Credit Union Directors NEWSLETTER

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Difference between good and great decisions

The board's oversight of risk management efforts can enhance credit union's long-term success.

The board's most important role is to evaluate, refine, and approve strategies about your credit union's future direction. An actively involved board adds significant long-term value and addresses expectations of oversight by outside stakeholders, such as members, auditors, and regulators.

Research indicates leaders are more likely to make good strategic decisions when they consider alternative views and thoroughly understand risk and reward trade-offs.

This level of decision-making significantly minimizes unexpected operational surprises and financial volatility.

Consistent risk-based decisioning elevates organizations to positions of market leaders with long-term sustainability.

The ability to make great decisions lies in being able to beat the odds in the face of uncertainty.

Fundamentally, having the wherewithal and processes to identify, quantify, and internalize potential future scenarios and events facilitates informed decisions. At the core, these decisions capture value by maximizing the risk/return trade-off.

Enterprise risk management (ERM) continues to advance organizational capabilities.

Risk management is an integral component of strategy, culture, and business operations, but it is often seen as merely a compliance activity and a hindrance. Decisions made without an understanding of the likelihood of future events and their effects on the organization's strategic plans cannot adequately create a solid picture of risk/reward trade-offs, which significantly diminishes the likelihood of success.

Success requires business leaders to have timely information and to accept that decisions are never 100% certain. It's a matter of increasing the odds of making the right decisions consistently.

> "The ability to make **GREAT DECISIONS** lies in being able to **BEAT THE ODDS** in the face of uncertainty."
>
> **Tony FERRIS**

The board can do its part to ingrain and facilitate ERM at the credit union.

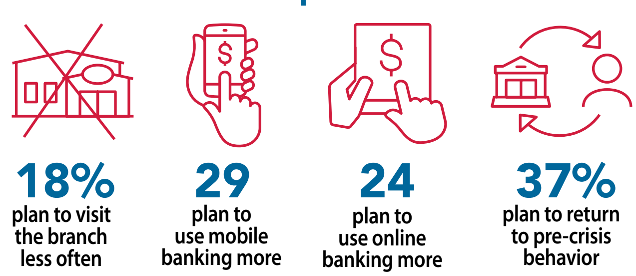
The board should not be involved in day-to-day risk management practices. Instead, through its oversight role, the board should ensure the credit union has in place a comprehensive and organization-wide framework, a culture of risk management across the organization, and effective processes in all levels of management.

The benefits of these efforts are far reaching. They include the determination of capital adequacy to balance growth and security, alignment on risk appetite to accomplish the credit union's goals by allowing management to freely make decisions within defined expectations, and a shared understanding of key risks and risk-mitigation efforts.

QUICK TAKE for your next board meeting

Accessing financial services after the pandemic
When the coronavirus (COVID-19) pandemic is over and it's safe to have in-person interactions, most consumers say they will continue to carry out their financial business in the manner they've adopted during COVID-19, according to the "Financial Services and COVID-19 Pulse Survey" from J.D. Power.

Consumers' access to financial services after the pandemic



Source: J.D. Power

This allows for more effective and efficient use of capital and resources by focusing efforts on what is truly important.

Boards can take five key actions to build a strong risk management program:

1. Create a formal risk framework and make the CEO accountable for the risk program.

2. Set the tone for open, independent communication by demonstrating a willingness and receptivity to hearing bad news and providing a credible challenge to underlying management assumptions for improved transparency.

3. Define an acceptable risk appetite to serve as a set of guardrails for risk taking. Require regular dialogue on the principal risks facing the organization, and determine the appropriateness of risk-mitigation activities.

4. Develop a board risk committee to oversee this function and facilitate efficient governance practices.

5. Engage with outside experts to periodically review the risk process to eliminate bias and infuse evolving best practices.

By understanding the relationship between critical assumptions underlying business strategy and risk management, the board can strengthen its oversight role.

Ensuring these processes are culturally and operationally integrated will enhance the credit union's likelihood of long-term success.

TONY FERRIS *is CEO of the Rochdale Paragon Group. Visit Rochdale Paragon Group at* rochdaleparagron.com

Reevaluate 4 ALM assumptions during the pandemic

Look at cash flow, interest rates, loan deferrals, and deposit growth to set your balance sheet strategy.

As the coronavirus (COVID-19) pandemic takes its toll on credit union financials, how can leaders assess the current environment and make decisions that keep the credit union and its asset/liability management (ALM) efforts in line?

"Taking risks is the only way to get earnings," says Dave Koch, managing director at Abrigo. "What matters is managing the downside risk. You need to give up some of the possible upside gains to manage the downside risks because we're going to be here for a while."

During "The Impact of the Pandemic on ALM Assumptions," a virtual roundtable from the CUNA Finance Council, Koch offers four assumptions credit union leaders need to reevaluate during the pandemic:

1. Balance sheet cash flows. Balance sheets will continue to grow during the pandemic, but the cash flow will change, says Teri Grams, adviser at Abrigo.

Credit unions must consider the impact on loan amortizations and maturities, prepayments, curtailments, and deferrals, as well as the changing frequency of loan originations.

Also, consider the impact of reduced fee income from loan originations or sales.

"We're making different assumptions in relationship to all of these different pieces, and we want to see how those assumptions work together and drive cash flows on the balance sheet," Grams says.

2. Rate environment. Rate environments reflect current or "likely" rates and do not take into account immediate and permanent rate shocks, Koch says.

Learn how to operate in an environment that features a flat yield curve, he says. Determine what actions you'll need to take to achieve the ideal liquidity, credit risk, and other metrics.

3. Impact of loan payment deferrals. When members defer loan payments, the credit union does not collect principle or interest from the borrower, Koch says.

That affects the credit union's cash flow through decreased income, return on assets, and capital, he says.

Also consider that once the deferral period ends, the borrower's financial situation may not have changed and the loan may go into default.

4. Impact of core deposits. How has COVID-19 impacted the way members save money and how is the credit union handling deposits from stimulus checks?

Perform a deposit share sensitivity study to determine how to classify those assets—stable, surge, short- or long-term deposits—and how that impacts the credit union's balance sheet.

> **"Taking risks is the only way to get earnings."**
>
> **Dave Koch**

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Addressing social, sustainability issues

Values-based banking resonates with many members.

As stewards of the credit union, directors are charged with setting its strategic course, ensuring long-term success by remaining relevant to current and potential members. That means boards must be forward thinking—adept at assessing and managing risk, leading and adapting to change, and ensuring the credit union creates value.

In the for-profit world, there's increasing recognition that to succeed and create value, financial institutions must incorporate environmental, social, and governance (ESG) considerations into long-term strategies.

> "ESG is about risk and opportunity. It's about the ways in which value could be destroyed or created."
>
> PricewaterhouseCoopers

The components of ESG are:

- **Environmental:** How an organization helps conserve the natural world.
- **Social:** An organization's relationships with its community.
- **Governance:** How an organization governs responsibly.

According to a report from the accounting firm PricewaterhouseCoopers, "ESG in the boardroom: What directors need to know," while ESG may bring to mind important environmental issues like climate change and resource scarcity, the term means much more. It also covers social issues such as labor practices as well as governance matters such as board diversity, executive pay, and business ethics.

"It's about risk and opportunity. It's about the ways in which value could be destroyed or created," the report notes.

Clearwater Credit Union in Missoula, Mont., plays a vital role in creating thriving, sustainable, and inclusive communities, says Jack Lawson, president/CEO of the $598 million asset credit union.

Clearwater joined the Global Alliance for Banking on Values in 2017.

"As part of our commitment, we are working to evolve our balance sheet and measure total loans directed at building inclusive economies, empowering people, and protecting the planet," Lawson says.

The credit union's strategic plan outlines clear environmental and social impact metrics and reporting standards. For example, Clearwater set out to be carbon neutral by year-end 2020 by reducing absolute greenhouse gas emissions by 20% and funding carbon offsets benefiting the local economy.

United Nations Federal Credit Union (UNFCU) in Long Island City, N.Y., is pursuing an agenda to fight climate change, poverty, and inequality.

The $6.1 billion asset credit union established a Global Sustainability Program (GSP) in 2015, aligning with the UN's Sustainable Development Goals (SDG). UNFCU became climate neutral in 2016.

"We believe in collective action on the SDGs, and this has included working closely with UN Greening the Blue, a network of more than 50 UN organizations," says Kumiko Matsuura-Mueller, UNFCU board chair. "UNFCU is also a member of the UN Global Compact, the world's largest corporate social responsibility initiative, advancing the SDGs."

"As staunch supporters of the SDGs, which aim to fight climate change, poverty, and inequality, UNFCU has embedded sustainability into our operations, culture, and values," says Laura Rockwood, a member of the UNFCU Foundation Board and the UNFCU Board.

"Sustainability is another way we are providing our members with peace of mind," she says.

LUCY HARR *is freelance writer based in Stoughton, Wis., and a board member at Heartland Credit Union in Madison, Wis.*

Resources

CUNA Councils: *cunacouncils.org*

CUNA board and committee solutions: *cuna.org/board*

CUNA learning events: *cuna.org/learn*

CUNA Environmental Scan: *cuna.org/escan*

Redirect your strategic course

Adapt to the sweeping changes wrought by the pandemic.

Every decade or so, a momentous event shakes the business world to the core, bringing forward the full impact of fundamental changes that most people saw coming—just maybe not quite that soon.

The fallout from the coronavirus (COVID-19) pandemic is a classic example of a "structural break." Almost everything about how we operate has changed in the short term.

There will be lasting effects on our economy and significant disruption to many organizations' value propositions.

Written at the time of the Great Recession, the *Harvard Business Review* article, "Strategy in a Structural Break," is relevant again. The author hammers home one main point: There are many ways forward, but the wrong way forward is more of the same.

Trends to watch

A forward-looking strategy can position your credit union to address shifts and meet customer expectations and business goals. Consider these strategies:

▶ **Digital.** Watch for opportunities to serve members' growing digital habits. CUNA Mutual Group is accelerating investments in digital as the pandemic quickly made digital a way of life.

For instance, we introduced our simplified-issue TruStage life insurance in 2016 with a fully digital application process.

This approach has grown our portfolio 18% annually, with 60% growth in online sales alone. We've unveiled an updated, seamless TruStage.com, and we'll launch a digital lending platform soon.

▶ **Remote work.** As we prove people can do many jobs regardless of location, we're no longer bound by geographical constraints. Pursuing the best and brightest people wherever they live means you can turbocharge your diversity, equity, and inclusion (DEI) initiatives by expanding your recruiting base.

Use this opportunity to establish new pipelines of talent that can infuse your credit union with fresh perspectives and varied skill sets.

▶ **Demographic shifts and disparate impact.** We're much more likely to serve people of color today than in the past.

CUNA Mutual Group's Multicultural Center of Expertise is an industry leader in research that shows us how to best serve Black, Hispanic, Indigenous, and other underserved communities. We incorporate their insights into every element of our operation.

Those communities need your help now. Numerous data-driven studies demonstrate the disparate impact of the pandemic, with greater health and financial implications upon people of color than the U.S. population as a whole.

> "How have you altered your operations and mindset to continue to earn consumers' business in this 'next normal'?"

What is your credit union doing to serve people of color in their time of need? This is a chance to live your mission and earn their loyalty.

▶ **Changing consumer preferences.** The upheaval in our normal schedules and habits has severely tested brand loyalty.

How have you altered your operations and your mindset to continue to earn consumers' business in this "next normal"?

Adjusting to evolving consumer tastes is now a mandatory survival activity.

You can't do everything at once. As board members, you need to help your credit union make tough choices that advance your strategic goals.

Recognize that the pandemic has empowered you to rebalance your priorities, aligning around a few that promise to put your credit union on a path to success.

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