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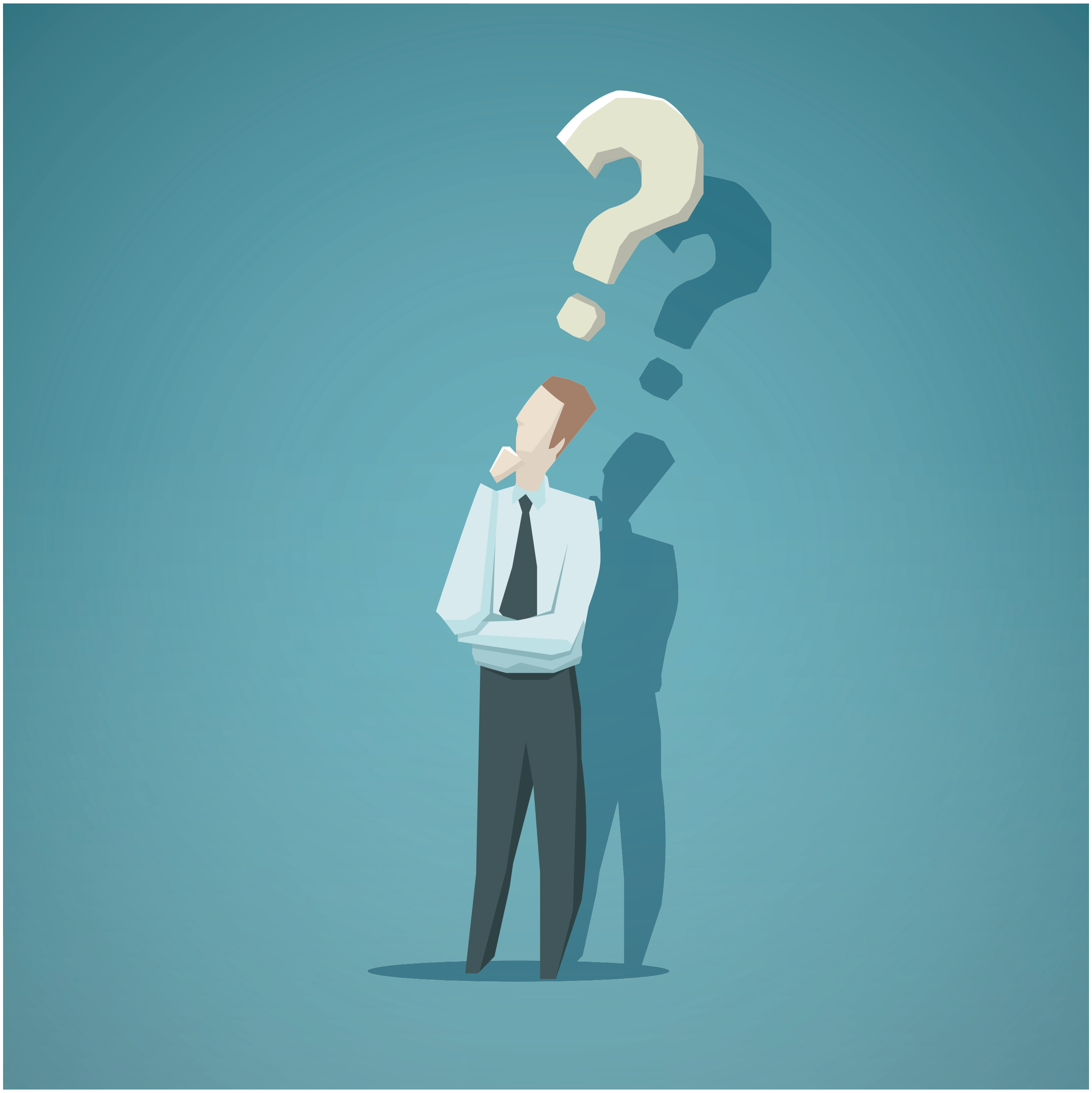

FOR MORE CREDIT UNION STRATEGY & PERFORMANCE VISIT

CREDITUNIONS.COM

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New regulations require more time, money, and more resources to stay compliant. This Callahan Collection outlines different strategies for making sure the credit union is not only compliant now but also remains there in the future. Learn best practices in staffing strategies, CUSO development, technology security, and more from credit unions in the know.

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BANKING'S NEWEST COMPLIANCE ENIGMA COMES WITH A DATA PLAN

An abundance of devices, each with their own respective compliance unknowns, has muddied the waters for many financial institutions. Here's how to get clarity..

BY MARC RAPPORT

Mobile security is an opportunity wrapped up in a problem. That's because it isn't just one more link in the transaction chain like a new branch or a unified fleet of ATMs. Rather, it's a conglomeration of hundreds of different devices from different manufacturers, including both smartphone and tablets, all of which are further modified and customized by the end user.

Consumers love these tools in part because of that customization component, yet for a credit union that delivers services through these channels, this environment also has significant implications for compliance and cybersecurity.

"Mobile security is like an onion; it has layers," says Kris Kovacs, senior vice president of operations at Coastal Federal Credit Union ($2.5B, Raleigh, NC). "When you're dealing with PCs, they're basically the same regardless of manufacturer. But each mobile device can be different, so we have to test different configurations between the device and any native apps we release."

BALANCING SECURITY AND REAL TIME

Mobile complications stemming from new features and functions grow daily, meaning security is a battle no credit union should fight without help, Kovacs says.

Greg Hughes, the information security officer for digital channels at Fiserv, agrees.

"Asking your mobile application vendor how they protect their own apps is always a reasonable thing to do," he says.

On the upside, most mobile operating systems tend to build upon lessons learned from earlier platforms, like the desktop operating system. That's why, in most cases, it makes sense to extend online banking security practices to the mobile channel, Hughes says. Still, new lessons do emerge from time to time.

That's something Apple Pay issuers and processors realized after fraudsters quickly began provisioning purloined credit card account information — including authentication credentials — using the newly released service.

"Fraudsters exploited the weakest link in the chain," says senior product manager Brian Day at The Members Group, an Iowa-based card processor. "But we do have the benefit of learning from that experience."

Scott Schmidt, director of remote services at BCU ($2.2B, Vernon Hills, IL), says the credit union wrestles like everyone else with a "fragmented environment" in the mobile channel, especially when working with diverse Android apps versus the more controlled Apple universe.

CU QUICK FACTS

Coastal Federal Credit Union
RALEIGH, NC

$2.5B
ASSETS

204,853
MEMBERS

446
BRANCHES

6.53%
12-MO SHARE GROWTH

11.71%
12-MO LOAN GROWTH

0.80%
ROA

CU QUICK FACTS

BECU
TUKWILA, WA

$13.6B
ASSETS

925,593
MEMBERS

1,304
BRANCHES

8.15%
12-MO SHARE GROWTH

13.04%
12-MO LOAN GROWTH

1.48%
ROA

CU QUICK FACTS

Internet Archive Federal Credit Union
NEW BRUNSWICK, NJ

$2.2M
ASSETS

391
MEMBERS

4
BRANCHES

49.95%
12-MO SHARE GROWTH

29.92%
12-MO LOAN GROWTH

-3.06%
ROA

In mobile, "everything has to be in real time, but we still have to mirror that with a balancing act when it comes to security," Schmidt says.

SO MANY RULES, SO LITTLE GUIDANCE

The one thing that everyone can agree on right now is that mobile banking carries at least the same compliance requirements as walking into a branch.

According to Hoi Luk, senior manager for financial institution regulatory consulting at the California-based accounting firm Moss Adams, these include:

- Check 21 regulations
- Bank Secrecy Act anti-money laundering rules
- The PATRIOT Act
- Gramm-Leach-Bliley privacy strictures
- Uniform Commercial Codes
- Individual state rules and regulations

Yet little has happened so far to align today's technologies with yesterday's regulations, beyond authentication guidance from the FFIEC.

Andrea Stritzke, director of lending compliance at the Wisconsin-based CUNA Mutual Group, says regulators have considered mobile a separate channel only when it comes to remittance transfer disclosures.

"Otherwise, they have not taken into consideration how compliance and the disclosures consumers receive might need to evolve with the use of mobile channels," she says.

E. Andrew Keeney, a credit union attorney with Virginia's Kaufman & Canoles, sees potential problems in mobile for credit unions following the implementation of Truth In Lending Act/Real Estate Settlement Procedures Act (TILA/RESPA) regulations on Oct. 3 of this year.

An unintentional violation of this ruling could result in a fine of $5,000 per day, Keeney says.

"Mobile lending might also be impacted by TILA/RESPA because of the volume of pages of disclosures required," he adds.

Another possible pitfall could occur when credit unions need to reissue electronic documents and solicit new signatures because of routine administrative efforts.

3 RULES FOR MOBILE SECURITY

Greg Hughes, information security officer for digital channels at Fiserv Inc., suggests three ways to better secure mobile devices of all kinds.

- Continually warn members not to respond to emails, calls, or texts requesting personal and account information; help them identify new, evolving threats.
- Advise otherwise tech-savvy members not to modify their devices' operating systems. This is known as "rooting" in the Android world and "jailbreaking" in iOS.
- Conduct negative-case testing — an automated and ethical hacking attack on an app — or ask vendors to provide results of such testing they did themselves.

YOU ARE THE WEAKEST LINK

Member behavior remains one of the most unwieldy of all security variables in remote services, making investments in education a crucial part of any game plan.

"As much as we try to secure everything from our end, if a member picks a security question someone can get from Facebook or keeps passwords on sticky notes on their computer, our security measures aren't going to work very well," says Scott Schmidt, director of digital services at BCU.

"Keeping track of the latest and correct versions will be a burden that members might not be able to handle," Keeney says. "And that could potentially increase liability to the credit union."

STILL NO BASIS FOR STASIS

Jordan Modell, founding CEO of Internet Archive Federal Credit Union ($2.2M, Brunswick, NJ), has already seen increased NCUA interest in security audits that cover policies and particulars like penetration testing at his 3-year-old credit union.

"I think there's a little fear about mobile right now," Modell says. "We want to know in advance exactly what the regulators will want from us if we're going to do this stuff. And that's not there yet."

Despite these numerous challenges, the credit union industry continues to push boundaries on the mobile front, and Modell is just one of many credit union managers calling on regulators for more clarification so regulation — or lack of it — does not get in the way greater member service.

For those wanting to minimize uncertainties, Luk at Moss Adams recommends using as guideposts the FFIEC guidance about RDC issued in 2009, the FFIEC IT Examination Handbook, and the BSA Examination Manual.

Luk's other closing piece of advice? Make sure all investments the credit union does make in unchartered mobile waters have an institution-specific business case as well as a developed support system.

"Always understand the risk exposures, required controls to monitor and track transactions, and the regulatory disclosures involved," he says.

In other words, don't provide a product merely because the credit union down the street is. That's good advice that extends beyond mobile matters.

WHAT CAN A COMPLIANCE ADVOCATE DO FOR CREDIT UNIONS?

New roles are helping credit unions review regulations and disseminate information.

BY ERIK PAYNE

The regulatory burden on credit unions in 2014 is a divisive and heavily discussed topic. To keep up with the surge of new rules and regulations, credit unions are looking for ways to improve how they review and disseminate information in an effort to improve the member experience. Before ORNL Federal Credit Union ($1.6B, Oak Ridge, TN) named T. Wayne Hood senior vice president and general counsel in late 2012, the credit union had a one-and-a-half person department dedicated to both compliance and BSA. In the past year, much has changed at the 32-branch-strong institution.

"I needed my compliance officer to be able to focus on keeping up with the rule changes and writing changes to policies and procedures," Hood says. "That did not leave her enough time to implement those changes, much less respond to management's questions of: Why do we have this? Why do we have to do it this way? Would this be a better way to do it?"

To address hurdles, ORNL increased its commitment to compliance. Now the credit union's compliance department has five dedicated employees plus two employees who work in legal. The credit union even created a compliance advocate position to reinforce the department's efforts.

THE COMPLIANCE ADVOCATE

Leslie Daugherty became the credit union's first compliance advocate when she moved from ORNL's human resources department to compliance in February 2013. It was Daugherty who actually named the role.

"I was going to use something generic," Hood says. "She said, 'I'd like to be called a compliance advocate because that's what I'm going to be doing — advocating for people to stay in compliance and trying to explain to them why it's important.'

"Compliance to me is like the kitchen junk drawer," Hood continues. "If there is anything that seems legal or regulatory, it goes to compliance. So compliance is a great place to take assessment of where risk is in terms of everything from member service to legal risk."

The role of the compliance advocate is twofold. First, the employee gains as much face time with as many operational departments and employees as possible to determine the institution's compliance needs by asking questions such as what do employees need from compliance, where are the opportunities in compliance, where are the obstacles, and how can the compliance

CU QUICK FACTS

ORNL Federal Credit Union
OAK RIDGE, TN

$1.6B
ASSETS

148,027
MEMBERS

490
BRANCHES

7.03%
12-MO SHARE GROWTH

7.18%
12-MO LOAN GROWTH

0.51%
ROA

> "Compliance to me is like the kitchen junk drawer. If there is anything that seems legal or regulatory, it goes to compliance. So compliance is a great place to take assessment of where risk is in terms of everything from member service to legal risk."

department be a better resource? The first time Daugherty made the rounds among the credit union's headquarters and its branches, she received more than 200 responses that formed the basis of one of ORNLs biggest strategic goals for 2014 — to write a compliance manual of sorts. According to Hood, the manual describes how compliance interacts with all levels of the institution, from tellers to the CEO.

"It impresses the importance of compliance on every single role within the organization," he says.

In addition to helping determine the institution's compliance needs, the compliance advocate explains new rules and regulations to employees, contextualizing them with real world examples. Prior to the creation of the compliance advocate, the credit union sent emails explaining changes. Now, the compliance advocate allows the department to have high-level explanatory discussions with employees and listen to their feedback.

The biggest improvement Hood has seen since the position's inception is the improvement in communication that has led to employees understanding the "why" instead of just the "what." The time the advocate is able to devote to employees helps them understand the rules and regulations and reduces questions. Additionally, Daugherty can identify patterns the institution should address.

3 REASONS TO INVEST IN COMPLIANCE

Because Daugherty came from HR, the credit union needed to determine how to integrate an employee with little compliance knowledge into a compliance-heavy position. But Hood is confident Daugherty's attitude will help her quickly develop an expertise in the area.

"[She] cares about this credit union," Hood says. "She loves her fellow employees. They know she is trying to help this be the best credit union we can be, so she has instant credibility with our staff."

Communication skills play a large role in this position. Any compliance advocate must be able to talk and listen to staff. Additionally, the advocate must understand the distinct needs and operations of every department they visit to know which rules and regulations matter.

One of the advocate's main goals is to improve the member experience, though the results of the employee's work are often intangible. Hood says the advocate is responsible for the feedback that influences a range of processes and transactions, from account openings for members to health savings account access for employees. However, determining a concrete return on investment from this position — and the compliance department in general — remains a challenge. When it comes to benefits, Hood cites the value in the advocate's work, better procedures, and a stronger audit program.

"When you put those three things together, our compliance program is robust," he says. "We are beginning to see it pay off in terms of a decreased number of exceptions, a decreased number of problems with paperwork, and a decreased number of member complaints."

Hood hasn't run the numbers to show a figure for how much the department has saved the credit union on an annual basis, but he has seen improvements in account openings and decreases in risk areas. To wit: the credit union's average share balance has grown 6.6% since March 2013, according to first quarter Search & Analyze data on CreditUnions.com, and it has improved its delinquency ratio three basis points year-over-year, according to Peer-to-Peer analytics by Callahan & Associates.

"You can't always quantify what you save," Hood says. "What you do is determine from the feedback you're getting from your members and your staff that you're giving better member service."

STAFFING TIPS TO STEM COMPLIANCE CONCERNS

Whether you rely on a singular hire, a multifaceted department, or shared talent, the days of squeaking by without dedicated compliance resource are over.

BY AARON PUGH

All financial institutions operate in a restrictive regulatory environment, and the barrage of new rules from lawmakers and regulatory agencies makes the once-luxurious compliance department a now-vital resource. Yet acquiring talent and organizing it properly can be a haphazard undertaking. With significant variations in asset size, charter type, organizational complexity, budgetary allowance, and other considerations, credit unions often have a hard time finding the blueprint that's right for them.

The two staffing approaches below look different in practice, but they target the same goal — addressing the growing complexity of the compliance space. Regardless of where your own strategy falls on this spectrum, there are tips here you can use to attract and retain top talent.

INVEST MORE NOW, PAY LESS LATER

As is the case with many cooperatives, the past few years have necessitated rapid change in the compliance staffing strategy at ORNL Federal Credit Union ($1.6B, Oak Ridge, TN). In just over a year, the credit union's department has grown from one individual to four, says T. Wayne Hood, ORNL's senior vice president and general counsel. Hood joined ORNL in November 2012 to oversee the compliance department and develop a comprehensive enterprise risk management strategy.

"It's tough to go without a full-time compliance person at any asset size, but once you get past a couple hundred million, you need at least one person primarily dedicated to these tasks," says Hood, who ran a private practice that advised ORNL before joining the executive team. "We were fortunate to be able to bring on more staff in this department than some credit unions have in their entire organization."

As part of his hiring efforts, Hood ensures the talents of each individual complements, rather than overlaps, one another. For example, the credit union employs a full-time compliance officer who was hired primarily for research and implementation planning. It also uses a compliance advocate — promoted from the HR training program — to act as a go between for the different departments.

"This employee not only delivers compliance training to the front line but also listens to feedback and takes questions and suggestions for process improvements," Hood says. "This communication is crucial because we don't want the information we share to be perceived as only one way or always bad news."

CU QUICK FACTS

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12-MO LOAN GROWTH

0.51%
ROA

Although regulations limit what suggestions the credit union can legally implement, ORNL has been able to green light many staff suggestions that have saved time, dollars, or resources.

ORNL's third compliance employee focuses primarily on Bank Secrecy Act-related concerns, a "monstrous burden" that warrants the full attention of one person in and of itself, Hood says.

At ORNL, compliance is not restricted to middle management, and Hood's ability to have direct discussions at the executive level has helped his department secure resources, talent, and training as well as more accurately present the ROI of its efforts.

"Compliance is like insurance, you'll never make money from carrying it and it's sometimes hard to show the money you didn't lose by doing things the right way," Hood says. Still, his team is able to show how it has helped increased efficiency, standardize processes and policies, and manage the institution's reputation.

"We can point to things like the recent Target data breach and say, 'We have a plan for something like this and here's why we won't get caught by surprise,'" Hood says.

At the time of this writing, the credit union is on the hunt for a fifth compliance hire to focus on third-party vendor management.

SHARE AND SHARE ALIKE

"In the past, you really had three choices for dealing with compliance," says Steve Gibbs, manager of Shared Compliance Resources, a subsidiary of the Texas Credit Union League. "One, you could hire a compliance person, which was expensive and not always efficient because you would also have them focus on other tasks. Two, you could put an attorney on retainer, but you would likely only get feedback from them on major issues. Or three, you could have each department deal with things individually, which typically was the least productive and most destructive of the three."

Since 2006, Gibbs' organization has offered a fourth option — shared compliance officers. The company hires the officers and leases them among its 80 credit union clients in five states. A full-time compliance hire can cost anywhere from $60,000 to more than $100,000 annually. Through Shared Compliance Resources, credit unions pay for their compliance officer on an as-needed basis, which saves some organizations as much as 75%, Gibbs says.

A localized model pioneered by the Georgia Credit Union League served as inspiration for Shared Compliance Resources, but its multi-state approach offers several benefits.

"When I was with the Federal Reserve, there were former auditors and examiners who would provide consulting services to banks by pointing out inaccuracies and infractions," Gibbs says. "By using this free-agent structure, rather than simply assigning one compliance employee to be shared among a certain number of institutions, we can pull staff in and out monthly, quarterly, or annually as needed and they can provide assistance to almost anyone."

Following the Texas Ranger motto of "One Riot, One Ranger," the organization only hires those with key certifications and five-plus years' experience, which helps ensure officers can meet a range of institutional needs. And although the model seems like a natural fit for smaller credit unions, Gibbs says the service is most popular with credit unions in the $50-$500 million asset size.

"We've served credit unions from $1 million to more than $1 billion in assets," he says. "However, smaller credit unions might just want help to cleanup or eyeball things. It's the larger credit unions who typically want us to look over their existing compliance program or help develop a new one."

FINDERS KEEPERS

Once a credit union does find the right person or people for its compliance strategy, it must make sure they'll stick around for the long haul.

"Just like tellers and loan officers, once compliance individuals get good at their jobs, other businesses will want to lure them off to come work for them," Gibbs says.

Providing a competitive salary and benefits are a good start, but there's more to showing support than offering money.

"There are two things that matter more to compliance experts than their salary," Hood says. "One is securing the budget to have adequate training so they can keep up with the constant flood of regulation changes. The second is feeling that they are heard and respected by their executive management team."

To make sure you're providing adequate support, look beyond the employees to the job you are asking them to do.

"In a smaller credit union, it might be acceptable for a compliance officer to wear multiple hats," Gibbs says. "But at larger and more complex organizations, this puts a burden on them. [For example] compliance tasks should always be separate from audit because you need an independent perspective to be effective, and that can't happen if you have to audit your own work."

DO IT RIGHT THE FIRST TIME

How Belvoir Credit Union leveraged its compliance investment to benefit the credit union industry.

BY ERIK PAYNE

Early in 2010, Belvoir Credit Union ($326.6M, Woodbridge, VA) was considering new ways to generate non-interest income amid a tightening loan and investment market. Belvoir's CEO, Patricia Kimmel, suggested the credit union launch a compliance-focused CUSO to help credit unions manage regulatory requirements. By August of that year, Belvoir launched COMPASS 4 CUs.

"Rules and regulations have become thick, deep, and vast in terms of what they cover," says Jason Lindstrom, chief marketing officer at Belvoir.

To lead the new CUSO, which would focus on NCUA exams, Belvoir tapped its chief administrative officer, Gaye DeCesare, a 30-year industry veteran with experience in compliance solutions.

Initially, Belvoir's wholly owned CUSO consisted solely of DeCesare and the credit union's own compliance officer. Today, the staff includes four full-time employees as well as a marketing officer who are all dual employees of Belvoir and COMPASS. And although some employees have specialized areas of expertise, every employee must be knowledgeable about all areas of compliance so the CUSO avoids situations where clients can talk only to one person to satisfy a question.

3 COMPLIANCE SOLUTIONS

COMPASS offers three approaches to compliance. First, it can serve as as an external compliance officer on retainer. In this capacity, it reviews policies and procedures, conducts required independent tests, and trains volunteer staff. It cannot, however, act as a Bank Secrecy Act officer.

Second, it can serve as a marketing compliance officer on retainer. In this capacity, COMPASS reviews promotional material, website landing pages, and assorted marketing materials before clients distribute them. According to Lindstrom, this is a major asset for Belvoir's own marketing.

"To have COMPASS or a compliance team here looking at everything we send and [telling us] that it's wrong, or we want to change this language, or the font needs to be larger, all those things make a difference," he says. "Especially when there is someone out there watching you."

Third, COMPASS offers à la carte services to credit unions that can't afford or don't need a retainer contract. The CUSO offers this one-off service model as an affordable alternative for smaller credit unions. The CUSO's smallest client holds $35 million in assets, but despite its third option, the average

CU QUICK FACTS

Belvoir Credit Union
WOODBRIDGE, VA

$326.6B
ASSETS

26,709
MEMBERS

78
BRANCHES

2.13%
12-MO SHARE GROWTH

5.30%
12-MO LOAN GROWTH

0.26%
ROA

"None of us has worked anywhere but credit unions for our entire adult lives. So we talk the talk, we walk the walk, [and] we don't quote bank [regulations]."

asset base of the 20 credit unions that hold it on retainer is $150-$300 million.

"When we initially had the idea of this CUSO, our thought was that most of the credit unions would be small and wouldn't have a compliance officer on staff," DeCesare says. "But we are finding that small credit unions can't afford us even though we are more affordable than a staff person."

DeCesare declined to reveal the cost of COMPASS' services, other than to liken a 12-month contract to the cost of an entry level teller, and estimated the CUSO's services are no more than a quarter of the cost of one full-time compliance officer.

Although those costs are not insignificant, they are a necessary evil to which every credit union must acquiesce.

"You have to spend money on compliance," Lindstrom says. "There's just no way around it. If you don't, you are going to end up in trouble."

DeCesare agrees.

"It always costs less to do it right the first time," she says.

MORE THAN MONEY

Compliance is an ever-evolving, convoluted area in which credit unions must invest valuable time and money. As regulations change, officer training and credit union policies become irrelevant. However, as much as regulatory compliance affects back-office business practices, it also has a measureable impact on credit union membership.

"Compliance officers get a bad rap sometimes — and some of them deserve it because they are very black and white and didactic," DeCesare says. "Our approach is to keep a message in mind: Make it easy for the member to understand. Make it easy for the credit union while at the same time keeping them out of jail."

The CUSO would not be able to achieve its goals without the collective expertise of its team, which Lindstrom describes as, "100 years of experience for the price of a teller." COMPASS' solutions start with them, without their qualifications, experience, and knowledge of the credit union industry, the CUSO wouldn't work. They stay up to date on compliance, pass on their knowledge to their credit union clients, and the members reap the benefits.

COMPASS is not the only compliance services CUSO; nevertheless, DeCesare believes it serves a distinct niche. COMPASS works only in credit union regulatory compliance, while other compliance services providers merge into banking and trade associations.

"None of us has worked anywhere but credit unions for our entire adult lives," DeCesare says. "So we talk the talk, we walk the walk, [and] we don't quote bank [regulations]."

A CFO'S LESSONS FROM $10 BILLION AND BEYOND

Tips from BECU on how to manage growth and risk under increased regulator scrutiny.

BY AARON PUGH

With $13.6 billion in assets, 1,231 employees, more than 40 branches, and more than 886,000 members — a larger body of people than the population of the city it calls home — BECU ($13.6B, Seattle, WA) is a complex organization in every regard.

BECU is subject to oversight from both the NCUA and Consumer Financial Protection Bureau (CFPB). It is also one of five credit unions nationally subject to the capital planning and stress-testing requirement added last year by the NCUA for credit unions with $10 billion or more in assets. Ten billion dollars is also the threshold for the CFPB to impose direct oversight on banks and credit unions in several regulatory areas.

The brunt of managing these new balance sheet responsibilities — as well as the institution's accounting, planning, corporate insurance, fraud department, records, and much more — lies with Kathy Elser, the credit union's senior vice president of finance and administration, corporate treasurer, and CFO.

Here, Elser shares details of BECU's market positioning, tips for complying with regulators without letting innovation or member service levels suffer, and how the big credit union is preparing to work with examiners.

KATHY ELSER
SVP OF FINANCE AND ADMINISTRATION, CORPORATE TREASURER, AND CFO AT BECU

WHAT ARE BECU'S GOALS AND STRATEGIES FROM A BALANCE SHEET PERSPECTIVE?

KE: Lending, lending, and lending. Our loan-to-share ratio has been hard to move. The original plan for 2014 was to be around 65% loan-to-share. We ended the year higher because of changes in strategy we knew we could accommodate from an interest rate risk perspective. For example, we started holding some 30-year fixed-rate mortgages on our books, which was something we had not done in the past.

We kept investments short through 2014, waiting for rates to pop up. If we do see rate spikes this year, we'll take advantage of that. We don't look at our investments as an income-producing component so much as a rudder that helps steer our balance sheet.

Another big goal is to build capital. We don't know what the regulators' expectations are now that we're subject to capital planning and stress testing requirements. If you look at our plan, we're targeting to end 2015 with a capital ratio of 10.6%.

CU QUICK FACTS

BECU
SEATTLE, WA

$13.6B
ASSETS

925,593
MEMBERS

1,304
BRANCHES

8.15%
12-MO SHARE GROWTH

13.04%
12-MO LOAN GROWTH

1.48%
ROA

“We’ve developed risk appetite statements, which are definitions that management creates and gets board approval on.”

HOW WOULD YOU CLASSIFY BECU’S APPETITE FOR GROWTH?

KE: We have an appetite for growth but not growth for growth’s sake. We’ve been growing at about 5% of assets — about $1 billion a year. It’s been an interesting world growing beyond $10 billion.

If I were to look at our biggest areas for growth, engagement — further deepening relationships with the membership — is first.

Then there’s market penetration. We have opportunity for further penetration, especially in some of our calmer micro-markets. But we still have to weigh the value we can present to an individual community against the costs to the broader membership.

The third bucket is mergers and the last would be growing our affinity relationships. For example, this year we’ll be launching a national co-branded credit card with the Boeing Company.

HOW HAVE BECU’S ERM STRATEGIES EVOLVED OVER TIME?

KE: We’ve developed risk appetite statements, which are definitions that management creates and gets board approval on. They cover everything from how we define risk to how much risk we can comfortably manage. Across the organization, we all have a clear picture of our thresholds.

The capital planning and stress testing is forcing us to step back and take a comprehensive view of all the pieces of our business, how they all fit together, and how that ultimately impacts capital. If you don’t understand those things, how can you make the best decision on behalf of your members?

The big unknown for us right now is the examiner appetite for risk. You always want to make sure you can quantify your capital, what you think is adequate, and then hold true to that.

WHAT ADVICE WOULD YOU GIVE TO OTHER CREDIT UNIONS WHO MIGHT BE SUBJECT TO ADDITIONAL REGULATORY REQUIREMENTS IN THE FUTURE?

KE: Start documenting all of your procedures and policies, and make sure you have a board that can mature with you.

A good board isn’t a board that’s just going to say, “Yes management, we believe everything you say.” You need a board that’s going to trust, but also push, you.

Small credit unions are not going to be subject to an external stress test, but I think there will ultimately be an expectation for organizations to determine how they define capital adequacy. From there, you’ve got to work that back into your risk identification framework and how that feeds into your strategic vision.

3 ERM LESSONS FROM BECU

BECU’s senior managers learned a lot about enterprise risk management (ERM) while managing their credit union’s growth. Here are a few.

1. CFO Kathy Elser says the discussions around building BECU’s ERM plan “were some of the best we ever had,” citing the wider perspectives that came from going beyond just the mathematical calculations of risk and reward.
2. “Risk is inseparable from strategy development,” Elser says. “You need to look at your risks and make sure you’re creating value for your members and making decisions that are consistent with your core mission.”
3. “We’re really conservative and protect our brand pretty much at all costs,” Elser says. But, she says there might be times where you have more room in your interest rate measurements or you’re going to go deeper on your credit. That’s the opportunity when you get to make this decision: “Our loan portfolio has been performing well, so do we get more aggressive on that?”

ENTERPRISE RISK OVERVIEW SHOWS PROGRESS, WAY FORWARD

Your risk management processes may be fine today, but are they sufficient to lead you tomorrow?

BY THE ROCHDALE GROUP

SCOTT HOOD
ROCHDALE GROUP

Those of us with The Rochdale Group have the opportunity to work with many credit unions, of all sizes, in implementing and enhancing their risk management processes. Our consultants have the luxury of viewing very effective risk management processes at some credit unions as well as a great number of processes that are less than "best practice."

We have learned from hearing stories about things that work well for credit unions as well as the things that didn't go quite as planned. We find the knowledge gained from these interactions valuable as we work with credit unions in improving their risk management practices to the levels necessary to consider diverse risk profiles and attain the delicate balance between best meeting the needs of members and ensuring safety and soundness going forward.

Our experience is that credit unions that fail to maintain sufficient risk management processes to confidently understand and manage key risks today often are ill-prepared to leverage uncertainties and opportunities tomorrow. Effective risk management is about much more than organizational value preservation. It's about embedding a process into the culture of the institution to constantly drive value creation.

CURRENT STATE OF ENTERPRISE RISK MANAGEMENT TODAY

Many credit unions, of all sizes, have enterprise risk management programs in place. Those programs range from comprehensive processes that analyze risk across the organization and use that information for strategic and operating purposes, to programs in their infancy, where the risk identification process has just scratched the surface. However, most struggle with bringing together information from all of their risk management silos into a comprehensive program and summarizing the information for senior management and boards.

CREDIT UNION RISK MANAGEMENT HAS IMPROVED

Most credit unions today have reasonably effective credit, asset-liability management, information security, and physical security programs. In fact, most are incurring net credit losses well below their allowances for loan and lease losses, and in sessions to identify and assess their lending risks, seldom identify residual credit risk that is much more than 50% of allowance balances.

Most credit unions also seem comfortable with their ALM processes. The ease of placing excess reserve balances at the Federal Reserve Banks for short-term

"Remember that you're looking out for the best interests of members, and certainly should be advising them of ways to improve their lives, even if that means having systems and processes to ensure your people constantly offer them your ideas."

investing, excess liquidity, and other reasonable ALCO processes mean that ALM is not a source of great discomfort for most credit unions today.

Physical security, meanwhile, is so well entrenched at most credit unions that it seems to be an afterthought. Most credit unions have strong processes around opening, closing, surveillance, locks, dual control, lighting, staffing, greeting, and robbery training, in addition to insurance.

Finally, the credit unions we meet generally describe extensive information security processes. Effective information security continues to be a challenge as security professionals are constantly trying to keep up with internal and external vulnerabilities and new security threats.

BIG RISKS CREDIT UNIONS FACE IN THE FUTURE

Although many credit unions are comfortable with their current risk management practices, tomorrow will bring increasingly complex risks requiring new tools, paradigms and vision:

- Lack of brand image in market and lack of emphasis on sales
- Increasing threats on information security and complexity or ineffective use of information technology
- Threats to credit union philosophy and difficulty in providing and measuring value to members
- Uncertainty of business continuity recovery processes
- Ineffective vendor management and potential loss of personal information by third parties
- Challenges in recruiting, hiring and retaining top performing staff

LACK OF BRAND IMAGE IN MARKET, LACK OF SALES EMPHASIS

Many credit unions continue to have lower than desired loan-to-share ratios and attribute this to a lack of lending demand or a member base that does not need to borrow. It's true that some credit unions have members that have relatively modest borrowing needs. However, why is it possible for so many credit unions in the same markets to serve their members so fully through healthy lending activity?

As we look at those credit unions, we usually see that they are highly effective in promoting their brands in their markets. They engage in strategic marketing, community involvement, and other promotional activities so that everyone knows they are full-service financial institutions and are "top of mind" when people look for loans. This is not always easy for non-community-based credit unions, but even those with narrow fields of membership need to heavily promote themselves within their field of membership.

Once successful credit unions have members in the door, they don't hesitate to inform them of the products that would be beneficial to them. Yes, this means selling products to people and not just idly taking orders, and some people feel uncomfortable with this. But just think about this for a minute — the entire reason members are with the credit union is to use its financial products.

Most members who are not borrowing from the credit union are borrowing somewhere. Remember that you're looking out for the best interests of members, and certainly should be advising them of ways to improve their lives, even if that means having systems and processes to ensure your people constantly offer them your ideas. You can bet your competitors do, and they might not share your philosophy of looking out for the best interests of members in the process.

THREATS TO CREDIT UNION PHILOSOPHY, VALUE-MEASURING DIFFICULTIES

Credit unions, like other financial institutions, tend to measure their financial success through a variety of measures, principally the return-on-assets ratio, but credit union value goes way beyond that metric. You provide value to members through lower loan rates, higher share rates, increased service levels, education, community involvement, and other avenues.

We recently met with a very large credit union that targets a significant portion of income to give back to the community, and the ability to generate returns sufficient to support that target is a key strategic objective. Almost all credit unions forget about many of the ways they support their members and very few track any measures of total member value.

Because supporting the credit union philosophy and providing member-owners with added value is critical to ensuring the survival of our industry, it's important for credit unions to think about the ways they provide that value, measure their returns to members, and communicate those benefits to the membership.

In many cases, we find that members are not even aware of their status as member/owners, further exacerbating the inability to differentiate credit unions through the overall value provided.

INFORMATION SECURITY, INFORMATION TECHNOLOGY

Every large credit union we meet tells us it experiences daily external penetration attempts! Even the credit unions with the most advanced information security programs are nervous about breaches, and fear a large incident could result in a loss of confidence and substantial reputation costs. Most credit unions assess this risk as having the largest potential impact of any of the risks they identify.

Clearly, every credit union should focus on ensuring it has the best information security processes it can afford. If the credit union cannot attain a best-practices level of security internally, it likely should consider the use of third-party services that can provide such a level.

Another interesting risk that we hear in this area is the potential for ineffective deployment of technology, coupled with the need to mesh technologies from a large number of systems. Almost every IT area cites a failure to involve IT personnel up front in selecting systems. Thus, every credit union needs an IT strategy, refreshed periodically, covering desired architecture and other system considerations, and IT personnel always should participate in the selection of every system.

UNCERTAINTY IN BUSINESS CONTINUITY RECOVERY PROCESSES

All credit unions say they have business continuity processes but often discuss uncertainty about their abilities to recover. Only about half of even the largest credit unions we work with regularly roll over or formally test their backup capabilities and many are afraid to do such testing due to uncertainty about being able to roll back.

Another issue revolves around relocation assignments and communication. After speaking with 10 to 20 areas in a credit union, we often are surprised to learn that they all plan to relocate to the same branch. It becomes apparent that the credit union never has thought about the number of personnel at certain recovery locations or communicated the actual plans to staff. Thus, even credit unions that think they have strong disaster recovery processes should revisit this topic.

INEFFECTIVE VENDOR MANAGEMENT, THIRD-PARTY INFORMATION LOSS

Vendors play a major role at most credit unions. The majority would say they have vendor management processes in place but what we see is that many of these processes have become a "check-off-the-list" exercise, done at the end of each period, providing little strategic value to the credit union.

Almost all credit unions could improve this process by ensuring the process receives the resources necessary, in terms of strong staff and systems. The process also should focus on the strategic side of the vendor relationships and ensure that personnel manage the vendors to strong performance that supports the specific goals of the credit union.

Credit unions provide a great deal of member and other information to their vendors. Many departments cite the potential loss or theft of member information as a large vendor risk. Thus, as part of the vendor management and information security processes, credit unions should identify the types of data being provided to vendors, evaluate the vendors' processes for safeguarding that information, and ensure they are comfortable with those processes.

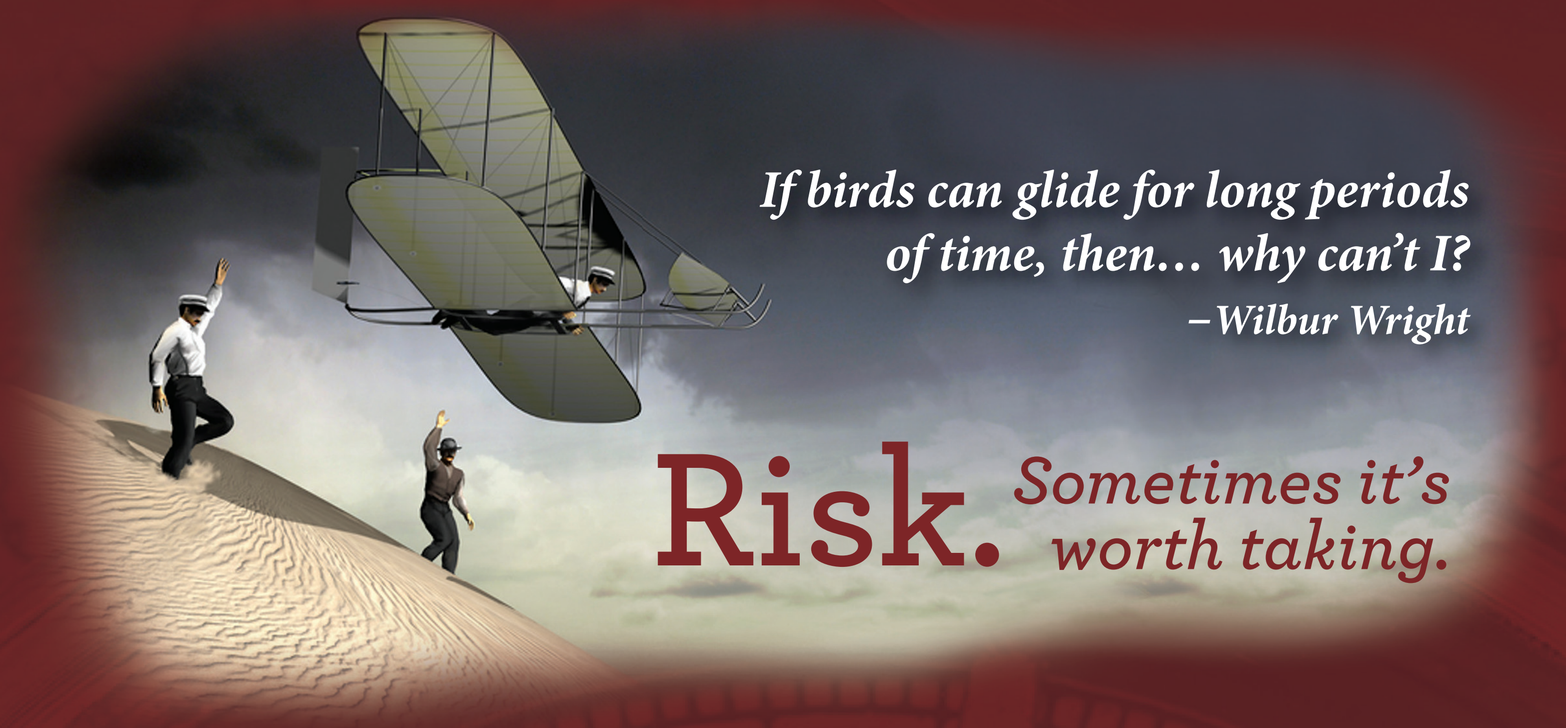
CHALLENGES IN RECRUITING, HIRING, RETAINING TOP-PERFORMING STAFF

Finally, most credit unions cite a key exposure to finding and retaining the people they need to provide the wide array of increasingly complex products and services demanded by members. This is experienced through unfilled positions, underperformance, the potential loss of key people needed to support certain business functions (e.g., member business lending), and lack of senior management succession capabilities.

Credit unions should ensure they have the compensation and benefit plans to attract strong talent; the culture, training and advancement opportunities to nurture those people; and plans for orderly replacement of senior management team personnel.

IN CONCLUSION

Credit unions have improved their risk management practices in recent years, and comprehensive enterprise risk management programs have contributed to this progression. It is not time to let down our guard during the recent, relatively stable economic environment. Credit unions are facing even larger and more complex risks, and must approach risk management strategically and opportunistically in order to achieve the greatest benefits possible from their risk management programs.



WHAT IS ERM DIRECTOR?

ERM Director provides a web-based solution for housing and periodically updating all of your ERM data. ERM Director significantly eases the generation and administration of reports, allowing the credit union to focus on the organization's key risks and opportunities rather than administrative processes.

ERM Professional Services:

- Implementation
- Risk Appetite
- Program Review
- Ongoing Support
- Strategy Execution
- Training
  (Practitioners, Management and Board)

BENEFITS

- Assurance in meeting strategic objectives
- Organizational alignment for better execution
- Coordination of resources across risk programs
- Improved ability to act upon opportunities and risks more proactively
- Enhanced risk taking for more efficient utilization of capital
- Improved regulatory relationships
- Elimination of organizational silos
- Engaged personnel across the organization
- Improved assessment and management of risk posture

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