

REAL

ENTERPRISE RISK MANAGEMENT

The Rochdale Group

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June 2013



Delivering Clarity to Credit Unions Through Expertise and Experience

- ❖ Enterprise Risk Management
 - ❖ Lending Execution and Risk Management
 - ❖ Merger Strategy and Realization
 - ❖ Credit Union Capital Markets
 - ❖ Compliance
 - ❖ Strategic Planning and Execution
 - ❖ Regulatory Response Activity
- 
- A 3D rendering of a wooden puzzle with several pieces missing, set against a dark red background. The puzzle pieces are arranged in a grid, and the missing pieces are scattered around, suggesting a process of problem-solving or strategic planning.

Risk = Opportunity



Except when it doesn't



Necessity of Change

Environment

- *Market conditions*
- *Regulatory pressure*
- *Member expectations*

What is RISK?

Avoid

Reduce

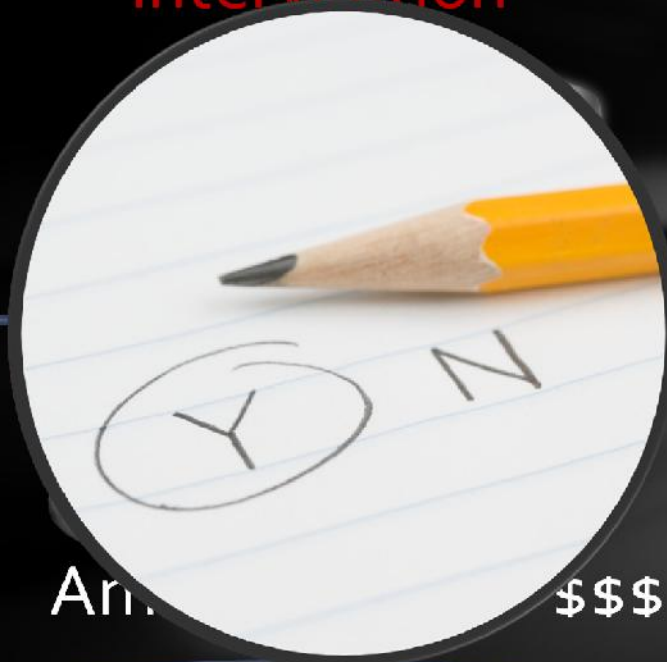
Share

Accept

Intervention

\$ Worth Now

\$ Worth Later



Ann.

\$\$\$

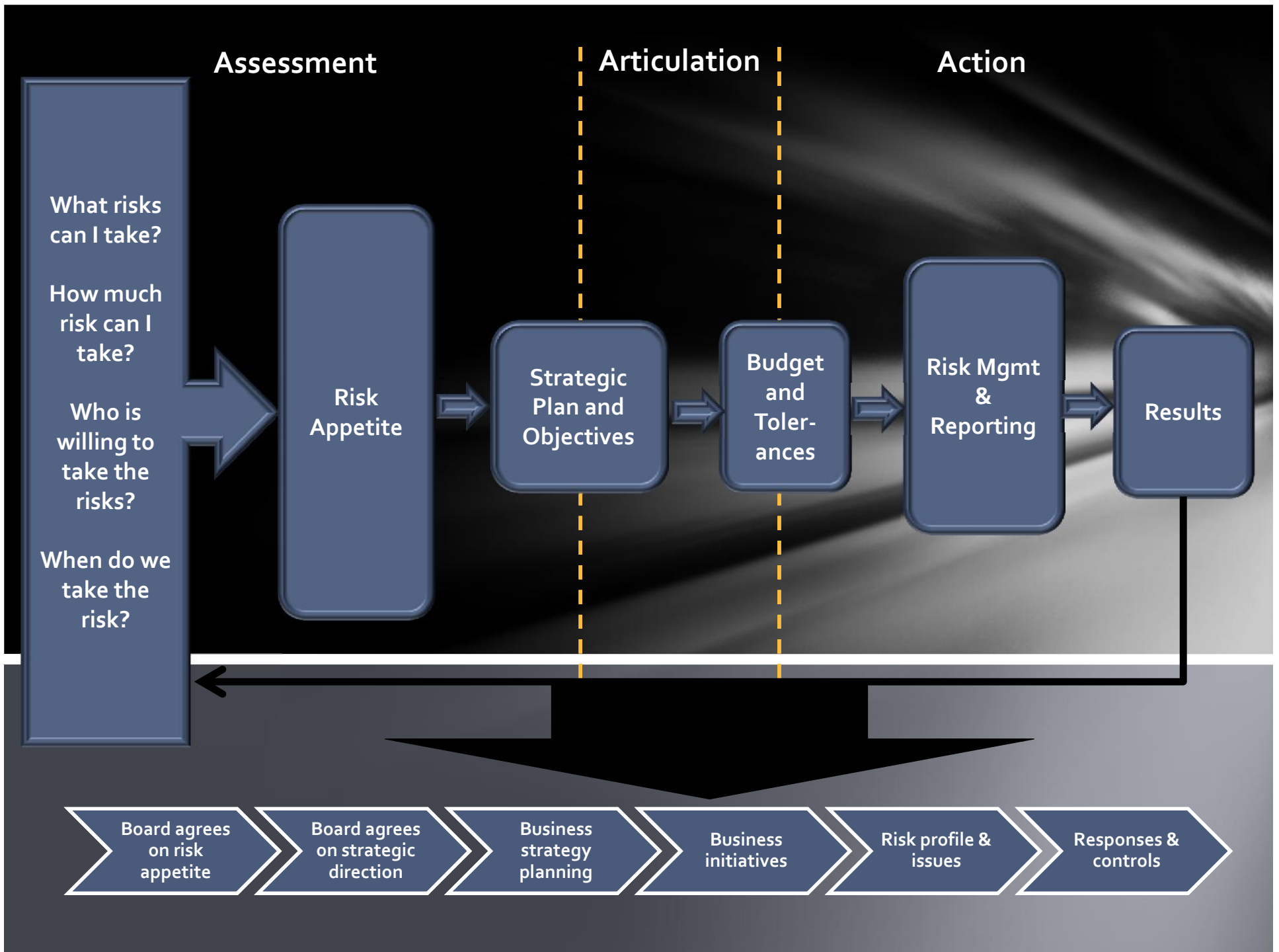
Risk

Probability of a specific loss of worth occurring

As a financial institution...

Understanding and managing risk should
be central to all we do!





ERM Findings

- Silo'd decisions –
 - department vs. organization
- Reactionary risk processes
 - educated guess vs. informed decision making
- In-ability to understand risk in relation to strategy
 - desire vs. intent
- Misunderstanding of risks
 - some
- Lack of an Enterprise solution
 - decision feel vs. decision tool
- Assistance of a Third-party partner
 - status quo vs. culture change

Reactive vs. Proactive

ERM Qualitative Results

- Board and management understanding of organizational risk profile and its correlation to strategies of the organization
- Enhanced ability to rapidly identify and take advantage of opportunities and the expansion of revenue by better leveraging risk
- Minimization of unpleasant surprises and unexpected losses
- Improved preparedness and elimination of possible negative reputation and operational events.

ERM Quantitative Results

- Return on loans
- Net interest margin
- Return on assets
- Loan to share ratio
- Membership growth

Why “THEY” Don’t

- They ignore the human limitations – HUBRIS
- The past does NOT equate to the future
- Extremes do NOT equate to reality
- There is no short-cut
- I can’t
 - Too small
 - Too complex
 - Lack expertise
 - Perfectionistic Paralysis
 - Too busy

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Forget What You
Know!

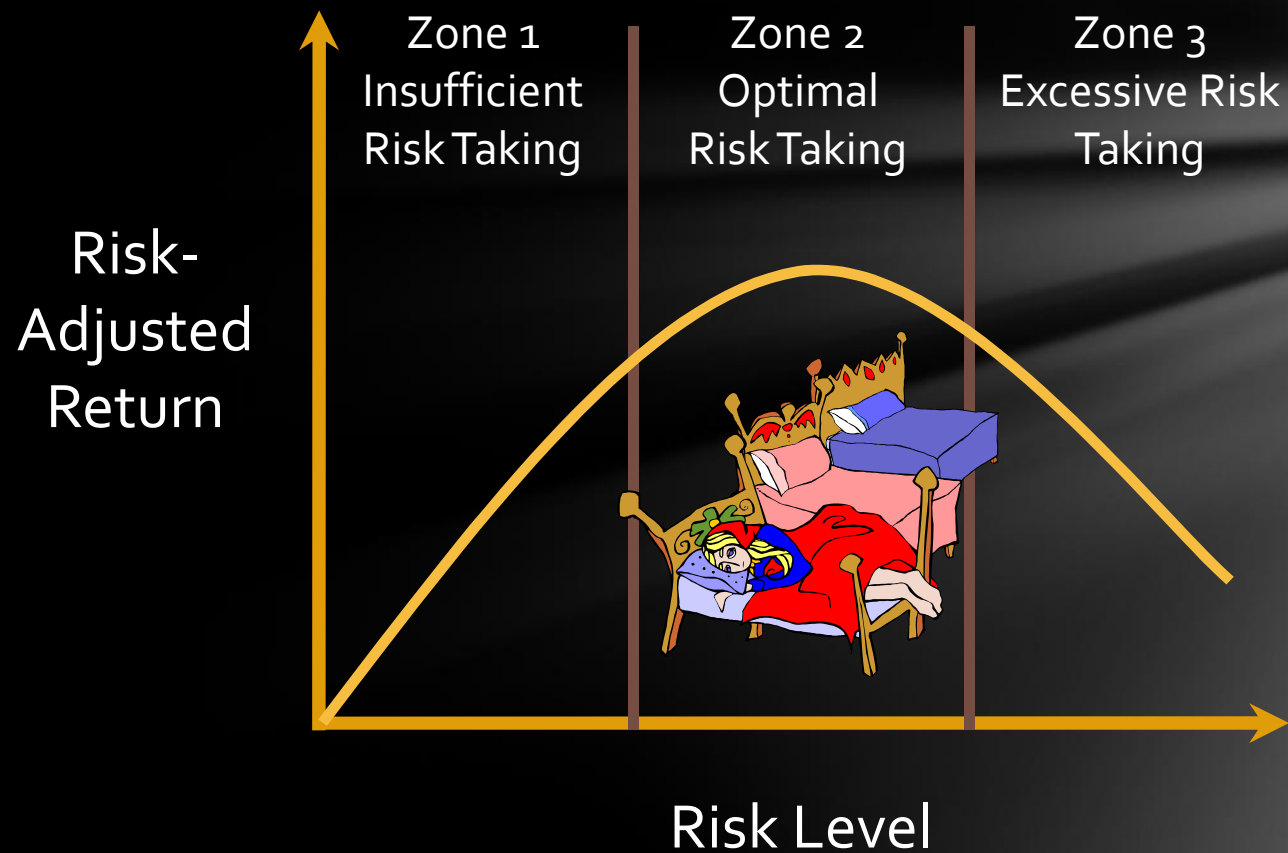
- *Bottom-line*
- *Business orientation*
- *Informative*

Why we need it?

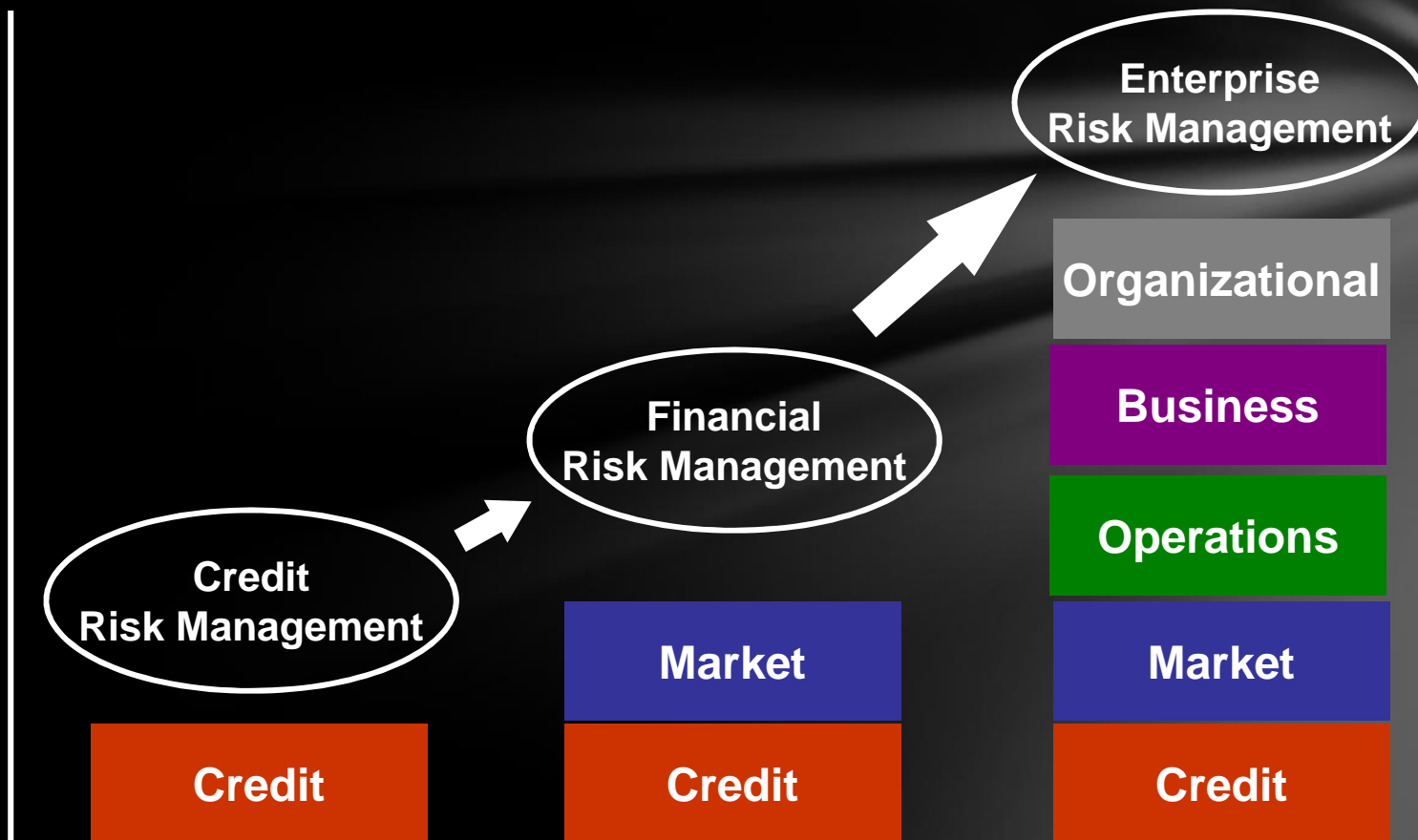
- An organization's opportunity for success is only as good as its collective ability to make good decisions
- Each and every improved decision positively impacts the organization's brand and financial standing
- It is impossible to effectively manage what you don't see and measure

Risk vs. Return

"*Risk and return*" is an inseparable concept



Evolution of ERM



A Conceptual View of Risk Management



Failures of The Past

- *Lack of transparency*
- *Sr. management engagement*
- *Uninvolved Board*
- *Reactionary processes*
- *Devoid of risk tolerances*

Program Necessities

- Culture
- Broad organization involvement
- Proactive and systematic processes
- Transparency
- Risk quantification
- Risk Appetite
- Operational and Strategic integration
- Business risk focused
- Action oriented

Keys to Your Success

- Data collection - Discussion and validation
- Culture / business ownership
- Board and Management
- Integration
- Quantification



Risk Matrix

Risk Unit: Accounting

+ Add new record

Open Date	Close Date
03/01/2011	
03/01/2011	

Exposure Details

Open Date: 3/1/2011

Close Date:

Risk Unit: Accounting

Strategic Objective: Technology - 1.0 Implement Star Wars Con

Short Risk Description: Inaccurate DR card and CC postings and a

Risk Category: Liquidity

Complete Risk Description: CU receives duplicate and otherwise inaccurate transactions from vendor and posts all of the transactions to member accounts, increasing member disputes

Impact: 8 - \$2.5M to \$4M

Likelihood: 4 - 70% to 90%

Mitigation: 2 - 95% to 99%

Insurance Coverage: Not specified

Impact Amt: 300,000

Policy References: Investment Policy

Likelihood %: 80.0000 %

External Factors: Out-Of-Pocket Loss

Mitigation %: 97.0000 %

Response: Accounting personnel review each adjustment and run the transactions through a settlement suspense account, and Risk personnel also review the

Quantification Description:

Response Last Validated:

Auditor: The Auditing Firm

Investment Amount:

Vendor: Not specified

Risk Reduction Amount:

RAP Section: Key Risks

Period: Q1 2011

Refresh

Impact	Likelihood
- \$325K to \$625K	4 - 70% to 90%
- \$2.5M to \$4M	4 - 70% to 90%
9 - \$4M to \$6M	3 - 30% to 70%
3 - \$75K to \$150K	4 - 70% to 90%

Risk Examples

Contact Center - Lack contact with member during loan process

Inherent Risk = \$2,000,000 Residual Risk = \$600,000

IT - Lack of formalized change control process

Inherent Risk = \$500,000 Residual Risk = \$250,000

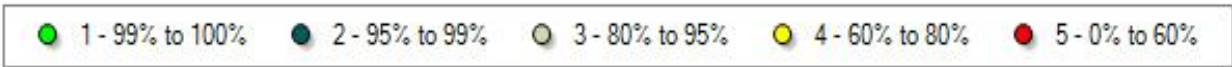
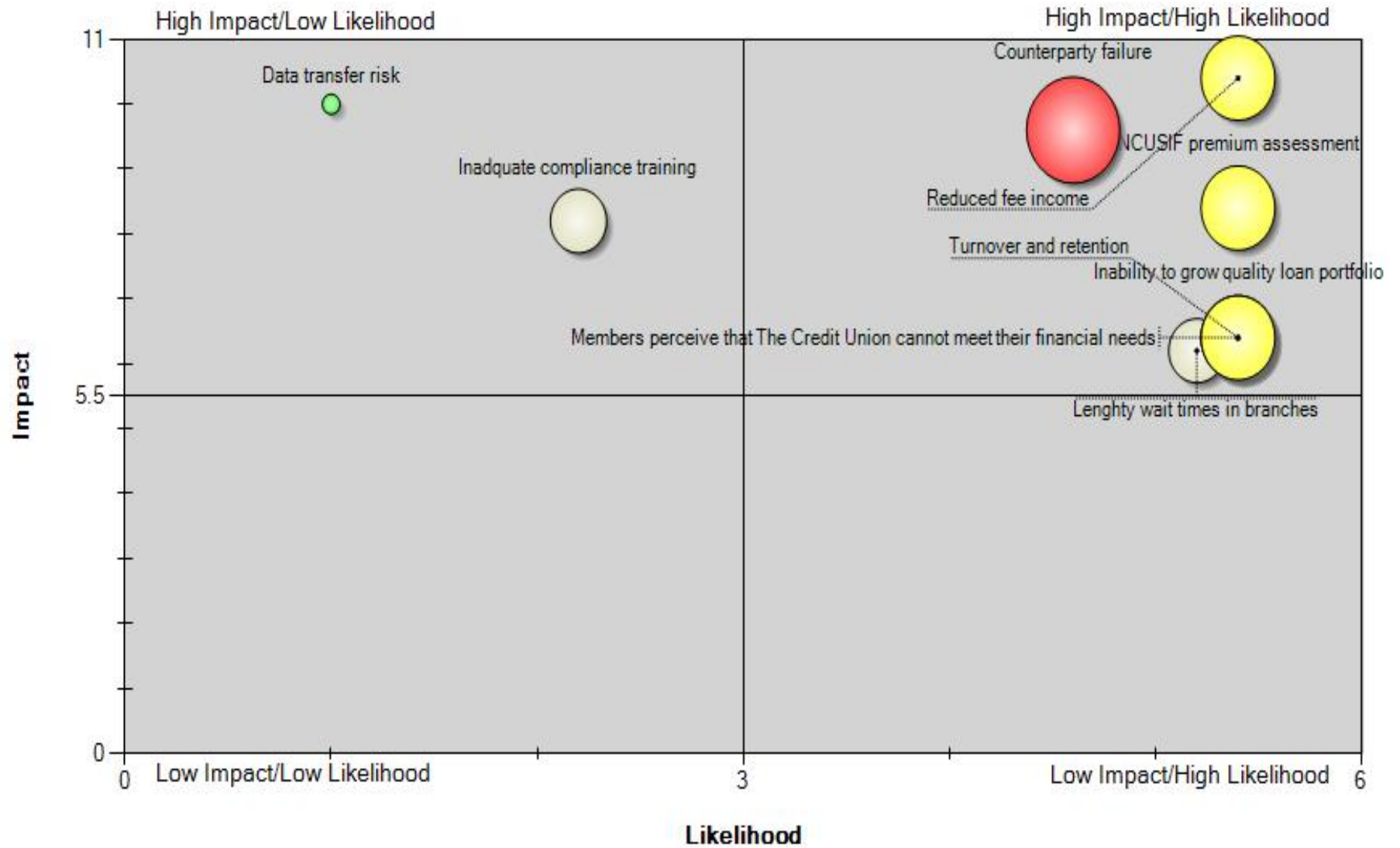
IT - Security breach compromises member data

Inherent Risk = \$4,250,000 Residual Risk = \$2,125,000

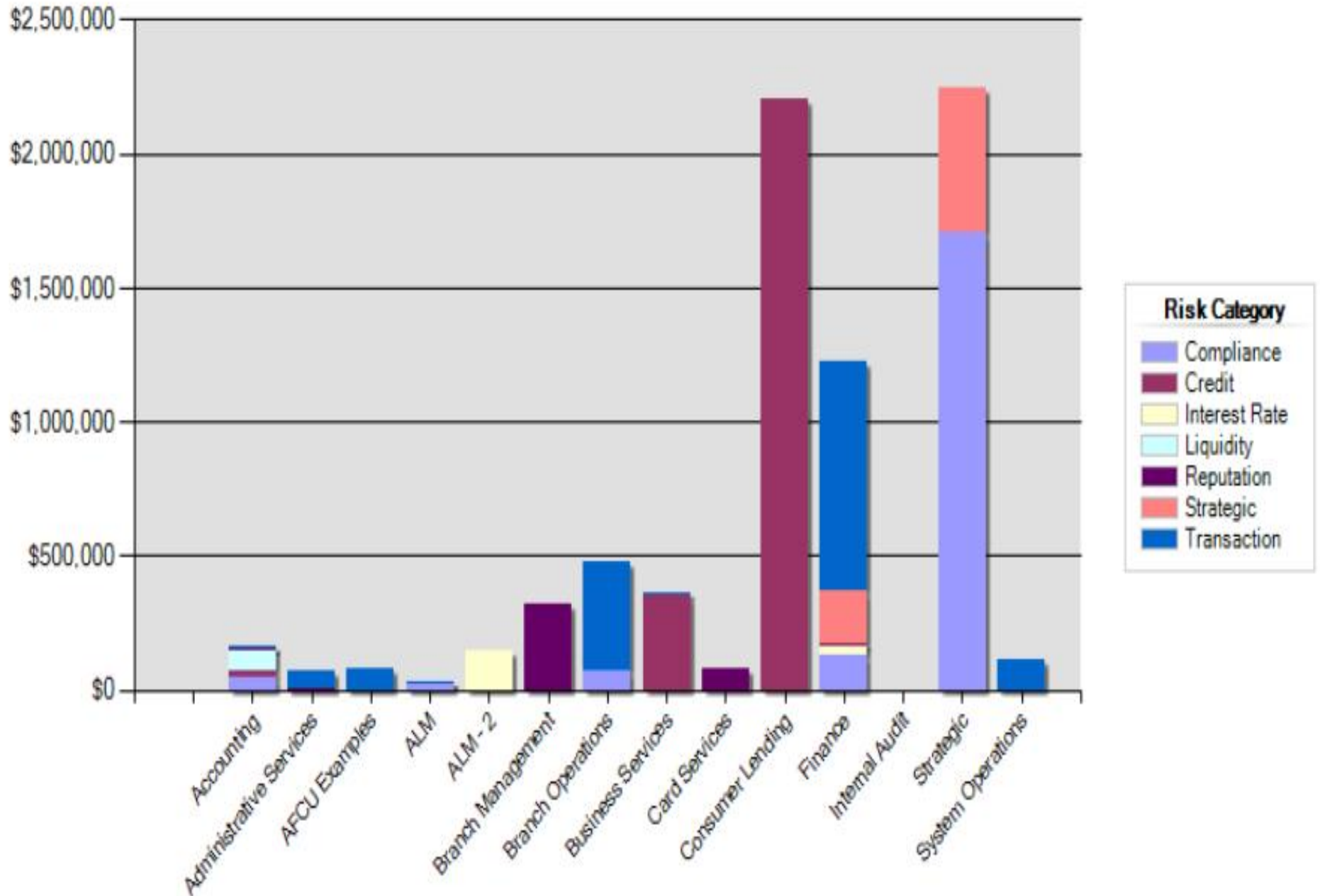
Debt Management - Missing contact information

Inherent Risk = \$2,000,000 Residual Risk = \$600,000

Heat Map Risk Action Plan

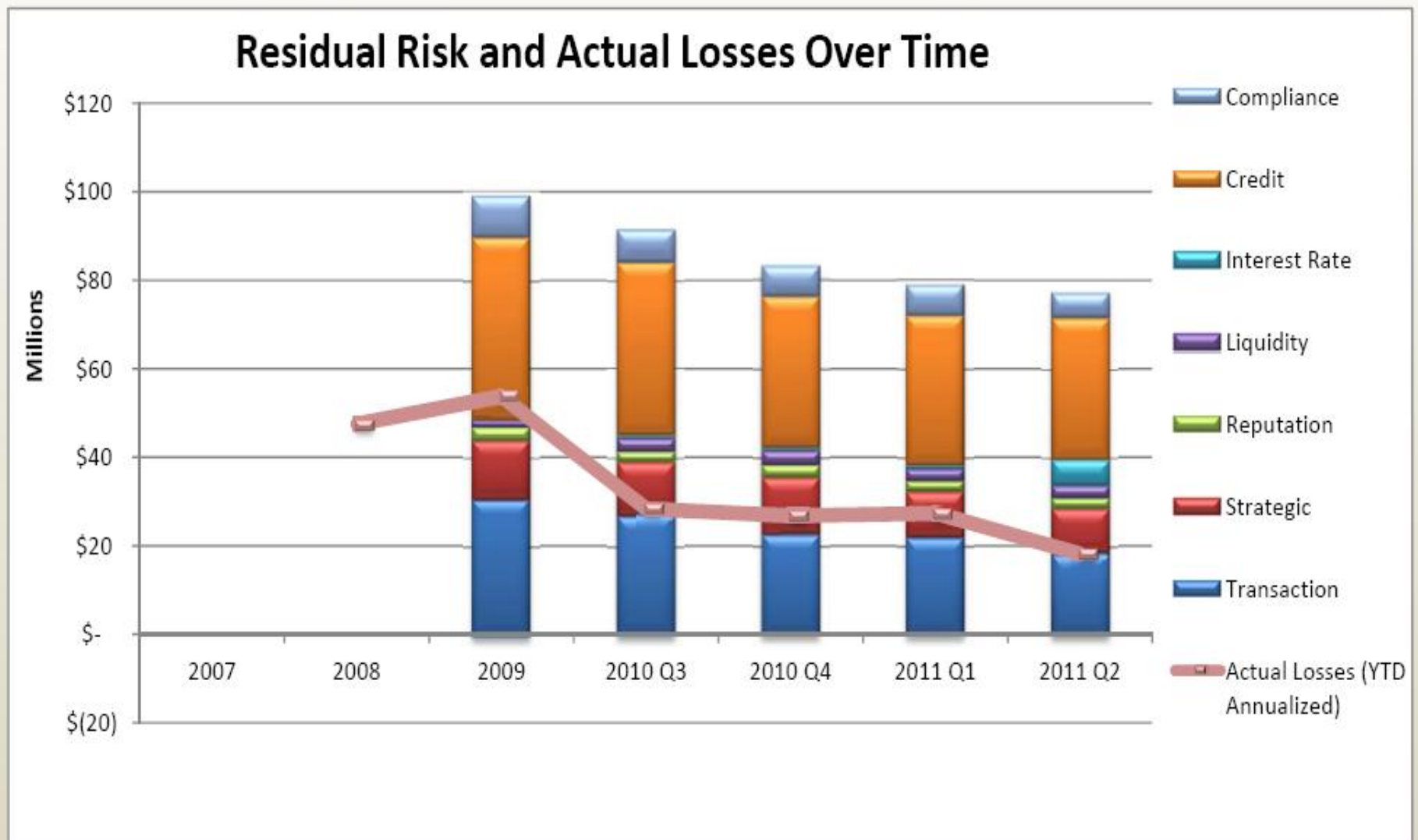


Residual Risk by Risk Unit



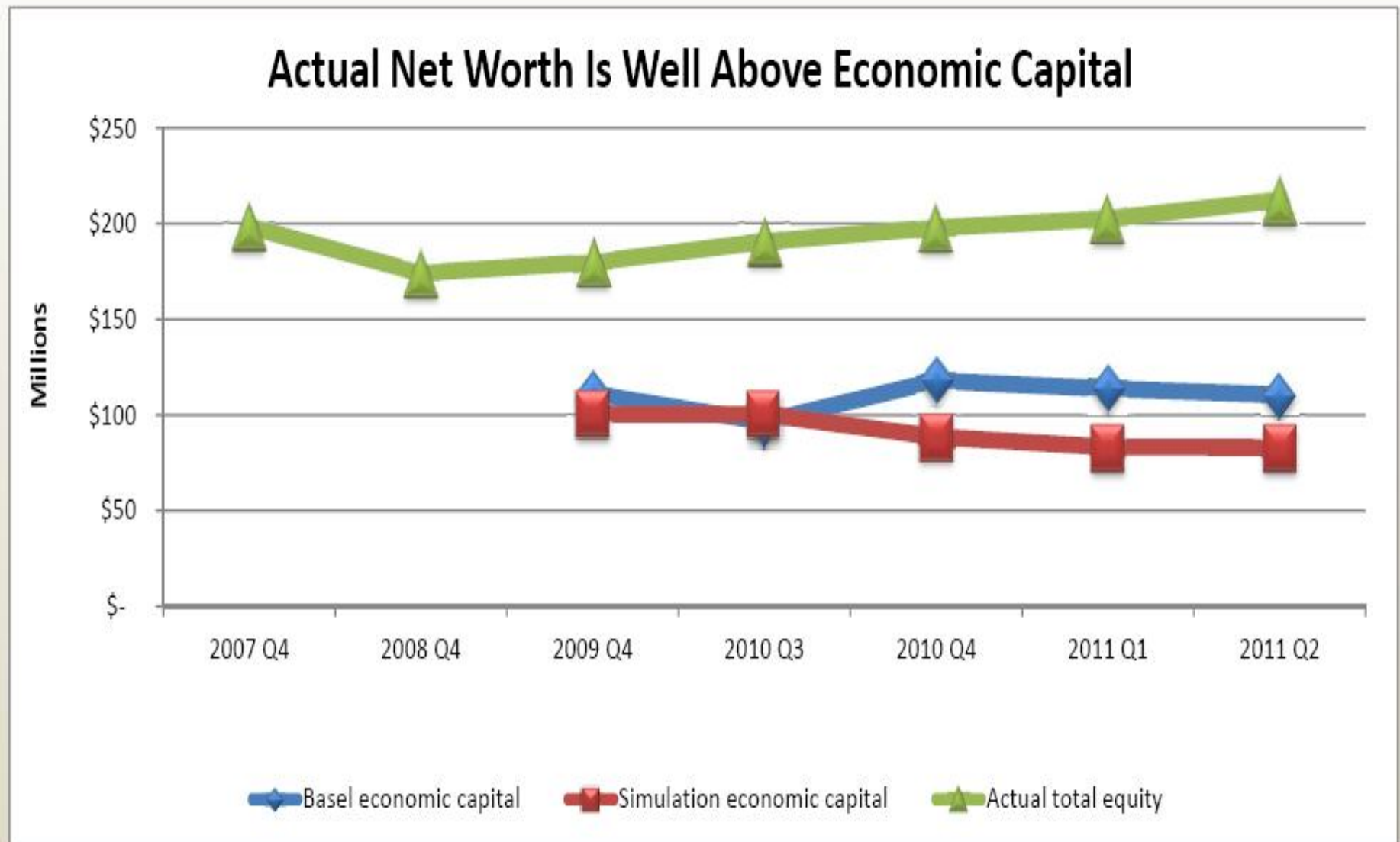
Residual Risk and Actual Loss Trends

Residual risk represents the impacts and likelihoods of the exposures, reduced by the mitigating effects of the procedures that Credit Union uses to manage the exposures. This chart shows the trends in residual risk, broken down by risk category in a bar chart, compared to an actual loss trend line. (Note that the actual loss figures as of the non-year-end periods are annualized year-to-date figures as of those times.)



Total Equity in Comparison to Economic Capital

In Credit Union's case, actual capital is more than twice as large as its economic capital, indicating an abundance of capital given the risk position.



Ongoing ERM Process

- Regular RMCO meetings
- Regular risk reviews
- Board and management reporting

- Robust discussion and decision making

Structure

Board

- Commitment for ERM process
- Culture placing importance on risk management
- Risk centric strategic planning

Board Risk Oversight Committee

- Detailed review of periodic ERM reporting
- Ongoing risk appetite and tolerance discussions

Management

- Identification and assessment of exposures
- Continual improvement of mitigating responses
- Incorporating ERM concepts in new products/svcs

ERM Function

- Ongoing leadership and coaching
- Risk assessment and action planning
- Quarterly report development and presentation

Operational RMCO

- Support for ERM process
- Cross-functional input on risk ID and assessment
- Identifies and acts on emerging risk issues

Existing Risk Functions

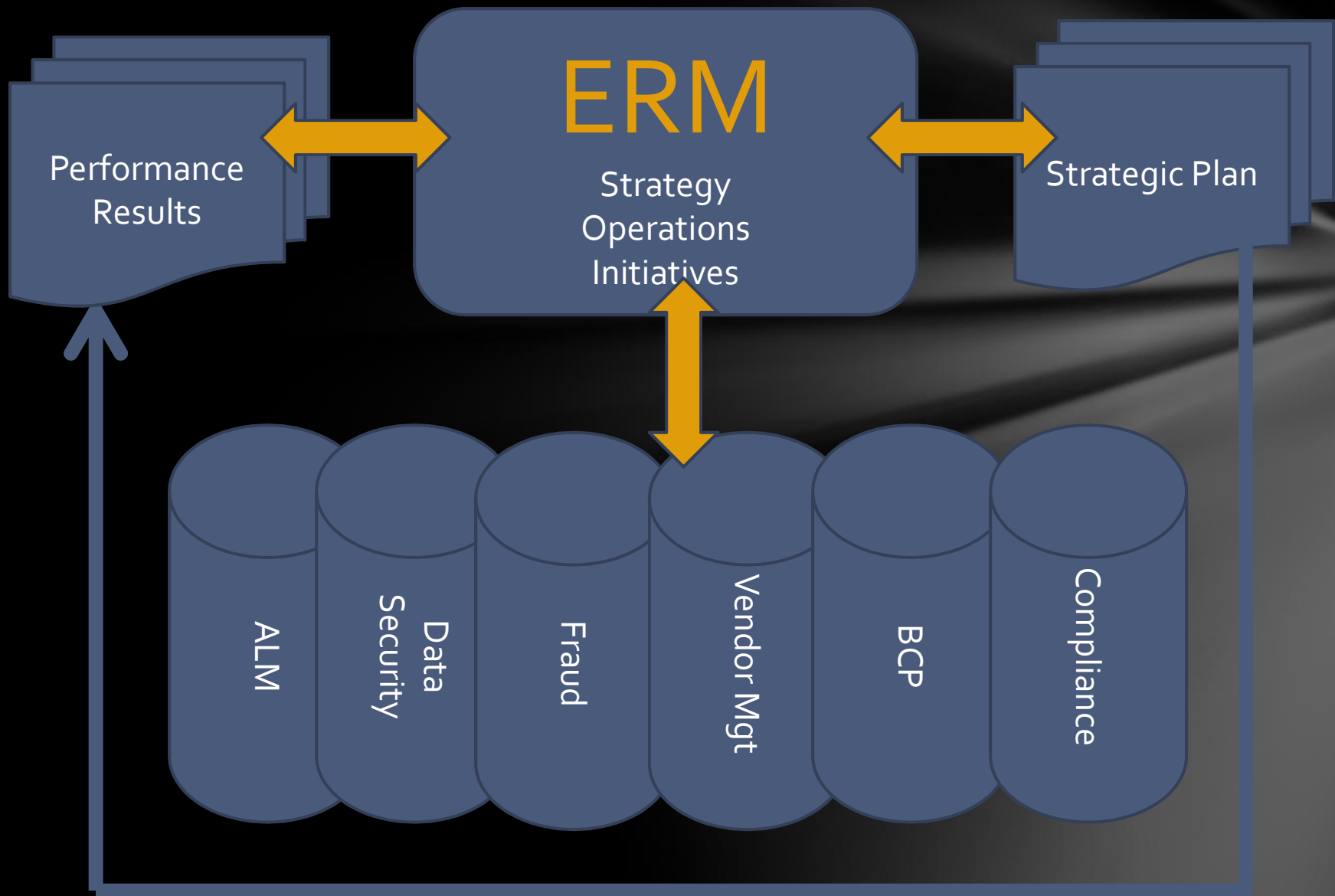
- Close working relationships with ERM function
- Sharing of output to avoid duplicative efforts

Overall Integration

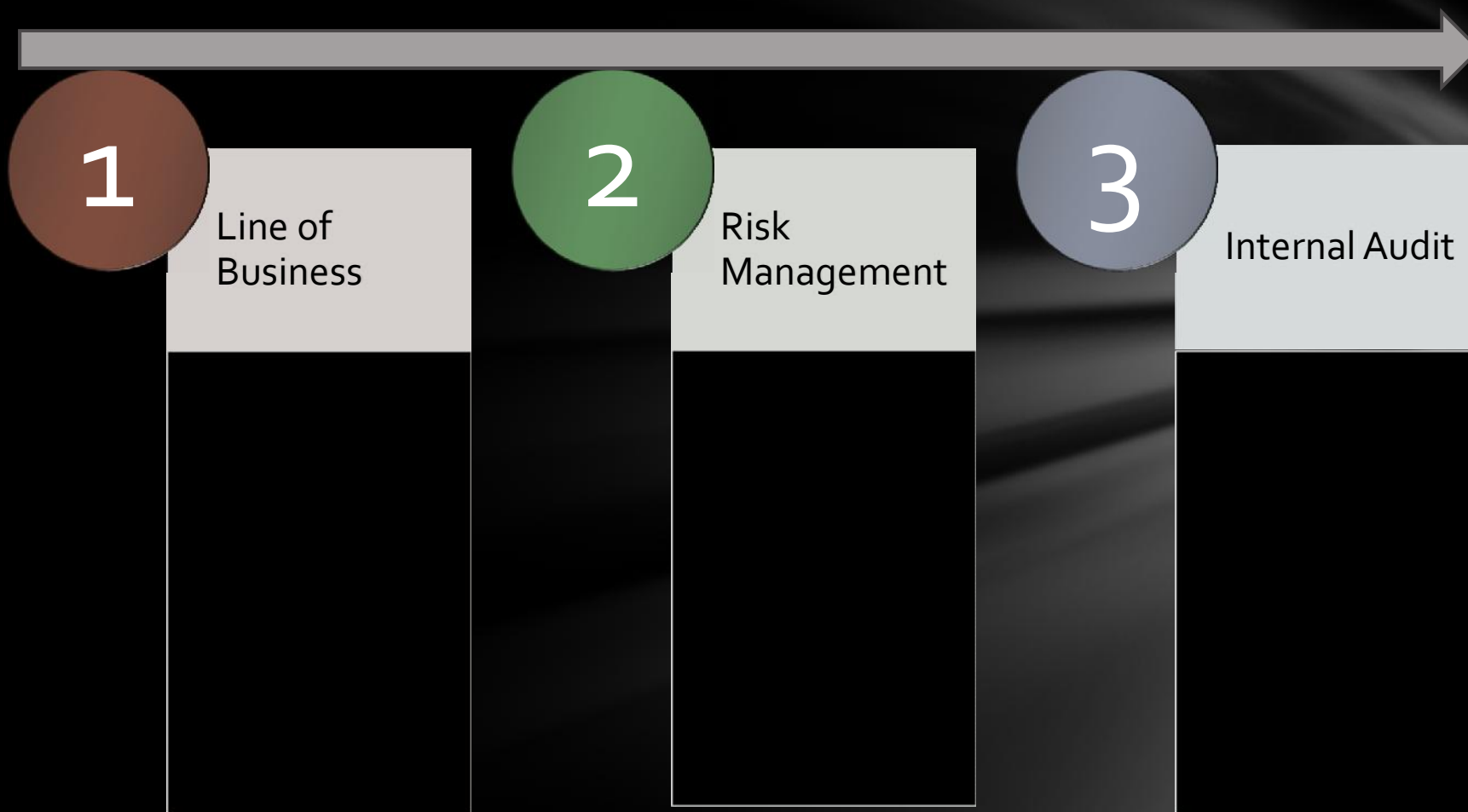
ERM must be integrated throughout organization

- Vertically from the board room down the line to employee cubicles and front-line teller stations
- Horizontally across functional areas, vendors, CUSOs, etc.
- Within new products, services, etc.
- If an institution's strategy and objectives are not determined or communicated effectively, the ability to understand or maximize ERM's value is impaired

ERM – The Connection



Lines of Defense



Audit Function – Two Roles

1. Review, assess and validate mitigation activities
2. Ensure adequacy and robustness of ERM program

Audit Function

- Establishes risk-weighted focus
- Supports secondary review of controls / response mitigation
- Acts as last line of internal defense
- Participates frequently on Risk Management Committee

At the end of the day...

- Given that risk management should be a core competency of the organization, everyone needs to play an active role in risk management!



ERM Program Assessment

Your ERM Program Must...

Assist management in achieving the entity's performance and profitability targets and preventing loss of resources

Ensure effective reporting and transparency of significant strategic and tactical risks and emerging issues

Avoid damage to the entity's reputation and associated consequences

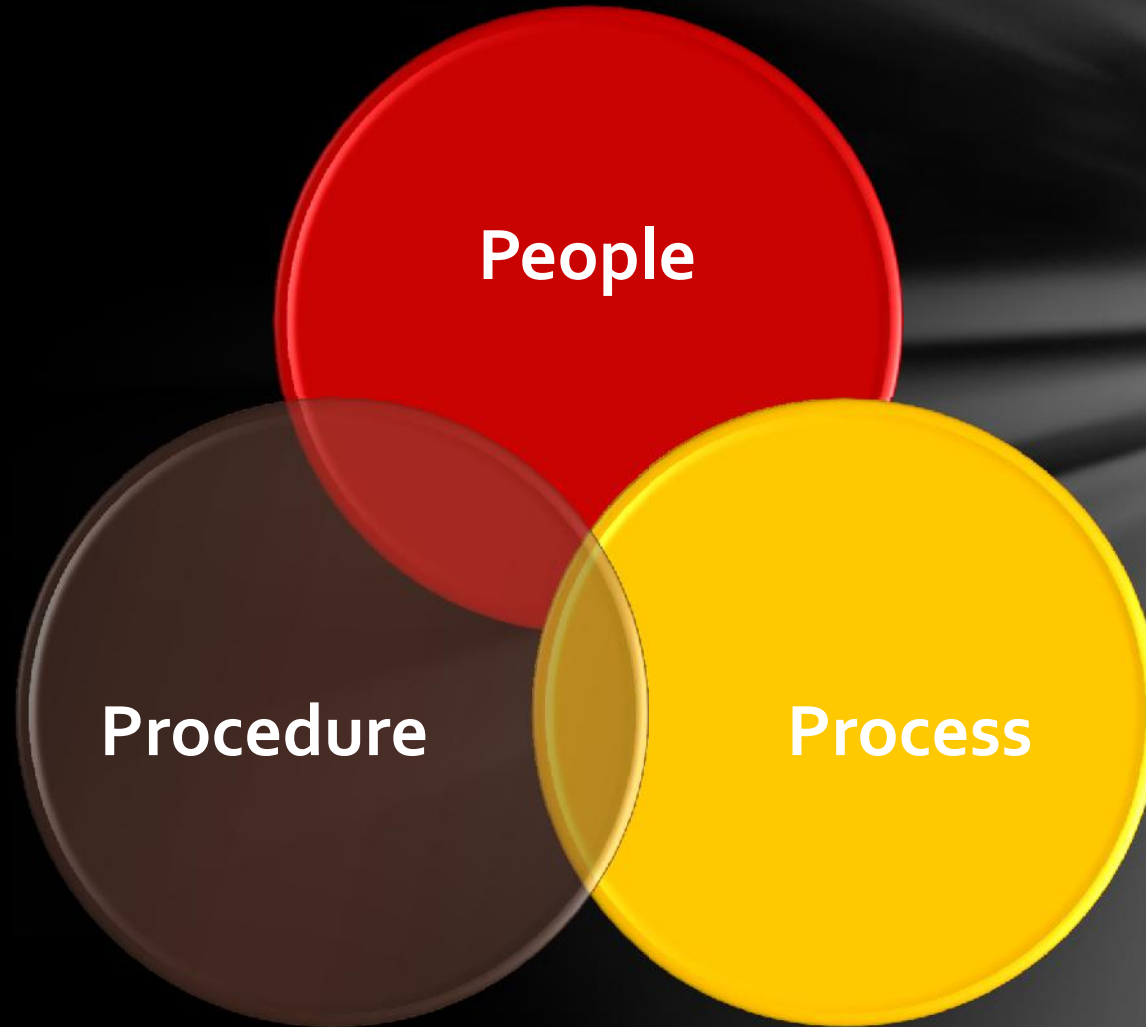
Help the entity get to where it wants to go and avoid pitfalls and surprises along the way

Premise for Program Evaluation

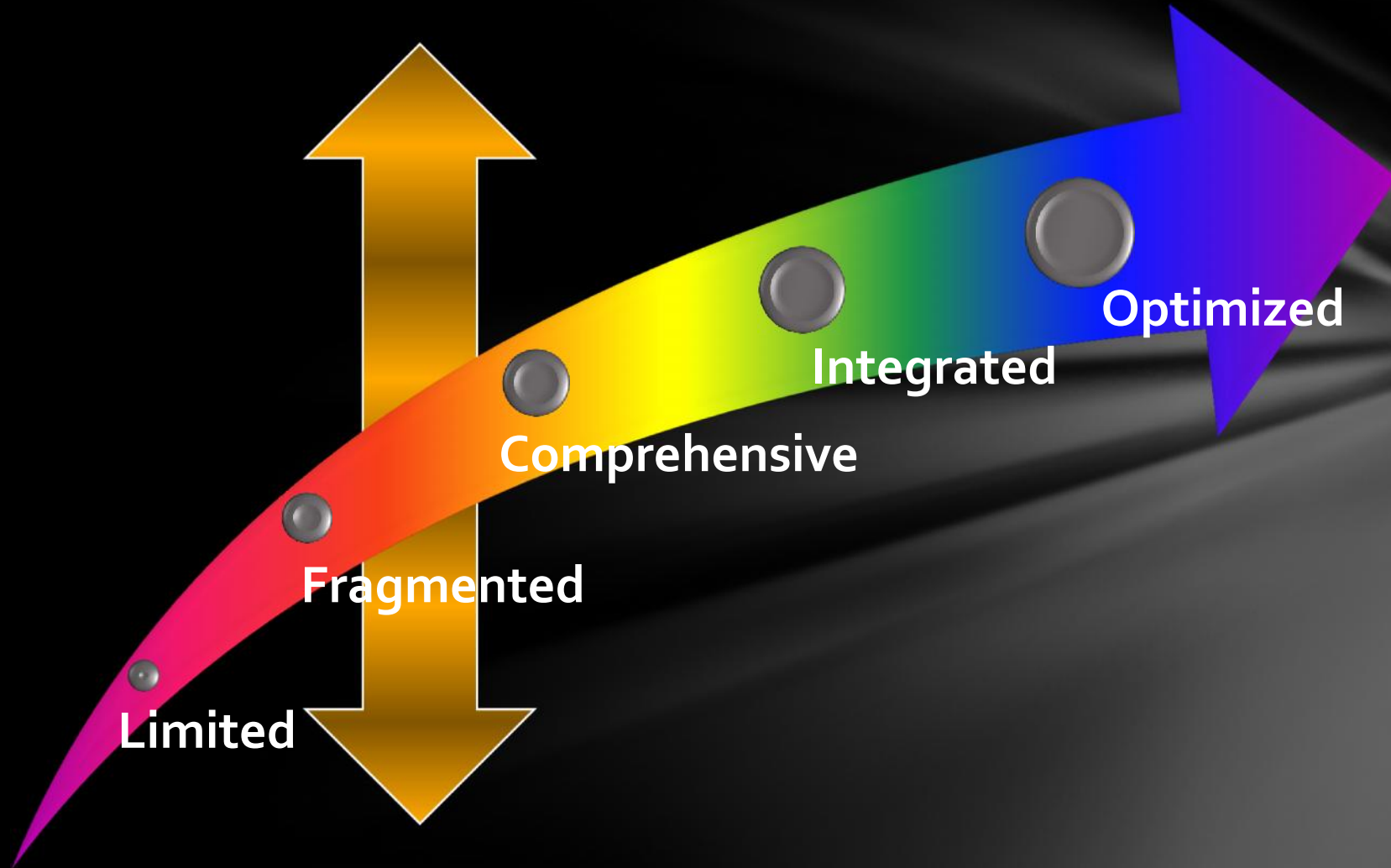
- Assessing program capabilities
- Proactive risk Identification and management
- Board & management Involvement
- Organizational integration



Evaluating Your Program

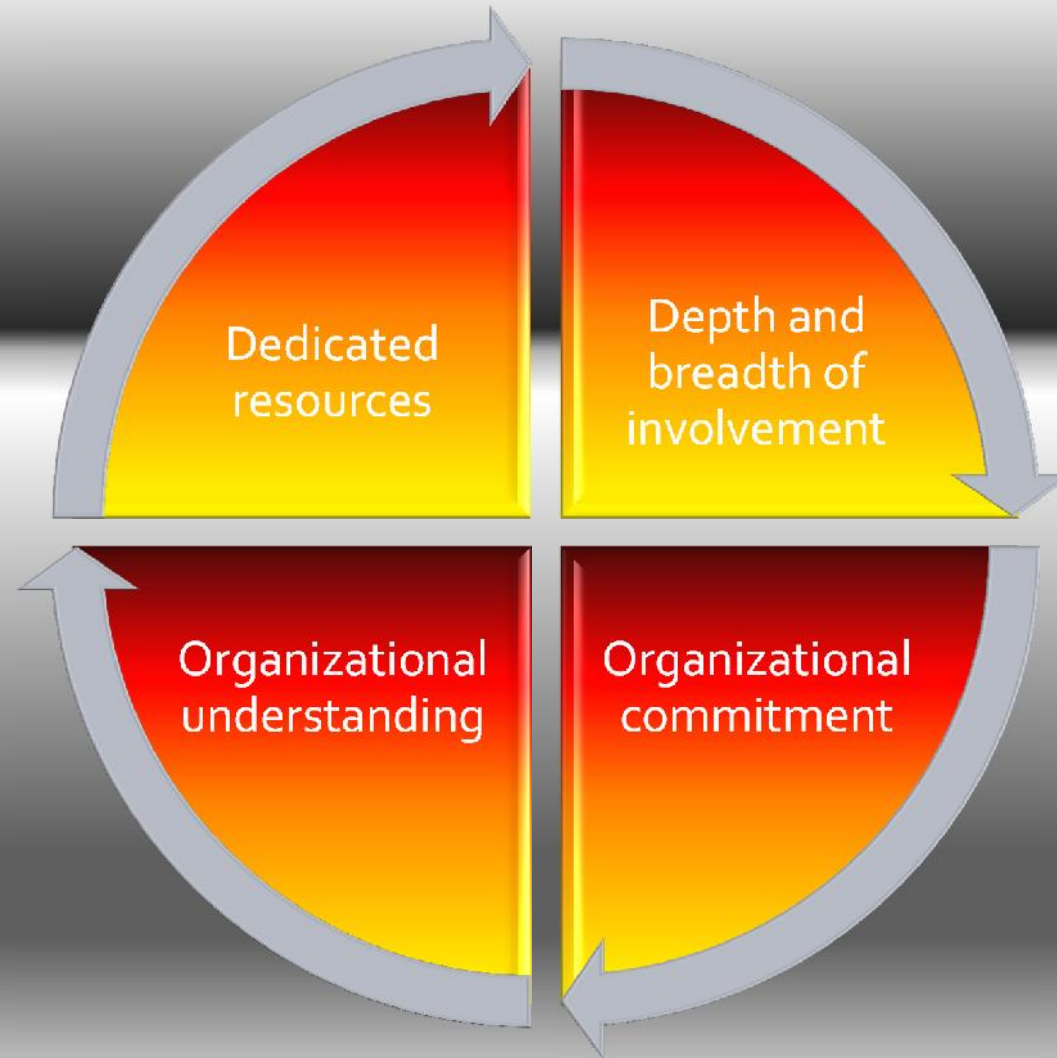


ERM Program Maturity

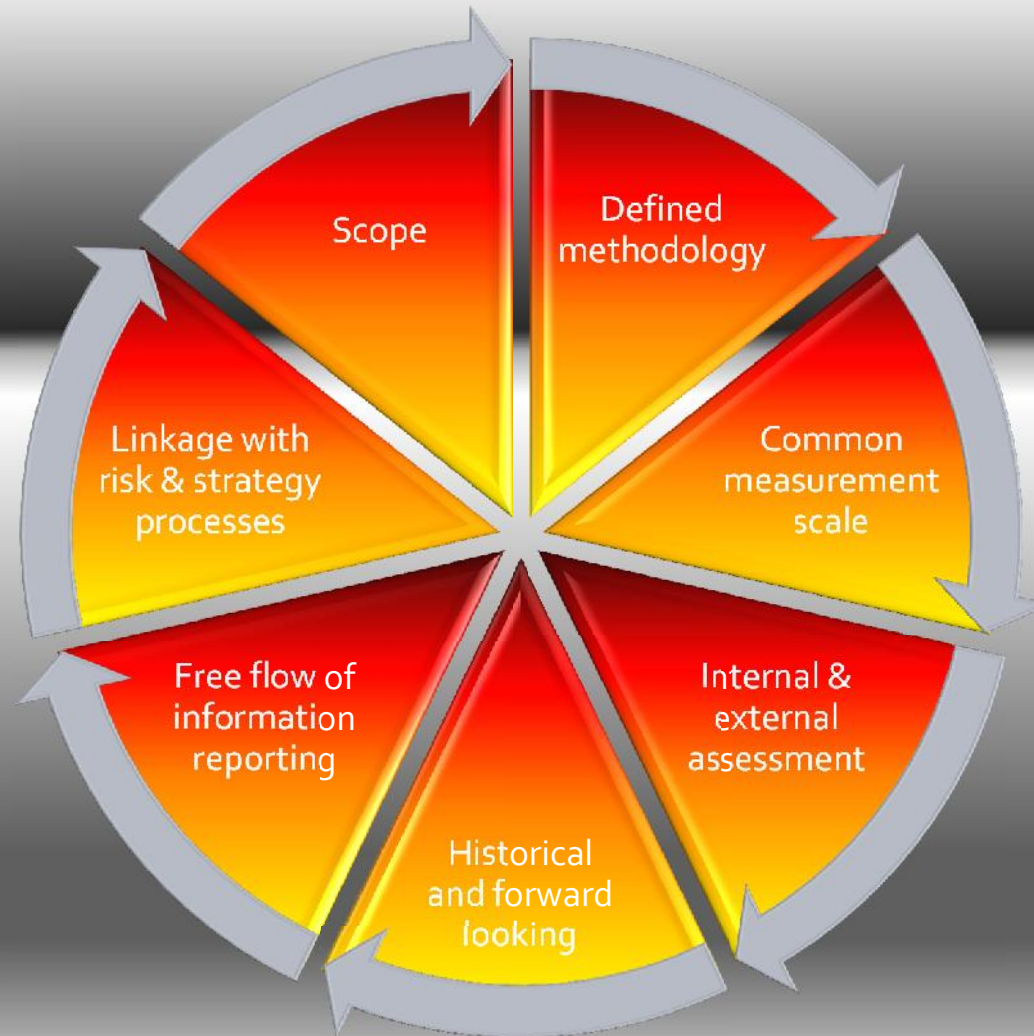


<p style="text-align: center;">Limited</p> <p style="text-align: center;">WEAK</p>	<p style="text-align: center;">Fragmented</p> <p style="text-align: center;">WEAK</p>	<p style="text-align: center;">Comprehensive</p> <p style="text-align: center;">MODERATE</p>	<p style="text-align: center;">Integrated</p> <p style="text-align: center;">STRONG</p>	<p style="text-align: center;">Optimized</p> <p style="text-align: center;">STRONG</p>
<p>Risk activities are ad hoc with no organizational risk objectives or tolerances defined.</p>	<p>Risk functions are handled disparately across the organization by individual business units. Risk factors are limited to business continuity, Info security, financial and compliance within business silos.</p>	<p>Risk is evaluated organization-wide and attempts to assess all risk types. Limited integration with strategic and business decision making. Risk evaluation is limited to qualitative measures.</p>	<p>Risk management practices are tightly integrated with strategic and business decision making. Risks are aggregated by risk type.</p>	<p>Risk management is utilized for predictive modeling and value creation through opportunity exploitation. Risks are well defined and quantitative. Risk management is institutionalized.</p>
<ul style="list-style-type: none"> - Limited risk experience - Risk responses are reactionary - No risk policy - No risk function - Success is based on individual employee response of risk 	<ul style="list-style-type: none"> - Risk expertise is limited predominately to BCP, ALM, Info Security & compliance - Risk communication is silo'd within individual areas - Risk management is reactionary - Risk management responses are procedural in nature - Limited risk controls testing 	<ul style="list-style-type: none"> - Risk function has been established - Organizational understanding of risk mgt - Criteria for measuring likelihood and impact are established - Risk tolerances have been established for significant risk factors - Comprehensive collection and communication of organizational risks - Ongoing risk priority plans are developed and managed - Risks are internal in nature with limited predictability - Risks are measured in qualitative terms - Annual assessment of risk environment is performed - Risk management process, methods controls are tested 	<ul style="list-style-type: none"> - Part of strategic planning framework - Integration with traditional risk management activities - Balanced qualitative and quantitative risk measures - Risk tolerance is formulated and managed as part of organizational goals - Strong risk management culture organizationally - Strong board and staff understanding - Risk measures are calculated and aggregated across organization - Risk profile is communicated organizationally - Methodology for evaluating inherent and residual risk is present - Risk program is forward looking - Predictive indicators and organizational influencers have been established - Continuous assessment methodology has been established 	<ul style="list-style-type: none"> - ERM value is quantified and measured in both strategic benefits and bottom line dollars - Risk management expertise and organizational linkage has been institutionalized - Strong risk management benchmarking and best practices have been established - Integrated risk management application has been implemented - Capital allocation models have been developed and installed to maximize risk-adjusted returns

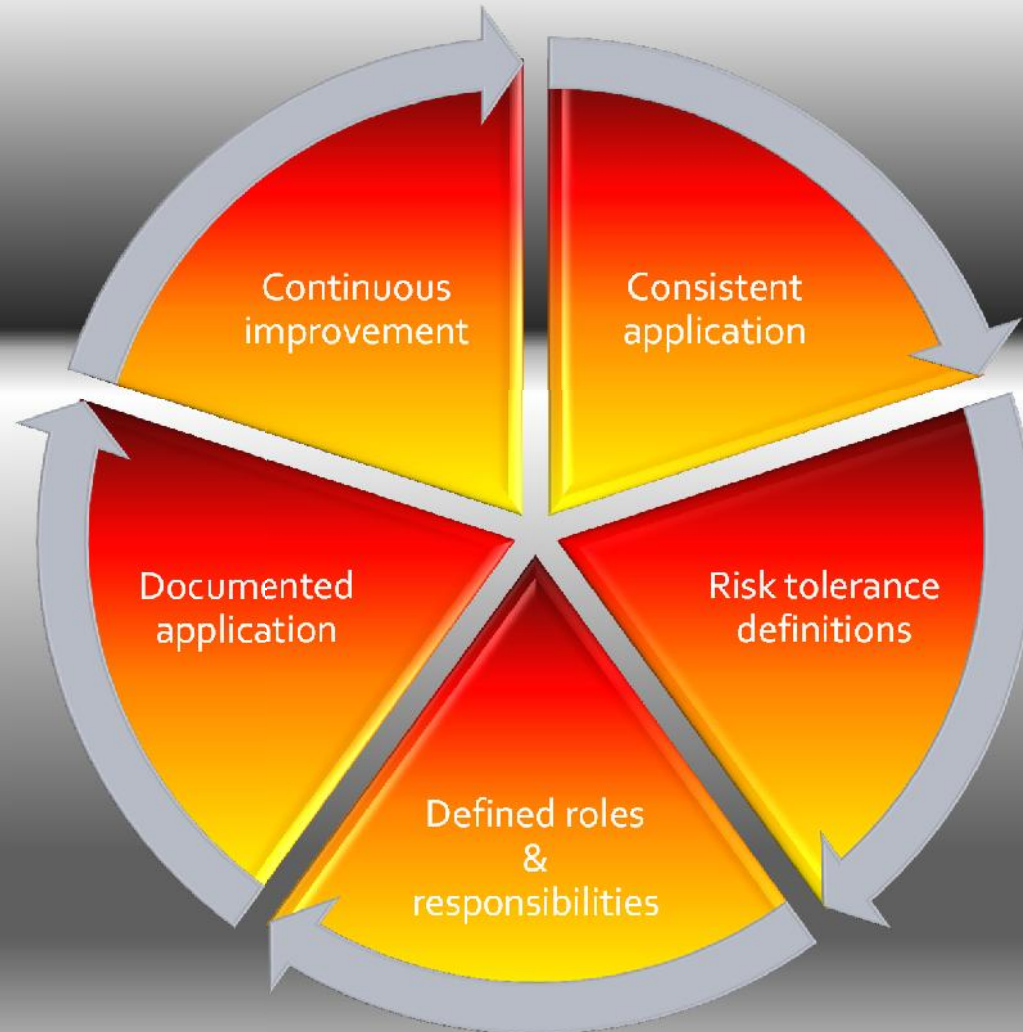
People



Process



Procedure



Conclusion

It's about improving financial returns on organizational efforts and capital deployed by delivering proactive and measured data

Questions

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