member data or privacy breaches
- ✗ Roll out products and services with untested functionality or that do not work properly



Risk Tolerance and Metrics

Risk tolerance metrics provide guardrails monitor whether the credit union is operating within the established risk appetite. These are measurable and has boundaries or guidelines.

While risk appetite is broad, risk tolerance is tactical and operational.



Credit Risk Tolerance Metrics Example

Credit Risk Tolerance Metrics	2018	2019	Q1 2020	Within Tolerance	Tolerance Trigger	Tolerance Breach
Delinquency Ratio	0.37%	0.43%	0.48%	< 0.75	0.75 - 1.25	> 1.25
Net Charge-Off Ratio	0.33%	0.46%	0.43%	< 0.45	0.45 - 0.70	> 0.70
Allowance for Loan Losses / Loans	0.51%	0.62%	0.69%	> 0.60	0.50 - 0.60	< 0.50
Loans / Assets	78%	77%	72%	< 90	90 - 95	> 95
Consumer Lending / Equity	367%	320%	328%	< 480	480 - 500	> 500
Member Business Lending / Equity	52%	49%	50%	< 165	165 - 175	> 175
Total Real Estate Loans / Equity	273%	273%	296%	< 450	450 - 500	> 500
Real Estate Loans > 15 Years Maturity / Equity	75%	86%	91%	< 125	125 - 150	> 150
Real Estate Loans > 10 Years Maturity / Equity	170%	174%	188%	< 280	280 - 300	> 300

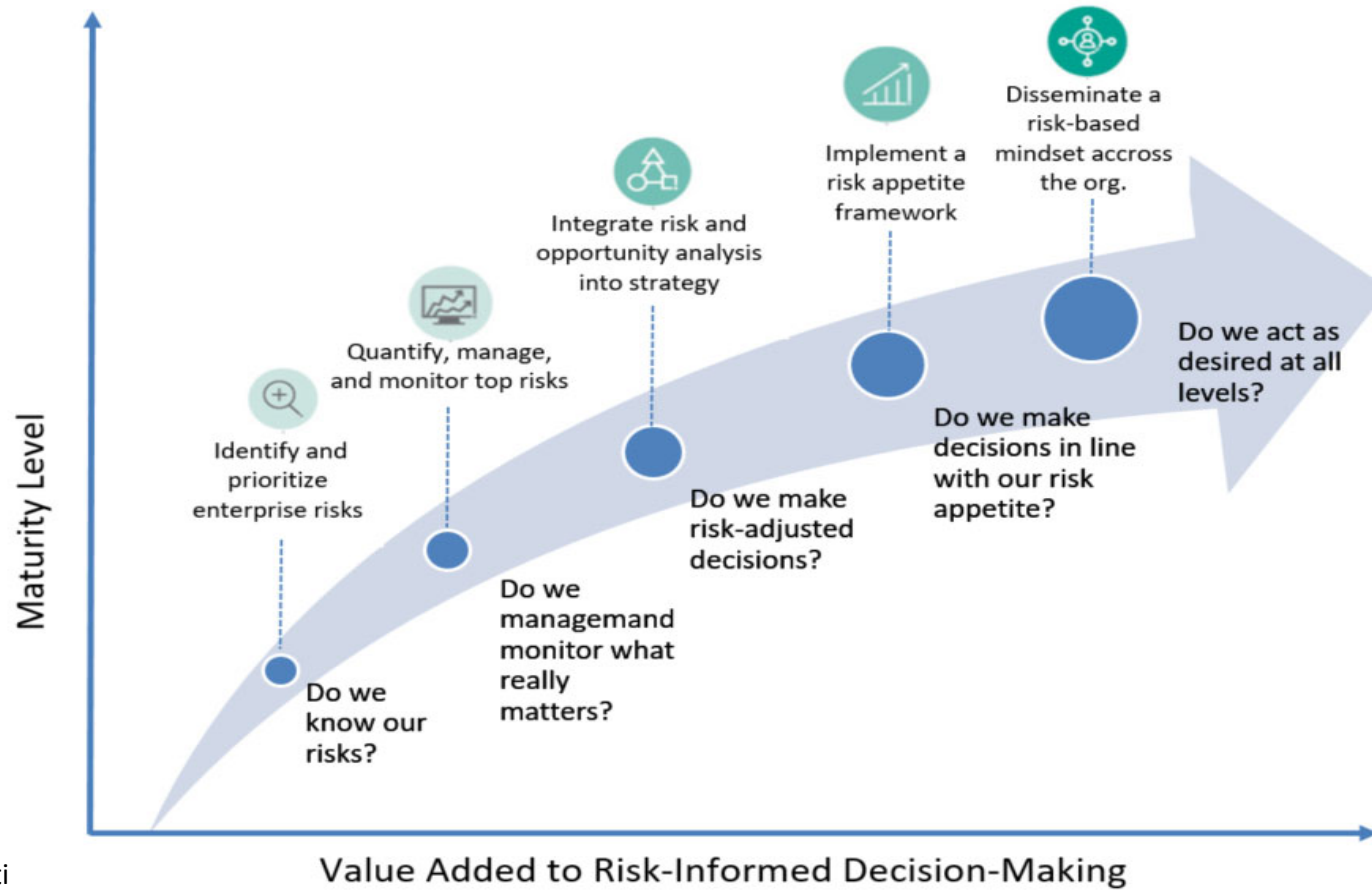


Risk Summary Report Example

Regulatory Risk Category	Risk Appetite	Residual Risk	Within Risk Appetite
Credit Risk	Moderate	Moderate	✓
Interest Rate Risk	Low	Low	✓
Liquidity Risk	Low	Low	✓
Transaction / Ops. Risk	Moderate	Moderate	✓
Compliance Risk	Low	Low	✓
Strategic Risk	Low	Low	✓
Reputation Risk	Low	Low	✓



ERM Program Evolution



Source: Protiviti



Contact Info

Berenice Villarreal

bvillarreal@rbfcu.org



Appendix A - Sample Risk Assessment Schedule

ERM Assessment Sessions & Attendees					
#	Business Unit	2018 Risk Matrix	Size*	Session Date	Session Time
1	Finance: Procurement Services	8	Small	9/6/2019	2-4pm
2	CentralOps: BSA Compliance	9	Medium	9/11/2019	10:30-12:30
3	Finance: Financial Reporting and Analysis	19	Large	9/11/2019	1:30-3:30
4	Finance: Accounting	13	Medium	9/16/2019	1-3pm
5	Human Resources: Learning and Development	8	Small	9/16/2019	8-10am
6	Records & Research	9	Medium	9/17/2019	11-12
7	Human Resources: Recruitment, Benefits and Employee Relations	14	Medium	9/17/2019	2-4pm
8	IT Technical Services (Tech Services, Data Center, Service Desk, Network, & Telephony)	20	Large	9/17/2019	9-11am
9	Branch Management (includes Support & Branches)	13	Medium	9/23/2019	8-10am
10	Lending: Collections	15	Medium	9/23/2019	1-3pm
11	Lending: Business	18	Large	9/25/2019	8-10am
12	Risk, Compliance, Legal and Audit	19	Large	9/27/2019	9-11am
13	IT Applications (Application Support, Core Dev)	16	Medium	9/27/2019	2-4pm
14	Facilities and Safety & Security	24	Large	9/30/2019	3-5pm
15	Marketing: Business Development	11	Medium	9/30/2019	1pm - 3pm
16	Lending: Mortgage	16	Medium	10/1/2019	1-3pm
17	CentralOps: Card Fraud	16	Medium	10/2/2019	1-3pm
18	Lending: Consumer	18	Large	10/2/2019	8-10am
19	CentralOps: Payments	16	Medium	10/4/2019	1-3pm
20	Marketing: Agencies (Graphics, Analysis, & Communications)	18	Large	10/4/2019	9-11am
21	CentralOps: Accounts Services (Fraud & Asset Protection)	13	Medium	10/7/2019	3-5pm
22	IT Web and NetBranch	16	Medium	10/7/2019	9am - 11am
23	CentralOps: Remote Member Services	11	Medium	10/7/2019	1-3pm
24	IT Information Security	13	Medium	10/9/2019	9-11am
25	Strategic	14	Medium	10/10/2019	1pm - 2pm
		367			
* Size is based on the number of risks identified in the previous year risk assessment per review of the risk matrix.					



Appendix B – Risk Tolerance Metrics

Compliance Risk Tolerance Metrics

of External Complaints (NCUA) per quarter
of Open Violations of law or regulation
of Critical or High Risk issues open > 12 months
of New Lawsuits / Legal Actions in Progress or Total

Credit Risk Tolerance Metrics

Delinquency Ratio
Net Charge-Off Ratio
Allowance for Loan Losses / Loans
Loans / Assets
Consumer Lending / Equity
Member Business Lending / Equity
Total Real Estate Loans / Equity
Participations / Equity
Real Estate Loans > 15 Years Maturity / Equity
Real Estate Loans > 10 Years Maturity / Equity

Interest Rate Risk Tolerance Metrics

NII Decline - Rates Up 300
NII Decline - Rates Down 100
NEV Decline - Rates Up 300
NEV Decline - Rates Down 200
Capital Level - Rates Up 300
Capital Level - Rates Down 100

Liquidity Risk Tolerance Metrics

Contingent Liquidity
One Year Liquidity
Loans / Shares

Reputation Risk Tolerance Metrics

Net Promoter Score (MembersXP)
% Turnover

Strategic Risk Tolerance Metrics

12 Month Member Growth
12 Month Loan Growth
12 Month Deposit Growth
Return on Average Assets
Regulatory Equity / Total Assets
Efficiency Ratio, *annualized*

Transaction Risk Tolerance Metrics

Information Security Operational Readiness
of Data Loss Incidents
Total Operational Losses / Product Revenue
Total Card Fraud Losses/ Product Revenue

