STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association CUNA

CREDIT UNION Directors NEWSLETTER

SEPTEMBER 2017
VOLUME 43
ISSUE 9

Adopt a Holistic View of Risk

GRC builds on the foundation of enterprise risk management.

Ever since the first credit unions were organized, credit union volunteers have looked for ways to meet members' financial needs while simultaneously managing the risky business of doing so.

But with credit unions increasing in size and complexity, "there's more pressure than ever on boards to understand what it is they are supposed to be doing and what they ought to be involved in," says Randy Harrington, CEO of Extreme Arts & Sciences.

To accommodate this surge in responsibility while keeping a focus on their twin missions, many credit unions have adopted an approach known as governance, risk management and compliance (GRC).

Each of these components have been around for a long time: Leaders govern, and they manage risk and compliance responsibilities. What's different is the integration and coordination of these elements to support and improve an organization.

> 'UNDERSTANDING AND ACCEPTING RISK AT A STRATEGIC LEVEL CAN HELP EVERYONE FOCUS.'
>
> DOUG FERRARO

Building on ERM

GRC builds on the foundation of enterprise risk management (ERM), which has become the standard for risk professionals, says Tony Ferris, CEO of The Rochdale Paragon Group, a CUNA partner.

ERM not only involves the methods and processes to identify, measure, and manage risks, it seizes opportunities related to the achievement of the credit union's goals.

According to "Contrasting GRC and ERM: Perceptions and Practices Among Internal Auditors," a report from the Institute of Internal Auditors Research Foundation, GRC is "the manner in which a board of directors (trustees) ensures an organization attempts to meet its objectives by identifying and managing risks and obtaining assurance that controls (including compliance) are in place and efficiently and effectively mitigating risk."

Harrington points out that all components of GRC are the board's domain:

- **Governance** is the process of putting expectations into operation—the art of producing policy that you can write down.
- **ERM** is a tried-and-true risk management system that enables an organization to avoid being blindsided.
- **Compliance** is often seen as an expense or as a set of constraints. But credit unions can use it as an offensive tool—an opportunity to become a healthier institution.

"GRC brings together more pieces than ERM. It's like layers of an onion, with ERM at the center," Ferris says.

An evolving process

GRC is not a one-and-done project. The nonprofit think tank OCEG describes the components of the GRC model as learn, align, perform, and review.

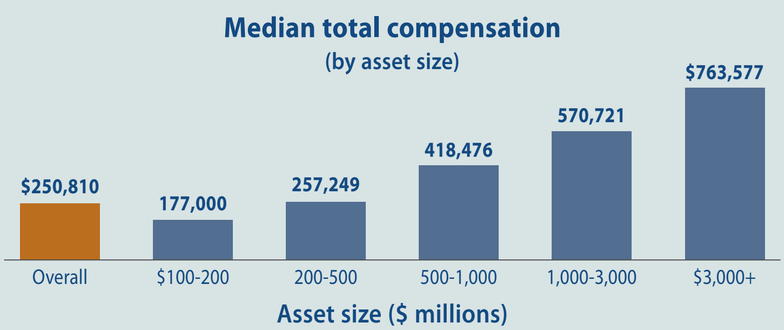
"It's a constant assessment process," says Doug Ferraro, president/CEO of $4.3 billion asset Bellco Credit Union in Greenwood Village, Colo. "Our strategy is to look at areas of risk that benefit our members."

Many boards simply react to problems, says Ferris. "One board member will experience a hiccup with a service, and then the entire board starts talking about a particular hiccup."

QUICK TAKE FOR YOUR NEXT BOARD MEETING

CEO Compensation Inches Upward

The median total compensation in 2017 for CEOs from credit unions with assets of $100 million or more is $250,810, up from $247,500 the prior year, according to CUNA's 2017-2018 CEO Total Compensation Report.



*Excludes employee retirement, pension, profit-sharing, and supplemental executive retirement plans
Source: *CUNA's 2017-2018 CEO Total Compensation Report*

- CUNA Governance, Risk Management & Compliance Leadership Institute, Oct. 2-4: *cuna.org/grc*
- Rochdale Paragon Group: *rochdaleparagon.com*

The result is a discussion that quickly can stray from the strategic to micromanagement. GRC can take the bias out of decision making, and it allows the board to challenge management.

"Management wants to be challenged, but often boards don't have the right tools to ask the key questions," notes Ferris.

To that end, adopting GRC has prompted Bellco to make structural changes. The credit union altered its committee structure to not only have a supervisory committee, but also a risk committee to monitor its risk profile.

The risk committee focuses on interest rate, liquidity, credit risk, and information technology security. Committee members evaluate short- and long-term risk elements.

The committee meets quarterly rather than monthly, Ferraro says, to avoid being too reactive and "to get a feel of trends instead of blips."

Understanding risk allows you to understand opportunity, says Ferris. "If you don't understand risk, you might be overly conservative," he says. "If you do understand it, you're much more inclined to pull the trigger."

Operating within a framework of GRC allows faster and better decisions, he says.

At Bellco, accepting credit risk has become an accepted practice, says Ferraro. "We make loans that others won't make. We know our members, and we know how to price our loans. But we won't accept long-term interest rate risk. We've made a conscious decision, and that helps us avoid being distracted."

Risk management can't prevent risk, Ferraro emphasizes. "But understanding and accepting risk at a strategic level can help everyone focus on the idea that if we have the best information, we can be the best credit union, and in the best position to meet our members' needs," he says.

CUNA board and volunteer training and resources: *cuna.org/volunteer*

Boards Should Focus on 'Central Ideas'

Consider whether these ideas are sound, driven by trends, and capable of execution.

The best boards ask the best questions.

That's because they know asking probing questions leads to good ideas, says Jeff Rendel, president of Rising Above Enterprises. He addressed the 2017 CUNA National Credit Union Roundtable for Board Leadership in Las Vegas.

Board questions should focus mainly on "central ideas," which serve as the credit union's foundation, Rendel says. "Strategy derives from these ideas, and plans for execution are developed by the CEO and her team. For directors—and to remain strategic in thinking—focus on whether the ideas are sound, driven by trends, and capable of execution."

Some examples of central ideas and related questions board members should ask the CEO:

- **A differentiated member experience.** How do you measure the member experience? What have you learned and what have you changed? What's on the horizon for the next level of member experience, and what investments will be required?
- **Strong lines of business.** What products drive most of our revenue? Are there products we offer that haven't met their potential with members? Are there products we should offer, discontinue, or reprice?
- **Noninterest income.** Where is our net interest margin headed? How do we manage our margins and interest rate risk? How much do we rely on noninterest income, and how will that change in the future?
- **Efficiencies.** Where is the credit union efficient, and where are greater levels of efficiency required? What investments are required to build efficiency in our processes? How do we measure efficiency, and what results do we expect?
- **Strong workforce.** What culture is necessary for the credit union to make strategic progress? Do we have that culture? How are we developing our next generation of managers and executives? Do we offer competitive compensation?

Board members should require the CEO to provide quarterly updates on the plans, progress, and results for these central ideas, Rendel says, and conduct occasional "deep dives" that discuss strategic factors behind the ideas.

"You need to ask, what's in it for the members?" he says. "Ensure that you address the near-term member experience while managing long-term value."

Improve Your Director Onboarding Process

Follow these 10 steps to prevent new board members from flailing.

As is the case with many industries, credit union internal training and development processes aren't always what they should be. Many people have to either sink, swim, or just tread water.

It's the treading water category that creates the greatest challenge for boards and credit unions.

These directors:

- **Have been** strong enough not to drown, but are ill-prepared to swim. They have been treading water long enough to stay on the board but aren't ready for prime-time governance.
- **Ride the current.** They have good attendance and you can always count on them to make a motion or second, but they rarely speak up, ask strategic questions, or take a stand. They tend to follow the leader.

I frequently receive feedback about these treaders—comments such as, "They're just a warm body" or "They don't make any waves and support all our decisions." Both descriptions frighten me.

Today's directors have to be good at strategic inquiry. To reach that point, they must have ample education, preparation, and clear governance expectations.

Onboarding ideas for a stronger board

An effective director onboarding program makes it possible for your credit union to develop, get the most from, and retain the best board members. Consider these 10 ideas on how to structure such a program:

1. Onboarding policy. Outline your program, noting clear roles, responsibilities, expectations, and outcomes. Executing the policy is your road map to success.

2. Orientation. Explain how the board governs and operates. Transfer information about the established direction, expected outcomes, values, vision, mission, and traditions of your credit union. Invite your marketing department to explain the credit union's brand and unique value proposition. Address current strategic priorities and their importance. Provide an overview of the credit union's business model.

3. Meet and greet. Have an open house where directors can acquaint themselves with members and staff, and get a sense of the credit union's culture. It's been said that "culture eats strategy for lunch." Keep this in mind when establishing strategic priorities because you depend on credit union staff for execution.

4. Relationship building. Use regular meetings and other opportunities to build rapport, camaraderie, and inclusion. Stronger relationships and a high level of trust will result in more strategic thought, contribution, and action. Encourage new directors to weigh in and contribute. The more they do it, the easier it will become.

5. Formal education. The more directors know, the better decisions they will make. Provide education, internal or external, to deepen understanding of:

- **Governance** within specific roles and responsibilities.
- **Enterprise** risk.
- **Financial** statements and key operating ratios.
- **Regulatory** compliance.
- **Advocacy**.
- **Red flags**.

6. Engage them. Find committee opportunities for new board members right away. This will give them a chance to get to know the team better, provide an early sense of accomplishment, and shorten their learning curve.

7. Leverage contacts. Hopefully, your new directors arrive with contacts in the community and among select employee groups—or other areas that could translate into new business. Encourage them to make introductions and pursue those opportunities.

8. Mentor. Assign a mentor to new directors to provide encouragement and direction, answer questions, and develop and connect them as they become active members of the overall team.

9. Assessment. Check in frequently with new directors to gauge their progress and development. These are individual assessments, perhaps with the board chair or someone else the board chair assigns. It's separate from the board's group assessment, which should also occur annually.

10. Resources. The credit union space is full of excellent educational opportunities, including free NCUA training videos and first-class educational opportunities through CUNA or your league. When training funds are scarce, the board should make the most of free or low-cost opportunities.

Why it matters

High-performing credit unions always seem to have an equally high-performing board of directors.

Increasing your effectiveness at director onboarding will improve your organization's strategic direction. It's as simple as that.

SCOTT BUTTERFIELD *is the principal at Your Credit Union Partner* (yourcreditunionpartner.com).

CUNA volunteer certification school: *cuna.org/vcs*

CUNA board and volunteer training: *cuna.org/volunteer*

Know Your Cybersecurity Responsibilities

Establish a framework for mitigating exposure to threats.

Breaches, employee errors, and ransomware seem to hit the headlines almost daily. So it's no surprise that credit unions face a variety of rapidly evolving cybersecurity threats that require senior leaders and directors to be prepared to respond.

NCUA charges credit union directors with decision-making responsibilities that require them to act in the best interests of their credit union members, exercise reasonable investigations, understand the risks faced by their credit unions, and more important, understand the controls necessary to mitigate these risks.


iStock

ADDRESS THE RISKS AND EXPOSURES UNIQUE TO YOUR CU.

So, while directors don't need to be cybersecurity experts, they do need to stay sufficiently informed to fulfill their fiduciary responsibilities.

Safeguarding credit union and member data can be a complicated process that is best learned before a situation arises. Use this simple approach to establish the necessary framework for navigating today's cyber threat landscape.

Understand the landscape

Understand the landscape of cybersecurity threats, and be aware of the essential strategies for mitigating cybersecurity exposures. Study these resources for information and updates on cybersecurity risk and loss controls:

- **NCUA** cybersecurity resources.
- **Financial** Services-Information Sharing and Analysis Center (FS-ISAC).
- **CUNA Mutual Group's** Protection Resource Center.
- **The Federal** Financial Institutions Examination Council (FFIEC).

Set expectations

Work with credit union leadership to set expectations regarding the credit union's cyber risk appetite and lay the groundwork. Ask questions such as:

- **Where** do you want to be in the cyber risk environment?
- **What** risks can you absorb?
- **Which** risks require upfront loss controls?

Based on your cyber threat knowledge, you can drive many of the expectations at the credit union.

Develop a cybersecurity program

Next, ensure the credit union has developed a documented cybersecurity program that specifically addresses the risks and exposures unique to your organization.

These factors include network controls, data loss prevention, awareness training, staff and third-party expertise, monitoring, and incident response.

Provide oversight

"Trust but verify" is often the best approach to exercising adequate board of director oversight for the credit union's cybersecurity program.

That's one big reason your board should periodically review the program and ensure it is updated regularly. At a minimum:

- **Request** routine updates of the security posture.
- **Be prepared** to ask questions related to critical operational areas such as regulatory requirements, existing vulnerabilities, and remediation efforts.
- **Ask** how current controls compare with peers'.
- **Ensure** management and staff implement the plan and continuously monitor, measure, and enforce it.
- **Assess** cybersecurity insurance options to transfer risks that aren't economically practical to mitigate.

Unfortunately, financial services is one of the industries cyber criminals most heavily target. A cyber incident or breach can expose weaknesses, shake member trust, and cause reputational damage that can take years to repair. There are no easy solutions in this fight.

As a director, it's your responsibility to proactively manage cyber risk. Consider it a critical component of your strategic plan, and ensure that you stay educated, set expectations, and provide the necessary oversight to give your credit union the best chance at minimizing risks in a rapidly evolving cybersecurity environment.

CHRIS R. GILL *is a senior manager of risk and compliance solutions at CUNA Mutual Group. Contact him at* chris.r.gill@cunamutual.com.

Send us your comments: *directors@cuna.coop*

Follow: @CUDirectors

CREDIT UNION Directors NEWSLETTER

CREDIT UNION DIRECTORS NEWSLETTER (ISSN 1058-1561) is published monthly for $138 per year by the Credit Union National Association, 5710 Mineral Point Road, Madison, WI 53705-4454. (Multiple-copy discounts available.) Also available as a downloadable PDF for an annual subscription rate of $675. Periodical postage paid at Madison, Wis.

POSTMASTER: Send address changes to CREDIT UNION DIRECTORS NEWSLETTER, P.O. Box 461, Annapolis Junction, MD 20701-0461.
Advertising is accepted only from reputable firms, but inclusion of advertising does not imply endorsement by the newsletter or CUNA Inc.
Publisher: Ann Hayes Peterson, vice president and editor in chief, *apeterson@cuna.coop*
Editorial staff: Adam Mertz, associate manager, *amertz@cuna.coop;* Jennifer Woldt, senior editor, *jwoldt@cuna.coop*
Design and production staff: Ben Tenorio, digital media design specialist, *btenorio@cuna.coop*
Editorial: 608-231-4211 **Subscriptions:** 800-348-3646, fax 301-206-9789, or *cuna.org/directors*

AMERICA'S CREDIT UNIONS®