Credit Union Directors NEWSLETTER

January 2021
Volume 47
Issue 1

Navigating risk in a changing landscape

Pandemic stresses importance of risk programs, oversight of strategic execution.

Supervisory committees have seen their role expand to include more involvement in risk management, the enterprise risk management (ERM) process, and oversight of strategic execution, says Scott Hood, strategy, risk, and assurance partner at Rochdale Paragon Group.

That role has never been more important than now, when the risk landscape is continually changing due to the coronavirus (COVID-19) pandemic.

"We're living through an incredibly difficult time," Hood says. "We don't expect that to change. We expect to see an increasing focus on risk management. This is something we'll live with for quite some time."

Hood explored how credit union supervisory and audit committees can navigate the changing risk landscape during a session at the 2020 CUNA Supervisory Committee and Internal Audit Virtual Conference.

Five components of ERM

Hood defines an ERM program as a set of capabilities and practices that assist with setting strategy and achieving goals.

He advises focusing on five areas:

1. Governance and culture. The ERM program must have support from the board, supervisory committee, and senior management to gain traction in the organization and function at a high level in evaluating risk. Designate ERM roles and responsibilities, ensure you have the right people to run the program, and provide training on objectives, concepts, and terminology.

Create a risk management committee, develop an ERM policy and procedures, and reinforce concepts over time. "Governance sets the stage by preparing the organization," Hood says.

> "The risk **APPETITE** represents an acceptable path to **MEET** our goals."
>
> Scott HOOD

2. Strategy and objective setting. Inform senior management and the board about risks so they can make the best strategic decisions for the credit union. Explore the credit union's risk appetite and consider this factor when setting objectives and during strategic planning sessions. "The risk appetite is the link between strategic planning and ERM," Hood says. "The risk appetite represents an acceptable path to meet our goals."

3. Performance. Identify key risks and opportunities, and use qualitative and quantitative assessment techniques to assess them. Consider the potential responses to risks and assess the mitigation of the risks' impact and likelihood.

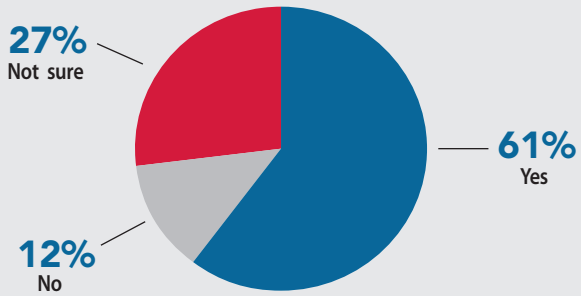
Establish control plans to ensure the responses function as designed, Hood says.

4. Review and revision. Assess competitive

QUICK TAKE for your next board meeting

Using ERM to influence strategy

Nearly three-quarters (73%) of organizations have an enterprise risk management (ERM) program and 61% use insights gleaned from the program to inform and influence corporate strategy, according to RIMS, the risk management society.



Source: RIMS Enterprise Risk Management Benchmark Survey

changes that are taking place and their effect on the credit union's risks and performance, Hood says. Make this an ongoing activity and not a one-time project to allow modifications to the risk management plan.

"Identify changes in risks and ensure the organization understands what is driving those changes," Hood says.

5. Information, communication, and reporting. Provide information to the right people at the right time, Hood says. Otherwise, "all of the risk assessment work we do will be meaningless."

Emerging trends and risk

Some new risks the pandemic has raised for credit unions include:

▶**Deferrals and the potential for higher charge-offs.** Delinquencies fell as borrowers took advantage of loan deferrals and other programs during the pandemic. But what will happen as these programs end, and how will credit unions manage the risk?

▶**Returning to work.** Many employees have been working remotely during the pandemic. What risks are associated with employees returning to the office and what protocols are in place to ensure the safety of staff and members?

▶**Low interest rates and lower net interest margins.** Interest rates are at historic lows, contributing to low net interest margins and putting pressure on earnings. How big is the impact on earnings and the credit union's ability to build and maintain capital?

▶**Challenges of a new workforce.** More employees have flexible work arrangements than in the past, which presents both opportunities and risks for credit unions. Remote work gives credit unions access to a larger talent pool, but it could lead to higher employee turnover.

▶**Pressure on capital due to increases in deposits.** How does the ERM program address capital requirements?

▶**Budget restrictions.** How will financial challenges affect credit unions' operational capabilities and ability to launch new initiatives?

"Credit unions are facing all kinds of new expectations for strong risk management programs, and the supervisory committee and internal audit can help credit unions meet these challenges," Hood says. "We must continue to evolve as we face these new challenges in the future."

NCUA extends virtual meeting relief

Board must approve bylaw amendment to adopt flexibility in 2021.

Relief measures pertaining to annual meeting flexibility issued in 2020 because of the coronavirus (COVID-19) pandemic will also be applicable in 2021.

The measures providing flexibility for annual and special meetings will also extend to regular meetings of the credit union's board of directors, according to NCUA Letter to Credit Unions No. 20-FCU-04.

CUNA raised the issue of meeting flexibility with NCUA as the effects of COVID-19 on credit unions will clearly continue into 2021.

To take advantage of the virtual meeting relief measures, federal credit unions must adopt an Article IV bylaw amendment by a two-thirds vote of the board. No additional approval is needed from NCUA.

The language for the amendment is provided in NCUA Letter No. 20-FCU-04.

The language for regular meetings of the credit union board is optional. If the credit union only wants the language to apply to annual/special meetings, the underlined language should be omitted from the amendment when presented to the board for the two-thirds vote.

Federal credit unions that adopt the amendment can invoke the provision at any time in 2021 if a majority of the credit union's board of directors chooses to do so.

The letter also includes clarification on:

▶**Quorum requirements:** For all virtual meetings, credit unions must still meet general quorum requirements.

▶**Postponements:** If a credit union decides to postpone its annual meeting in 2021, it should refer to the guidance issued in NCUA Letter No. 20-FCU-02.

▶**Elections:** Option A4 in NCUA's Federal Credit Union Bylaws is the only option that allows for electronic voting. Federal credit unions that will have electronic voting at meetings (annual or special) must have Option A4 as the election process in the credit union's bylaws.

▶**Meeting notices:** Section 2 of Article IV of NCUA's Federal Credit Union Bylaws allows for electronic mail notices to members who have already opted to receive statements/notices electronically. Members who have not opted in still need a paper mailing of the meeting notice.

▶**Member expulsion:** The relief provided under NCUA Letter to Federal Credit Unions No. 20-FCU-04 does not apply to special meetings held for the purpose of expelling a member from the credit union.

Credit Union National Association
CUNA

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CUNA MAP

MEMBER ACTIVATION PROGRAM

HOW CAN THIS HELP YOUR CREDIT UNION?

More Engagement
Advocacy communications make members feel more connected to your credit union.

More Business
82% of members are more inclined to do business with your credit union after receiving advocacy communications.

More Satisfaction
Self-described credit union "members" view credit unions 89% more favorably than banks.

CUNA Member Activation Program enables credit unions to fully harness the advocacy potential of their membership with **three simple steps:**

1. **We provide** plug-and-play content on advocacy issues.
2. **You deliver** the content to members.
3. **Members** find ways they can fight for your credit union's future.

"Advocacy is part of our Culture…We take our responsibility to keep our law makers informed of who we are and what we do very seriously. MAP has made it possible for us to take our message directly to our members and enlist their help in telling our story."
Angela McCathran - President/CEO, People's Trust FCU

"We felt strongly that advocacy is a huge cause for all credit unions no matter what their size. MAP made it easy for a small credit union like ours to educate and activate our members."
Amy Brodersen – CEO, Family Focus FCU

cuna.org/map

Oversight key to compliance efforts

Board, management play critical role in addressing violations.

The existence of policies, procedures, training, monitoring, and audit practices, as well as a process for complaint resolution, are key indicators of low compliance risk, according to NCUA.

Plus, the board and management play a role in overseeing compliance efforts and addressing violations discovered during examinations.

Key indications the board of directors and management are effectively overseeing compliance risk include:

▶**A commitment** to the credit union's compliance efforts.
▶**The effectiveness** of the change management process.
▶**The board and management** effectively manage risks associated with the credit union's products, services, and activities.
▶**The board and management** self-identify areas of noncompliance and take corrective action when needed.

Include third-party relationships when assessing compliance risk.

On CUNA's Comp Blog, Nancy DeGrandi, CUNA's manager of federal compliance information and research, offers several questions credit union directors and leaders should ask to ensure they are providing sufficient compliance oversight and are addressing violations correctly.

Oversight and commitment

▶**Do** the credit union's board and management effectively and comprehensively manage for compliance risk?
▶**Does** the credit union have significant compliance resources, including systems, capital, and personnel?
▶**Is** staff knowledgeable and held accountable for compliance with laws and regulations?
▶**Is** there a clear understanding and commitment to compliance throughout the credit union?
▶**Is** there ongoing due diligence and oversight of third-party relationships?
▶**Are** third-party relationships effectively managed for compliance risks consistent with NCUA regulations and compliance with consumer protection laws and regulations?
▶**Do** the board and management exercise effective and comprehensive oversight of third-party policies, procedures, internal controls, and training to ensure they meet their compliance responsibilities?

Change management

▶**Do** the credit union's board and management anticipate and promptly respond to changes in applicable laws and regulations, market conditions, and products and services?
▶**Are** changes promptly evaluated across impacted lines of business?
▶**Are** responses to the changes promptly implemented?

Comprehension and identification of risk

▶**Do** the credit union's board and management understand and identify compliance risks, including emerging risks in the credit union's products and services?
▶**Is** the life cycle of a product considered before implementing changes?
▶**Does** management engage in self-assessments and other methods to manage risk?
▶**Are** changes reviewed after implementation to determine if the actions taken have achieved planned results?

Corrective action and self-assessment

▶**Does** management proactively identify issues and promptly respond to compliance risk management deficiencies and violations, including remediation or taking corrective action?

Comprehensive and effective oversight by the credit union's board and management is key when assessing for compliance risk.

Resources

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

CUNA Compliance Community: *compliancecommunity.cuna.org*

CUNA Environmental Scan resources: *cuna.org/escan*

CUNA Finance Council: *cunacouncils.org*

Determining the right amount of capital

Use a blend of instinct, math, and analysis to establish the right level of net worth.

When determining your optimal net-worth ratio, aim for the "roughly right" amount, says Adam Johnson, CEO/principal at c. myers corp.

"There's no one right amount for everyone," says Johnson, who addressed the CUNA Finance Council Virtual Conference Collection.

Achieving the right capital level is becoming "a bigger balancing act" between the need to build or conserve net worth versus using capital to deploy initiatives that may lead to long-term growth, he says.

Many credit unions are struggling to grow capital due to increased deposits, lower earnings, greater demands for capital, and the need to meet rising consumer expectations and operate in a highly competitive environment, Johnson says.

While there are consequences for being either too conservative or too aggressive, "institutions that have a structured process to identify the amount of capital they need based on their unique business model, strategic direction, and risk tolerance are better positioned to make good decisions about their use of capital," he says. "Setting capital targets is a strategic decision credit unions should approach with the same rigor as other strategic decisions."

This process entails determining what you'll have to give up or slow down to achieve a certain level of capital and identifying the opportunity tradeoffs, Johnson says. It also involves using a blend of instinct, math, and analysis to build a process for achieving desired capital levels.

Consider these questions when determining your optimal capital level:

▶ **What** risks does your credit union face, and how much capital will you need to guard against each risk?

▶ **What** opportunities will you set aside to preserve net worth?

▶ **How** much capital do you need for each opportunity?

The wrong way to determine the right capital level is by applying pure probability to your risk factors, Johnson says. "When you're dealing with risks, you're usually dealing with some unlikely events."

He offers four key takeaways:

1. Decide. Work with decision-makers to understand your options and select an approach.

2. Incorporate opportunities. How will initiatives in your strategic plan influence your capital comfort level?

3. Enhance complex analysis with simple tools to explain your approach and document your conclusions.

4. Talk. There's no replacement for quality discussions. The bigger the decision, the more discussion and time are needed.

"The 'why' is more important than the actual number," Johnson says. "Understand what's driving you."

"Setting capital targets is a strategic decision credit unions should approach with the same rigor as other strategic decisions."

Adam Johnson

CREDIT UNION DIRECTORS NEWSLETTER

(ISSN 1058-1561) is published monthly for $150 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 $737. Periodical postage paid at Madison, Wis.

POSTMASTER

Send address changes to CREDIT UNION DIRECTORS NEWSLETTER, P.O. Box 461, Annapolis Junction, MD 20701-04661. Advertising is accepted only from reputable firms, but inclusion of advertising does not imply endorsement by the newsletter or CUNA Inc.

EDITORIAL STAFF

BILL MERRICK // deputy editor, bmerrick@cuna.coop

JENNIFER PLAGER // senior editor, jplager@cuna.coop

DESIGN AND PRODUCTION STAFF

CARRIE DOYLE // graphic designer, cdoyle@cuna.coop

CONTACT INFORMATION

EDITORIAL // 608-231-4290

SUBSCRIPTIONS // 800-348-3646, fax 301-206-9789, or cuna.org/directors