Effective Risk Oversight at the CFI Board level

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Presentation Outline

- Governances Compliance approach
- Oversight Approach
- Key Suggestions for effective Risk Oversight
    - Functional Board
- ***Presentation main source: Reference Guide for Manitoba Credit Unions (2010), A Board Perspective on ERM McKinsey and Company (2010),Report of the British Columbia Credit Union Governance (2012)***

Governances Compliance approach

- This involves two key elements

  a) Leadership

  b) Oversight

- Leadership: Responsibility to set direction and ensure the quality and Sustainability of the CFIs at highest levels of authority
- Oversight: the active stewardship and supervision of the CFIs operating environment.

Oversight Approach

- It is the duty of the Board of Directors to evaluate and periodically review the CFIs policies, compliance with regulation, and the performance of the CEO.
- It is the CEO's duty to ensure the board has adequate information to make informed judgments, and provide information about the credit union's control environment.

General Oversight Responsibilities

- Evaluate the effectiveness of the CEO annually in managing operations in accordance with the CFIs objectives, strategies, policies, and regulatory requirements
- Review all policies, no less than every two years, and approve all changes.
- Review and approve any proposed exceptions to policy that are recommended by management
- Evaluate the quality and effectiveness of the Board's performance annually.

Board Risk Management

- CFIs must have an approach to identify, manage and control business and operating risks
- Enterprise Risk Management: A comprehensive framework which involves identifying particular events or circumstances relevant to the CFIs risk and opportunities
- The objective of risk oversight is not to eliminate it but to manage it. ERM approach in CFIs will assist the Board identify perceived risk and opportunities and how to effectively deal with the risk

Board Dynamics have impact!

- Over three years the CEO's boss has totally changed.
- There will be a lot of uncertainty as to vision and direction. The new Board may not have the same views.
- Board expectations can change dramatically when the Board dynamics change.
- While the CEO will take the lead in managing risk, the board is responsible for approving the CFIs risk appetite and its risk tolerance.

Is the Role of Board important?

- The Board's primary role is to develop and articulate a vision for the organization and then ensure that it is carried out.
- The achievement of the vision requires the Board to develop a strategic plan that outlines the path as well as the measurable goals.
- To articulate clearly what the organization will be famous for: The board reviews and approves a level of risk tolerance that ensures the CFIs only takes on risks within its capacity to manage.

1: Human Resource Risk Oversight

- This risk results from inability to attract/ Retain quality employees
- Establish a HR and Compensation Policy
- Review and approve appropriate HR Policies
- Review and approve compensation programs that do not increase CFI exposure
- **The board ensures that the CFI has a disaster management and recovery plan for unforeseen disaster or the loss of key persons and that it is updated regularly.**

2. Credit Risk Oversight

- This is the financial loss resulting from third party failure to honour its obligation to CFIs
- The potential that the value of financial assets may not be recognized or that counterparties may extract value that had not been agreed, in which case the credit union could experience unanticipated loss
- Establish the credit-granting philosophy and risk tolerance of the CFIs
- Assign the CEO a level of decision making authority for approving credit

3. Capital Management Oversight

- This risk is associated with potential failure to determine, allocate and maintain CFIs current quality and quantity of capital and meeting future capital requirement
- The Directors should understand the Capital Needs of CFIs including statutory requirements
- Establish Capital Management targets determined by CFIs size and complexity (exceed minimum legislative requirements)
- Review and approve Capital Management policies

4 . Liquidity Management Oversight

- Liquidity Risk– A potential failure to meet anticipated day-to-day cash commitments or maintain minimum levels of statutory liquidity.
- BoD should Understand the CFIs statutory and operational liquidity needs
- BoD should Review and approve appropriate and prudent liquidity management policies
- GM/CEO to establish liquidity contingency plan

5. Informational Technology Oversight

- This is risk associated with potential loss from use, ownership, operation, involvement, influence and adoption of information technology within a CFIs
- The BoD is responsible for reviewing and approving appropriate and prudent information Technology
- The BoD input is important since implementing IT in CFIs may prove insufficient or too costly to allow it to compete effectively
- GM/CEO should ensure IT resources are aligned with CFI strategic plan and operational needs

6. Fiduciary risk oversight: Reputation

- This risk is associated with financial loss resulting from a breach of duty in offering the appropriate advise
- BoD ought to understand the residual risk arising from ineffective management ; its judgement may impact its ability to achieve its strategic objectives.
- Review and approve appropriate fiduciary risk management policies

7. Operation Risk Oversight

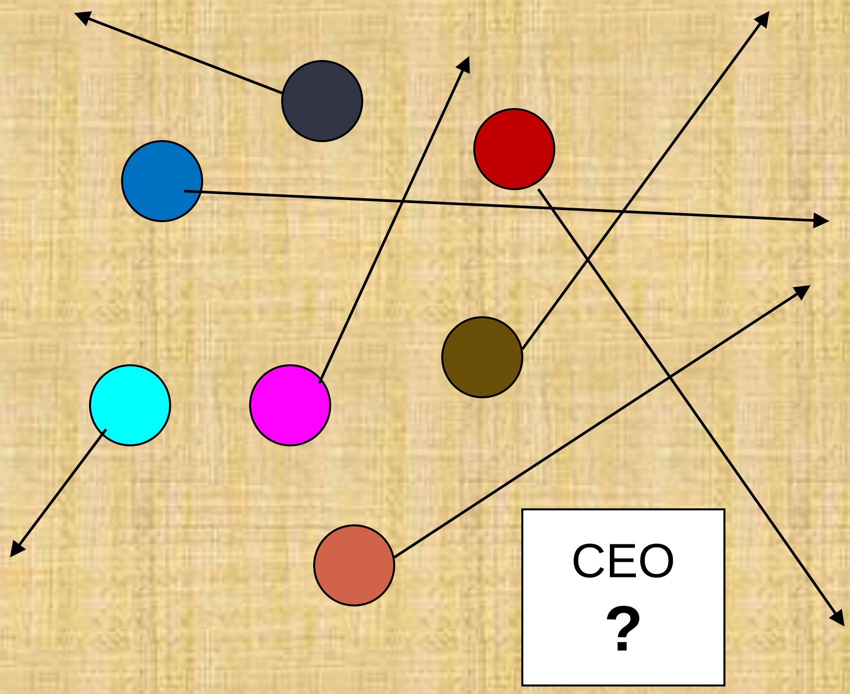
- Unexpected internal and external events arising in the day to day running of the credit union could affect the credit union’s ability to be effective and may have consequential effects on its ability to achieve its strategy
- Regulatory changes may require the credit union to change direction or alter its business practices with potential consequences to its profitability

Board Stress Testing!!

- Economic considerations beyond the control of the board or CEO may increase risk. The Board should understand the steps the CEO will take to manage overall risk and ensure that additional reporting is provided when warranted.
- CFIs with complex IT architectures, using complicated financial instruments, securitizations or foreign borrowings in their treasury management function and those undertaking significant expansion will need to expand their risk monitoring commensurately.

Dysfunctional Boards

Multi-Personality Board



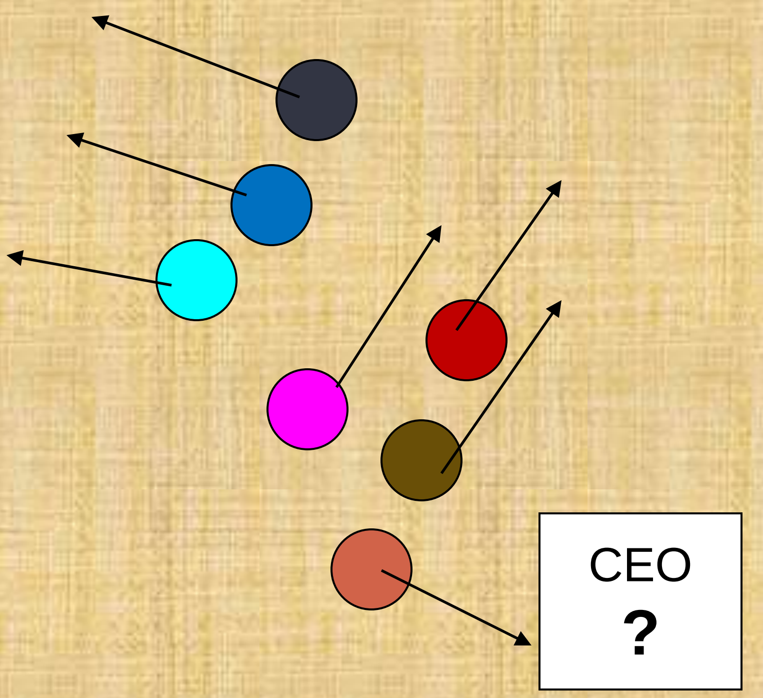
Directors have **multiple agendas** and cannot agree on what actions or direction to take.

The CEO/manager is confused and there is no vision or leadership.

This will result in Risk oversight failure.

Divided Boards

Multi-Personality Board



Directors have **opposing agendas** and cannot agree on what actions or direction to take.

The CEO/manager is confused and there is no vision or leadership.

This will also result in Risk oversight failure.

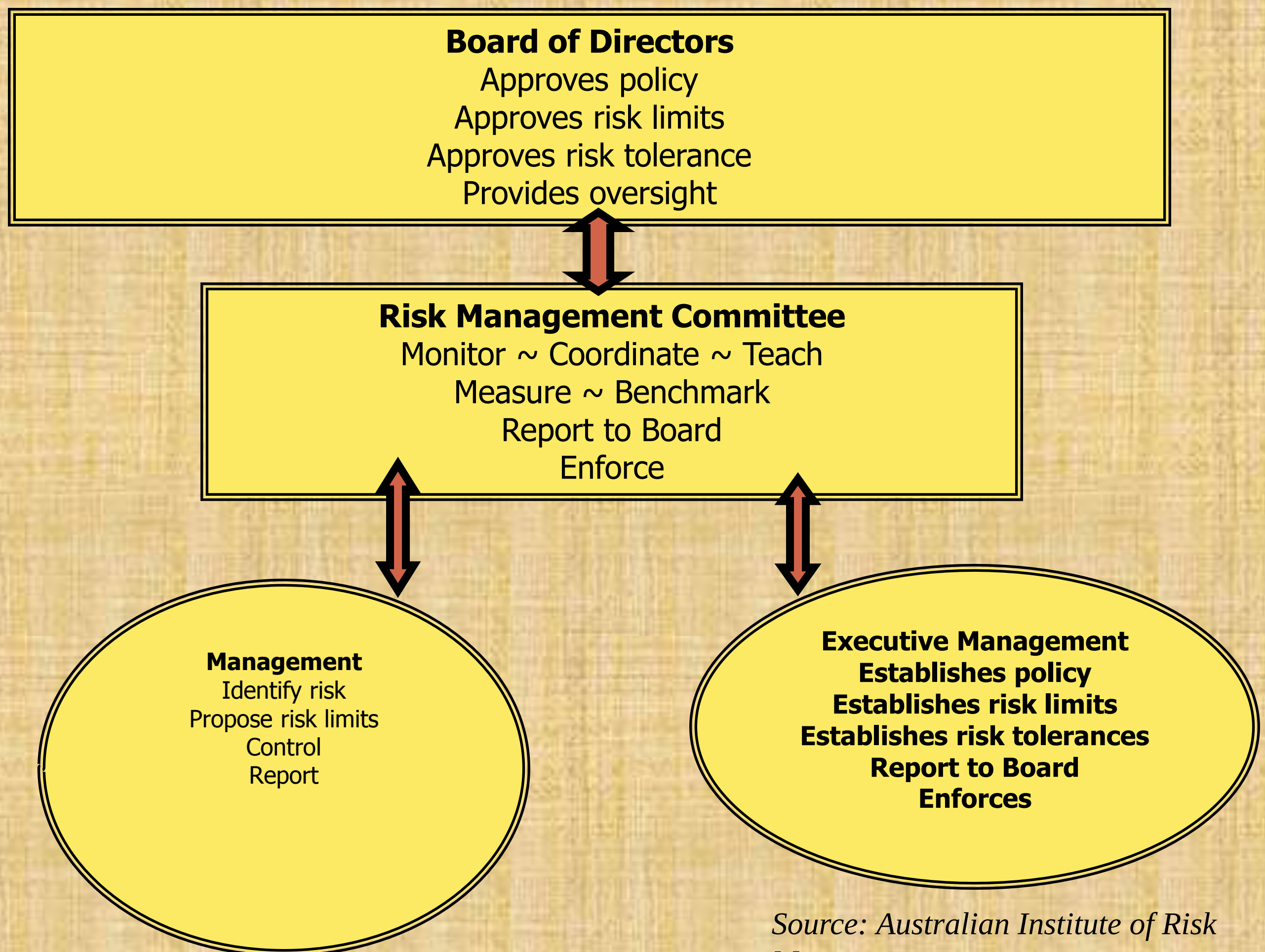
Key Suggestions for effective Risk Oversight

- Full board to assume responsibility for risk oversight
- Delegate to one or more standing committee i.e. Separate risk committee, expansion of audit committee etc
- Audit Committee: Does it have time, skills and supported needed given demanding role.
- Balanced qualified directors with knowledge of the alternative financial sectors

Board of Director Concern's

- Is the Board satisfied the current composition of directors in meeting required expertise and industry knowledge (level of Board Involvement)
- Is the Board or Selected Committee receiving adequate information to perform oversight role

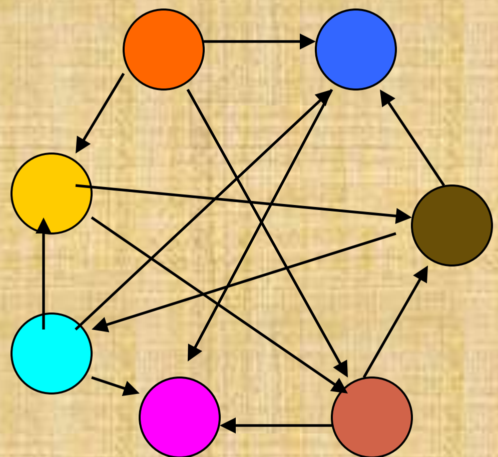
ERM Roles and Responsibilities



Source: Australian Institute of Risk Management

A Functional Board

Dialogue and Debate



The debate and dialogue must produce either consensus or an agreed course of action!

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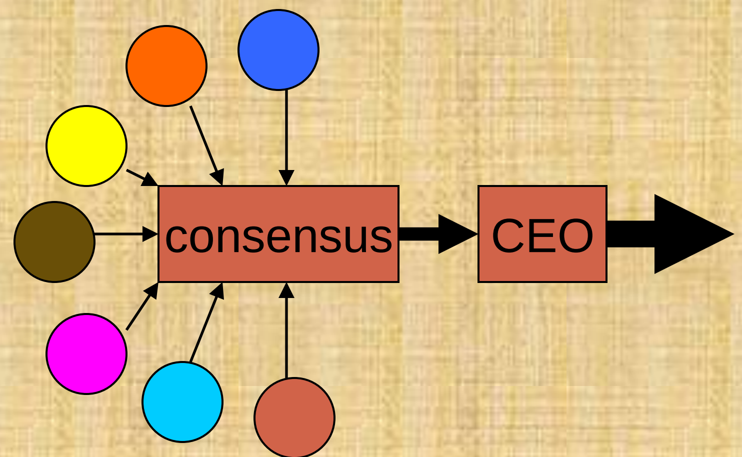
Consensus



The agreed action is what is communicated to the CEO and is what he or she is accountable for.

Develop Risk Oversight Policy

- Develop a Risk Appetite Statement
- Create an Information Loop
- Rank Risk Exposure

This policy needs a visual point of focus to give the Board and management a snapshot of the organization's risk profile.

Conclusion

- All new Directors should receive a comprehensive orientation about the cooperative's business, its operations, the role of the Board, the role of committees and the expectations for individual Board members
- The cooperative has a Board renewal policy which outlines the Board's approach to renewing and strengthening its needs to meet the cooperative's strategy as well as oversight needs.

Thank You

QUESTIONS AND DIALOGUE