An Introduction to Enterprise Risk Management

- Mark Brown,
- SVP, Chief Financial Officer
- First Carolina Corporate Credit Union
Introduction

• **Mark Brown**

• **First Carolina Corporate Credit Union, SVP/CFO – since 1997**

• **Sara Lee Credit Union, Accounting Manager/Controller - 9 years**

• **United Federal Credit Union, Accounting Manager - 3 years**

• **Licensed NC CPA**
Agenda

• Definition of Risk and ERM

• Responsible Parties

• Components of ERM
What is Risk?

- Certain events can be identified in the external environment (e.g., economic trends, regulatory changes, competition) and within an organization’s internal environment (e.g., people, process, etc.)

- When these events intersect with an organization’s objectives or can be predicted to do so—they become risks

- Risk therefore is defined as ‘the possibility that an event will occur and adversely affect the achievement of objectives’
What is Risk?

Simply stated:
Probability of a specific loss of worth occurring.

Possible Risk Actions

-Avoid
-Reduce
-Share
-Accept
What is Risk?

- Known knowns
- Known unknowns
- Unknown unknowns
Risk vs. Return

• “Risk and return” is an inseparable concept
Enterprise Risk Management

• NCUA defines Enterprise Risk Management as a comprehensive risk optimization process that integrates risk management across an organization.

• The board of directors ultimately makes the decision to develop and implement ERM, many times with the goal of aligning risk with strategic objectives.
Enterprise Risk Management

• Seeks to gather multiple risk components within the operations and quantify for entire business unit.
  
  • Credit unions are in the business of managing risk
  
  • Every decision made involves risk
  
  • Many decisions are made without consideration of the effect upon other departments or functions
Important Facts about ERM

• Currently not mandated by NCUA

• Not a one time project

• Ongoing process or culture requiring regular check ups
Important Facts about ERM

• Need senior level support

• Board should understand role

• More than just complying with regulation
Current Risk Management Practice—Silos

- Asset/Liability Management
- Investment/securities
- Lending policies
- Operations
Example of Silo Risk Management

- Residential Mortgage Portfolio-40% of Loans
- Investment Portfolio-60% in mortgage-backed securities

RESULTS-Combining total exposure to mortgage sector reveals overexposure for CU
ERM Participants

- Board
- Senior Management
- Line Managers
- Front line staff
- Everyone!!!
ERM

- An effective ERM program is a proactive approach to managing risks and opportunities.

- Looks beyond current identified risks and considers potential future risks as well.
Science of ERM

- Involves the methods and processes to identify, measure and manage risks and/or seize opportunities related to the achievement of the organization’s goals.
Where to Begin

- Identify risk events within organization
- Assess risk

• What is Impact - potential magnitude of an event
• What is Likelihood - frequency of an event

Consider Impact and Likelihood together to develop and assess particular risk event.
Key Terms in Risk Management

Responses - are actions taken to mitigate or manage particular risk exposure

Mitigation – degree to which CU responses manage down the impact or likelihood of an event
Where to Begin (cont.)

**Inherent Risk**

- Risk exposure *before* responses

- Measure of the expected exposure to the risk event before considering risk responses
Where to Begin (cont.)

*Residual Risk*

- Risk exposure *after* responses

- Measure of expected exposure to risk event, after considering risk response
Where to Begin (cont.)

The difference between Inherent Risk and Residual Risk is the completeness or benefit of the responses.

SO the question is-

How much do you spend to reduce a risk exposure?

Is the cost worth the risk avoided?
Example Risk Calculation

Assume an exposure with annual impact of $100,000, a likelihood of 30% and completeness of mitigation of 90%.

Inherent risk = Impact * Likelihood
             = $100,000 * 30% = $30,000

Residual risk = Inherent risk * (1-completeness of mitigation)
              = $30,000 * (1-0.9)
              = $3,000
What are my CU’s Risks?

*NCUA* has identified Seven Primary Risk Categories for Credit Unions in Letter to CU 02-FCU-09

- Compliance Risk
- Credit Risk
- Interest Rate Risk
- Liquidity Risk
- Reputation Risk
- Strategic Risk
- Transaction Risk
Benefits of ERM

• Increased communication/transparency
• Enhanced risk reporting and analysis of enterprise risks
• Improved resilience to environmental changes
• Heightened alignment of organizational strategy
• Reduced insurance premiums
ERM is Not

• Risk Checklist
• Risk Audit
• Compliance assessment
• Isolated technology solution
• One-time project
Next Steps

• Board