STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association CUNA

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Achieving Strategic Transformation

Consider your purpose and shorten your planning cycle for long-term success.

Credit unions can engage in strategic planning from a curbside seat that limits their view. But if they want to achieve a broader vision, they may need the equivalent of an aerial view to see where they are and where they want to go.

Experts say new approaches to strategic planning give credit unions the lift they need to set their sights on strategic goals that matter for long-term success. Those approaches include a shorter planning cycle and focusing on purpose.

TO ACHIEVE A BROADER VISION, CREDIT UNIONS MAY NEED AN AERIAL VIEW TO SEE WHERE THEY ARE AND WHERE THEY WANT TO GO.

For years, members of the International Association of Bridge, Structural, Ornamental, and Reinforcing Ironworkers Union from across the country called Ironworkers USA Federal Credit Union in Portland, Ore., to see if they could become members. At the time, the credit union was limited to serving union members and their families in five states.

"There is huge loyalty among ironworkers," says President/CEO Teri Robinson. But poor financial reports, including a 2010 income statement that showed a deficit of $80,170, had resulted in NCUA supervision. In strategic planning sessions, a broader charter seemed like something that could happen "someday."

Ironworkers USA Federal gradually launched affordable digital tools current members embraced and these tools strengthened financial performance. The credit union knew those same strategies could also make it possible to serve ironworkers nationwide.

"Our online services for members all came out of strategic planning sessions," Robinson says. "Members embraced remote deposit capture right off the bat because they work in remote places."

Individuals who saw members using mobile deposit during on-the-job breaks often asked for more information and then joined the credit union. From 2013 to 2017, Ironworkers USA Federal grew from 616 checking accounts to 2,500.

In 2018, the credit union obtained a national charter. In the year that followed, it grew from $24 million in assets to $38 million as of June 1, 2019. Net income rose to $613,078 in 2018, up from $250,655 five years earlier.

Strategic growth

Keeping up with growth is the biggest challenge for Ironworkers USA Federal's staff.

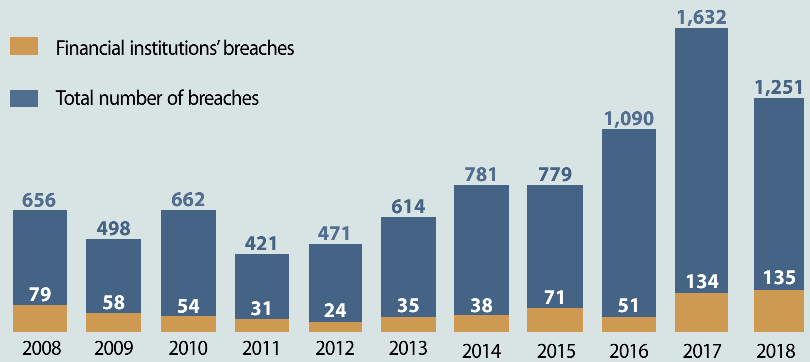
The board meets annually to discuss long-term strategic plans, and it focuses on the results of growth strategies at monthly meetings. Robinson says hiring a strategic planning consultant prevented the credit union from tackling too many opportunities at one time.

"We are strategic with our growth plan, slow and steady," Robinson says. "We know we have many opportunities, and the board and management are

QUICK TAKE FOR YOUR NEXT BOARD MEETING

A Decade of Data Breaches

The number of data breaches affecting financial institutions continues to grow. In 2008, 79 data breaches affected financial institutions, compared with 135 in 2018, according to the Identity Theft Resource Center.



Source: Identity Theft Resource Center as reported in the 2019-2020 CUNA Environmental Scan (*cuna.org/escan*)

- CUNA board and committee resources: *cuna.org/board*
- CUNA Environmental Scan resources, including the 2019-2020 strategic planning report, a DVD, and PowerPoint presentation: *cuna.org/escan*

making sure not to grow too fast."

Ironworkers USA Federal is an example of a credit union that used strategic planning to change its future, says Scott Butterfield, a consultant with Your Credit Union Partner who guides Ironworkers USA Federal's strategic planning process.

"They could have said, 'We don't have enough people' or cited other obstacles, but they wanted to survive bad enough to make changes and decide what they wanted to be. That's why they're thriving," Butterfield says.

Focus on purpose

Butterfield has seen many credit unions move to planning sessions focusing on a strategic conversation about their purpose. That conversation includes who the credit union will serve in the future and what these members' needs will be.

The outcome is a "tangible purpose" they can communicate to members.

Diversity of board and management is another important part of the conversation as credit unions learn more about who their members are now and in the future.

Long-term board members are asking "how can find individuals who are more refelctive of the community," Butterfield says.

Boards play a critical role in determining whether a strategic plan will help the credit union crash or soar.

The board ensures the credit union addresses members' needs with the right products and sound operations, while the leadership team and staff know how to turn a strategic plan into reality, says Jeff Rendel, president of Rising Above Enterprises.

He recommends seeking a "balance point" between them. The CEO can start by asking the board what opportunities, challenges, and trends they find most intriguing or valuable for discussion at an upcoming strategic planning session.

This process gives the board input and influence in setting the direction of the strategic conversation. Meanwhile, the CEO and executive team can prepare to describe what the credit union has already done to address diversity and what they learned while exploring the topic.

This allows employees to see themselves in practical and vital roles, Rendel says, "helping the credit union grow strategically."

CUNA Professional Development Online: *cuna.org/cpdonline*

Ratios to Remember

Financial statements—specifically the income statement and balance sheet—hold a wealth of information about the credit union. While the information is essential, these statements aren't all that useful when taken by themselves.

To get the most out of these statements, you must figure out the key ratios. *Credit Union Directors Newsletter* has been exploring 10 key ratios directors should know, including what the ratio measures, how to calculate it, and why the ratio is important.

The ratio:

Net charge-off

What it measures:

The quality of the loan portfolio based on the percentage of loans removed from the books as nonperforming.

How to calculate:

(charge-offs – recoveries) / average loans

* charge-offs and recoveries must be annualized

Why it's important:

Your credit union's strategic plan will set the acceptable range for charge-offs, but the industry standard falls in the 0.25% to 0.75% range. Credit unions that lend to members of modest means will often have a higher net charge-off ratio than credit unions that favor borrowers with A and B credit ratings. Some actions to improve the net charge-off ratio include tightening underwriting standards, discontinuing or curtailing higher risk loans, and implementing stronger collection efforts.

Understand Split-Dollar Life Insurance, 457(f) Plans

Credit unions use these tools to reward and retain executives.

Split-dollar life insurance agreements and 457(f) plans aren't new ideas for most credit union boards and executive compensation committees. But these tools are complex, and many board members encounter them rarely, so they often ask about other credit unions use them effectively.

Three scenarios where a 457(f), a split-dollar arrangement, or a combination of both are used to retain and reward executives:

Scenario #1

The board wants to reward and retain a high-performing CEO who is a prime target for recruiters and is about 10 years from retirement.

Recommended solution: Offer a collateral assignment split-dollar (CASD) life insurance arrangement to generate supplemental retirement income and a death benefit for beneficiaries.

Under the CASD arrangement, the credit union issues the CEO a loan to pay the annual premiums for a cash-value life insurance policy. The loan is 100% collateralized by the death benefit, and the credit union accrues interest throughout the loan term.

This provides a steady stream of retirement income for the individual that is designed to last 10 to 20 years. The annual amount is calculated to augment the CEO's projected Social Security, 401(k), and/or pension benefits to produce total annual retirement income of 60% to 80% of the CEO's annual pre-retirement income.

The CEO's beneficiaries receive any death benefit above the amount required to repay the credit union loan (including interest) for the life insurance policy premiums. The longer the CEO lives, the greater the final death benefit should be.

Scenario #2

Your credit union wants to retain multiple senior management employees of various ages and tenures. It's often part of a succession plan, not only to keep potential successors on board but to hold a strong team together around the successor throughout the transition.

Recommended solution: Offer a 457(f) plan that will generate a payment to each of the executives if they stay with the credit union for a specific period.

Under the 457(f) plan and based on the accrual schedule, the credit union allocates a payment for a corporate-owned life insurance policy that is projected to generate sufficient earnings to offset the agreed-upon payouts. Additional participants can be added to the plan at any time.

The agreement specifies a lump sum paid to each executive who stays for the period.

Scenario #3

Your credit union wants to offer young executives both short- and long-term financial incentives to stay with the credit union until retirement.

Recommended solution: Offer a combination of a CASD to supplement retirement income and a 457(f) with periodic payouts if the executive stays. Time the payment intervals to coincide with likely events in the executive's future, such as college tuition for children or a down payment for a home.

The CASD plan operates like the first scenario and the 457(f) plan operates like scenario No. 2. Any income above the 457(f) accrual expense can be used to offset other employee benefit expenses in some cases.

A message to future leaders

Split-dollar and 457(f) programs aren't always used for retention. Sometimes the credit union simply needs a tax-advantaged method to reward long-time executives for their loyalty and performance.

Even in those instances, your credit union is sending a message to other employees that they appreciate good service. That's something they'll remember when other potential employers come knocking.

BROOKS BERARDI *is an executive benefits specialist for CUNA Mutual Group.*

'USE SPLIT-DOLLAR ARRANGEMENTS, A 457(F) PLAN, OR A COMBINATION TO RETAIN OR REWARD EXECUTIVES.'

BROOKS BERARDI

- CUNA compensation resources: *cuna.org/compensation*
- CUNA Mutual Group: *cunamutual.com*

Work Together to Address Risk

■ CUNA Governance, Risk Management, and Compliance Leadership Conference, Sept. 23-25, Nashville: *cuna.org/grc*

■ Rochdale Paragon Group: *rochdaleparagon.com*

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

Board, supervisory committee, and internal audit all have roles in ERM.

A successful enterprise risk management (ERM) program requires the board, senior leadership team, and committees to work together to identify and mitigate an organization's risks by ensuring processes are in place and are followed correctly.

"An ERM program won't achieve maximum effectiveness unless you use it for strategic planning purposes as well as more tactically to mitigate operational risks," says Scott Hood, strategy, risk, and assurance partner with Rochdale Paragon Group.

Hood will address the CUNA Governance, Risk Management, and Compliance Leadership Conference in Nashville Sept. 23-25.

Q: What role do boards, the supervisory committee, and internal audit personnel play with ERM?

A: Boards play a key role in supporting an effective risk management culture throughout the credit union. They do this by establishing an ERM policy, asking for information on the organization's largest risks, ensuring the ERM process includes the right groups throughout the organization, and using the information in setting strategy.

Internal audit personnel and the supervisory committee participate in the ERM process by validating that the credit union's processes for mitigating risks function properly and result in the targeted residual risk benefits.

Q: Which group plays the biggest role in this?

A: ERM is an important source of information the board uses to understand the organization's key risks and the processes the credit union uses to mitigate those risks. It provides the board with confidence that management is taking the steps necessary to manage the credit union's overall risk.

Also, the board uses ERM information in setting and evaluating strategies, and ensuring initiatives are within the credit union's risk appetite.

The supervisory committee oversees the testing and analysis that internal audit personnel conduct. That testing is critical to ensure the credit union's responses to mitigate risk are working as anticipated. Internal audit work also provides confidence to the board and management that risk management processes are appropriate and effective.

The supervisory committee oversees the internal audit work.

Q: How can the three groups work together?

A: The board and supervisory committee should nurture a culture that supports effective risk management processes by setting the tone at the top of the organization, demonstrating interest in risk management activities, and securing adequate resources for effective risk management.

These groups need to lead by example that they value the risk management and internal audit activities, and benefit from the work of ERM and internal audit personnel.

> **'AN ERM PROGRAM WON'T ACHIEVE MAXIMUM EFFECTIVENESS UNLESS YOU USE IT FOR STRATEGIC PLANNING PURPOSES AS WELL AS MORE TACTICALLY TO MITIGATE OPERATIONAL RISKS.'**
> SCOTT HOOD

Internal audit has always performed risk assessments as part of their work in identifying processes to review. ERM personnel now also conduct slightly different risk assessments that go beyond the traditional internal audit assessments by, for example, identifying risks or achieving strategic objectives and opportunity cost exposures.

It's probably not realistic or even desirable for internal audit personnel to stop doing their risk assessment work. But they should use the ERM risk assessments to supplement their risk assessments in identifying the organization's key risks.

Then they should feed their findings back to ERM personnel so ERM can update the credit union's risk profile and understand the changes in procedures that need to occur.

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