



***Do's and Don'ts:  
10 Lessons From (Un)successful ERM  
Programs***

*“Driving Credit Union Performance”*

February 13, 2015

AUSTIN, TEXAS • [www.cuaccelerator.com](http://www.cuaccelerator.com)

***Accelerate*** *your credit union's performance*

# Why We Are Here

- Credit unions are pursuing various strategies to spur growth in membership, revenue, and profitability
- Many of these initiatives require partnering with various outsourcers and/or implementation of new technology
- Some of these initiatives include entering businesses that are not traditionally credit union strengths (various CUSO's, eMedia and marketing, sales culture development)
- Other initiatives require massive structural changes or reorganizations (new products & services, new marketing strategies, mergers & acquisitions)
- ***It is critical that credit unions understand, manage, and monitor the uncertainty in these initiatives***

# Lesson #1

Make Sure You Understand the  
Goal of ERM

# What is Risk?

*The **possibility** of an event occurring that will have an impact on the achievement of objectives.*

**A Prerequisite to any risk discussion in an organization:**

**You must know**

**.....the organization's objectives**

*Risk is measured in terms of impact and likelihood.*

*The Institute of Internal Auditors (IIA)*

# What is Risk?

*Alan's Definition*

*Risk = Uncertainty*

# What is Risk Management?

*Alan's Definition*

*Managing the uncertainty side of  
performance*

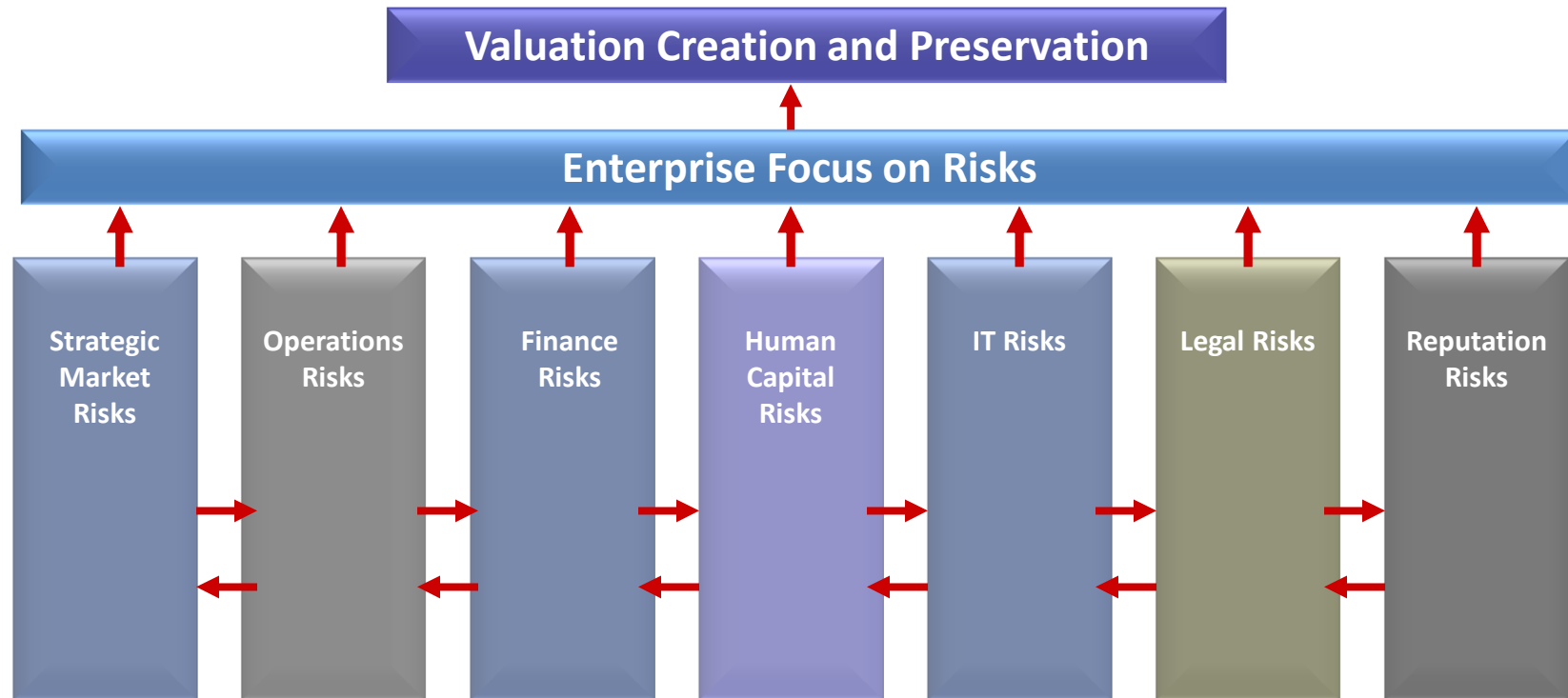
*Or....*

*Managing the horse race between Greed &  
Fear*

# What is ERM supposed to do?

- Quickly identify emerging risks and problem areas ***before*** they escalate and cause serious harm
- Reduce the incidence of serious negative surprises that undermine stakeholder confidence
- Reduce response time for emerging risks
- Enable the organization to more ***effectively take advantage of opportunities***
- Demonstrate to stakeholders that reasonable risk management processes are in place
- Provide an efficient way to link and manage risks across the enterprise

# ERM Brings Risks Together





## Lesson #2

# Understand the ERM Process Backwards & Forwards

# Risk Management Principles

- State your objectives
- Identify most critical areas of risk (risk assessment)
  - Keep in mind that you may not have seen the impact yet!
- Gather and analyze the relevant data
- Exercise sound judgment
- Identify potential root causes (WCGW)
- Determine best response
- Document and train
- Monitor, audit, and assure (and measure)

Assess  
Risk

Manage  
Risk

## Lesson #3

ERM is a Project that Requires  
Effective Project Management

# Project Success Statistics

	<u>1994</u>	<u>1996</u>	<u>1998</u>	<u>2000</u>	<u>2002</u>	<u>2004</u>	<u>2009</u>
Succeeded	16%	27%	26%	28%	34%	29%	32%
Failed	31%	40%	28%	23%	15%	18%	24%
Challenged	53%	33%	46%	49%	51%	53%	44%

Source: Standish Group Report Updated for 2009

## Lesson #4

Do not Simply Replicate the  
Internal Audit or Compliance Function

# Risk Management vs Internal Audit

<b>Audit</b>	<b>Risk Management</b>
<b>Independent from Management</b>	<b>Part of Management (like HR, Accounting, IT)</b>
<b>Assurance</b>	<b>Support</b>
<b>Evaluators &amp; Recommenders</b>	<b>Deciders &amp; Implementers</b>
<b>Protects Assets</b>	<b>Seeks Profit</b>
<b>Evaluates Controls</b>	<b>Is a Control</b>
<b>High Likelihood/Low Impact</b>	<b>Low Likelihood/High Impact</b>

# ERM vs Compliance

Criteria	Compliance	ERM
“Customer”	NCUA, Regulatory Agencies, Governments	Board, executive management, members, employees
Goals	Avoid fines and legal costs. “Pass the test”. Preset standards	Understand goals, proactively guide actions to achieve them
Penalties	Fines, legal costs, corrective action costs	Poor business decisions. Ineffective business practices
Documents	Mixed and Detailed	“Just Enough”

## Lesson #5

# Different Types of Risk Require Different Management Methods

*“When all you have is a hammer, everything  
looks like a nail.”*



# ERM Components

## *Operations Risk*

- Risk that operations are not designed or executed effectively
- Includes NCUA categories Transaction, and Compliance
- Also includes Fraud Risk
- Managed through effective business processes and controls
- Often over or under managed
- Requires prioritization of efforts and activities to manage effectively

## *Financial Risk*

- Relates to risk that is present in the credit union's investments and loan portfolio
- Includes NCUA categories Interest Rate, Liquidity and Credit risk
- Also includes Accounting and Concentration risk
- Usually Managed actively through the ALM, Budgeting, and Financial Reporting processes.
- Often includes executive and board level involvement

## *Strategic Risk*

- “Macro” risks, strategic decisions, economic trends and planning
- Includes NCUA categories of Strategic, Reputation, and Credit Risk
- IT Risk is also strategic
- Typically managed through the Strategic Planning process
- All significant strategic risks should be managed due to large impact

## Lesson #6

ALM and ALCO are Part of ERM –  
But They Need to Address *Uncertainty*  
not Just the Current Situation

## Lesson #7

Get the Data –  
And Use the Modeling Techniques  
Available to You

# Why Models Help

- Risks might happen
  - Then again, they might not
- Risks can be positive or negative
- Uncertainty, Value of Managing Risk, and Difficulty in Managing Risk all increase:
  - When more than one or two scenarios exist
  - When scenarios may be interrelated
  - As the event time horizon increase

# Options For Risk Models

- Decision Trees
- Regression Analysis
- Scenario Analysis (options a,b,c,d,e)
- Sensitivity Analysis
- Simulation

## Lesson #8

Models Only Take you So Far

# Some limits to models

- **Estimation:** Most, if not all, scores for operational risks are based on imperfect data. Many estimates are little more than educated guesses
- **Time:** All risks happen eventually. A risk that has a only one percent probability on a given day is extremely likely to happen during the course of the 250 or so work days within the year - probably more than once.
- **Point in time:** The risk assessment is only valid for the exact moment in time that it is completed. When circumstances change, so do the results.
- **Persistence:** Some risks end quickly, other last for a long time and impact other risks for varying periods of time.
- **Recurrence:** Some risks will happen more than once.
- **Data Bias:** Most historical data, especially that from different time periods or different regions or types of credit unions is biased to the specific circumstances.
- **Confidence interval:** It is impossible to simply say there are X dollars at risk at a point in time. Risk deals with uncertainty and there are a range of possibilities.
- **Incentive:** Eventually, the goal becomes getting to a number that is low enough to justify the proposal.

## Lesson #9

Not All Risks Can (or Should) Be  
Prevented -  
But They Can Be Managed



# Lesson #10

## Monitor Everything

# Top 10 ERM Lessons

1. Make Sure You Understand the Goal of ERM
2. Understand the ERM Process Backwards & Forwards
3. ERM is a Project that Requires Effective Project Management
4. Do Not Simply Replicate the Internal Audit or Compliance Function
5. Different Types of Risk Require Different Management Methods
6. ALM and ALCO are Part of ERM – But They Need to Address Uncertainty not Just the Current Situation
7. Get the Data – and Use the Modeling Techniques Available to You
8. Models Only Take You So Far
9. Not All Risks Can (or Should) Be Prevented - but They Can Be Managed
10. Monitor Everything

## A Bonus Lesson

Software Cannot do ERM for You

(Neither can tools, nor consultants, nor models, nor wizards, nor magic pixie dust)

# About CU Accelerator

<u>Service Line</u>	<u>Example Services</u>	
<b><i>Performance Management</i></b>	Process Improvement Project Management	Metrics & Controls Monitoring Revenue Assurance
<b><i>Strategic Planning</i></b>	Strategic Initiative Analysis & Financial Modeling M&A Analysis & Integration    Governance & Incentive Planning	
<b><i>Internal Audit</i></b>	Quality Assurance Reviews Internal Audit Co-Sourcing	Skills & Resource Assessment Audit Planning
<b><i>Risk Management</i></b>	Operational Risk Assessments Financial Risk Modeling & Metrics	Strategic Risk Analysis IT Risk Management
<b><i>Outsourcing &amp; Vendor Management</i></b>	Vendor Selection Audits & Risk Management	Due Diligence & Compliance Contract Management

# Questions

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