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THE FRONTBURNER

Welcome to the August edition of *The FrontBurner*! As the environment in which we operate continues to be unpredictable, one thing remains quite predictable – it is getting more and more complicated out there. With this increased complexity, comes the need for more intricate strategies. And, with that, you guessed it – greater risk. Perhaps the greatest risk is not understanding how to align a culture of risk management with your risk appetite, your actual risk exposure, and your strategy. Having a comprehensive understanding of how to tie all of this together will position your organization, and thus your members, for greater success. In this edition of *The FrontBurner*, we address exactly that.

On a side note, we have a really great Forum coming together next month and I truly hope you have found a way to join us, either in-person or virtually, as we celebrate our **40th Anniversary** and the ability to **Come Together** for the first time in too long. With the virtual option, you can have some folks in your shop join us for critical training topics that normally would not have the opportunity to do so. We are excited to be able to offer both alternatives this year and I hope one of those options work for you and your teams. See you in August at Forum'21!

With that, I hope you enjoy this month's edition of *The FrontBurner*.

Jeff Merry, President/CEO

Inject a Little Risk Into This Year's Strategic Planning Session

For as long as I can remember, I have sought to live my life by the *Golden Rule* – i.e. Treat others as you wish to be treated and aim to "do the right thing" at all times – concepts ingrained into my being, serving as my personal (and professional) *North Star*. Early on, I was given an opportunity to pursue a career in Risk Management and quickly realized these values – *my* values – were at the heart of this oft-misunderstand business practice. A few decades later, the Credit Union Movement – an industry built upon the aforementioned ideals – came calling, allowing for a true harmonious convergence on a personal and professional level.

So, why do I share this backstory?

The business world has become much more complex, interconnected, and, well, risky over the last several decades. The proliferation of technology and the rise of the Internet have drastically altered the way organizations operate and connect with their constituents, impelling business leadership to consider their willingness to achieve an appropriate risk vs. reward balance in order to compete effectively. For the Credit Union Movement, a wide-array of sharks – e.g. banks, FinTechs, non-banking institutions offering financial services, shared interest communities (SIC), other credit unions – are circling our membership, seeking to lure them away forever. (Yes, I am a life-long fan of *Shark Week!*)

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While difficult, is it time to admit we have become a commoditized industry? Our competition is no longer just other credit unions, but, rather, for-profit entities with deep pockets, broad reach, and an insatiable appetite to steer financial services towards an all-digital experience. In this author's opinion, we need to resolve an important conundrum: How do we ensure our relevance outlasts our ability to remain solvent?

One important step is to recognize the intrinsic linkage between culture, risk, and strategy. How does organizational culture impede (or enhance) a calculated risk-taking mentality and what is its effect upon your organization's ability to achieve its goals and fulfill its ultimate mission?

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Culture, Risk Appetite, and Strategic Planning

More than most are willing to admit, culture is the keystone upon which an organization's identity is built, serving as the primary driver of tactical behavior, decision-making, and strategy development. This is supported by *Merriam-Webster*'s definition of corporate culture as "…the set of shared attitudes, values, goals, and practices that characterizes an institution…" and the *risk* culture definition provided by the *Risk Management Association (RMA) Journal* as "…the set of encouraged and acceptable behaviors, discussions, decisions, and attitudes toward taking and managing risk within an institution…" For additional perspective, the *Financial Stability Board* professes *risk* culture is most effective when it promotes sound risk-taking, addresses emerging risks beyond risk appetite, and ensures employees conduct business in a "legal and ethical manner."

With those sentiments in mind, it is reasonable to conclude *corporate* culture directly affects *risk* culture within a credit union. How, then, does this differ from, relate to and/or impact organizational *risk appetite* and why should one care?

The Committee of Sponsoring Organizations (COSO) of the Treadway Commission, the governing body behind the globally-accepted framework for internal controls over financial reporting, cites *risk appetite* as the "…amount of risk, on a broad level, an organization is willing to accept in the pursuit of value…" To personify this concept, think about how and when you choose to fill your gas tank – at a half or quarter tank, the "low fuel" light first illuminates, or your "Distance to Empty" estimate is in the single digits. If you chose half- or quarter-tank, you are likely risk adverse (low appetite) – or have been burned by waiting too long! – versus playing "beat the clock" with your fuel gauge (high appetite). When applied professionally, a credit union may choose, for example, to follow every regulation to the extreme (low) or consider a "shades of gray" approach (high), taking advantage of ambiguous language within legislation, where applicable.

It is the Board's responsibility to establish organizational risk appetite while Management is accountable for its execution.

Why is this important to developing a viable business strategy? Without a defined *risk appetite* – one which sets the boundaries against which corporate strategy is designed – Management could potentially proceed with initiatives which violate the amount of risk deemed acceptable by the Board. Said another way, the development of a well-communicated and thought-out *risk appetite* **prior** to constructing a strategic plan allows for Management to understand the rules of engagement and for all staff to understand and be empowered to act (versus ask for permission) when seeking to meet member-related needs. ***Take a minute to re-read this paragraph and think about how powerful this could be to your credit union.***

> "By defining risk-taking boundaries with the Board of Directors *prior* to a Strategic Planning session…Management should have a comprehensive under standing of the risks involved (and, thus, confidence) their Strategic Plan is viable, yet adaptable in the event things go awry."

Unfortunately, few credit unions define *risk appetite* prior to their strategic planning sessions. This is akin to letting someone with little to no driving experience or knowledge of local/state/federal driving laws loose with a vehicle during rush hour in <pick your city of choice>. To quote former President George H. W. Bush: *"Wouldn't be prudent."* (How many of you heard Dana Carvey's voice?) We strongly urge your credit union to consider having a facilitated *risk appetite* session to kick off your next Management Strategy Planning Session.

While I am not one to automatically advocate to do something just because regulations say to do it, it is important to understand what state and federal examiners say about *risk appetite* and its overarching governance framework, Enterprise Risk Management (ERM). The National Credit Union Association (NCUA) issued guidance (Supervisory Letter 13-12) in November 2013 stating, "*Natural person credit unions are not required to implement a formal ERM framework*. However, <they> are expected to have sound processes sufficient to manage the risks associated with their business model and strategies." Even though it is not a requirement, the Letter goes on to define ERM, components of a viable program (including *risk appetite*), NCUA supervisory perspectives, and examination expectations. This is strong evidence the practice of ERM is an important part of your exam despite it not being a regulatory requirement. (For the record, the NCUA did enact §704.21 after the financial crisis, mandating ERM for Corporate Credit Unions.)

Conclusion

The Credit Union Movement needs to adapt, quickly and assertively, in order to remain relevant with our membership. Utilizing the concepts taught within the discipline of ERM will aid credit unions of all sizes to do so more intelligently and efficiently, allowing them to keep pace with their expanded competition. By defining risk-taking boundaries with the Board of Directors *prior* to a Strategic Planning session, including the identification of both downside and opportunity (where do we place our bets?) risks, Management should have a comprehensive understanding of the risks involved (and, thus, confidence) their Strategic Plan is viable, yet adaptable in the event things go awry.

If you have questions regarding your credit union's ERM program and how a facilitated risk appetite discussion can strengthen your Strategic Planning efforts, please contact:

Jeff Dato, *Symphony Consultant* - jeff.dato@symphonycuso.org - 615-232-7980

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