

Embedding a risk management and compliance culture in credit unions

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Title of Presentation

Deconstructing parts



“Embedding a risk management and compliance culture”

1. Embed

2. Culture

3. Risk Management

4. Compliance

} Not defined in legislation

} Defined in legislation

Title of Presentation

Deconstructing parts



- “Embed” and “culture”
- Qualitative
- Dependent on the use of individual judgement
- “Implement” versus “embed”
- “Practice” versus “culture”

Structure of Presentation

Format



1. Risk management as per legislation
2. Compliance as per legislation
3. Concept of embedding a culture
4. How do you measure this?
5. Conclusions

Layout of Presentation

Context



But first, two stories to set some context

1. One old.....
2. One new.....

Old Story

Medieval Europe



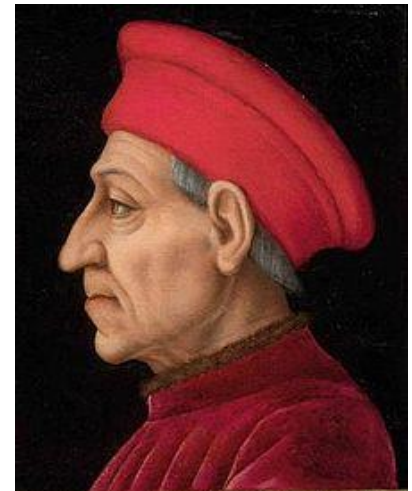
- Banking made major advances in Medieval Europe
- Traders in Northern Italy, Lombards, developed sophisticated banking structures
- Piazzas in Genoa, Venice and Florence enabled the provision of credit
- Credit was provided on benches – “*banca*”
- When the bench ran out of money, the bench was rotten, “*banca rotta*” i.e. bankrupt

Old Story

The First Major Bank



- First major Bank was “Medici Bank” near Florence
- Grew sophisticated internal systems
- Expanded across borders
- Became first major multinational bank
- Brought down by its London branch
- Who failed to manage risk.....



Old Story

The First Major Bank



- The London branch made big loans to a British royal



- Edward IV
 - Total losses of 51,533 gold florins
 - War of Roses
 - London branch failed
-
- The first major failure in credit risk management

New Story

Timothy Geithner



- Timothy Geithner
- President of the New York Federal Reserve, 2003-2009 (i.e. Central Bank)



New Story

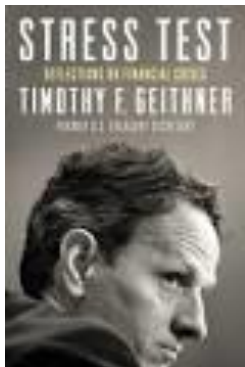
Timothy Geithner



- Went onto become Secretary of the Treasury 2009-2013



- Wrote his memoirs. “Stress Test”, May 2014



New Story

Timothy Geithner



- Geithner tells a story from 2008 at time when Lehman crisis was looming....
- He met with Merrill Lynch to discuss their financial strength.....



- USA Investment Bank
- It had >\$1 trillion in assets
- Over 60,000 employees

New Story

Timothy Geithner



- Merrill Lynch CEO was John Thain



Nickname on
Wall Street....
“Superman”



- AP: Earned \$83m in 2007
- Reported to have decorated office for \$1.2m, spending \$1,100 on a thrash can

Context

Timothy Geithner



- So Timothy Geithner meets John Thain



- And Geithner recounts an event...
- *“When Merrill Lynch CEO John Thain brought his team to see me that spring, there was an awkward moment when it became clear he didn’t know the name of his chief risk officer, who was sitting right next to him.”*

Context

Old and New Story



Conclusions

1. Embedding risk culture is not a new challenge...



2. Embedding risk culture is not just a challenge for the small.....



Structure of Presentation

Format



1. Risk management as per legislation
2. Compliance as per legislation
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4. How do you measure this?
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1. Risk Management

Risk Management

Requirements in ROI & NI



Credit Union Act, 1997 (as amended)

“a credit union shall develop, implement, document and maintain a risk management system with such governance arrangements and systems and controls to allow it to identify, assess, measure, monitor, report and manage the risks which it is, or might reasonably be, exposed to”

CREDS 2.2 (Guidance)

“A credit union must have robust governance arrangements, which include ... effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms...”

Risk Management Process



Identify

Assess

Measure

Monitor

Report

Risk Management

Identify.....



Identify

Assess

Measure

Monitor

Report

Risk Management

Identify....



CBI handbook:

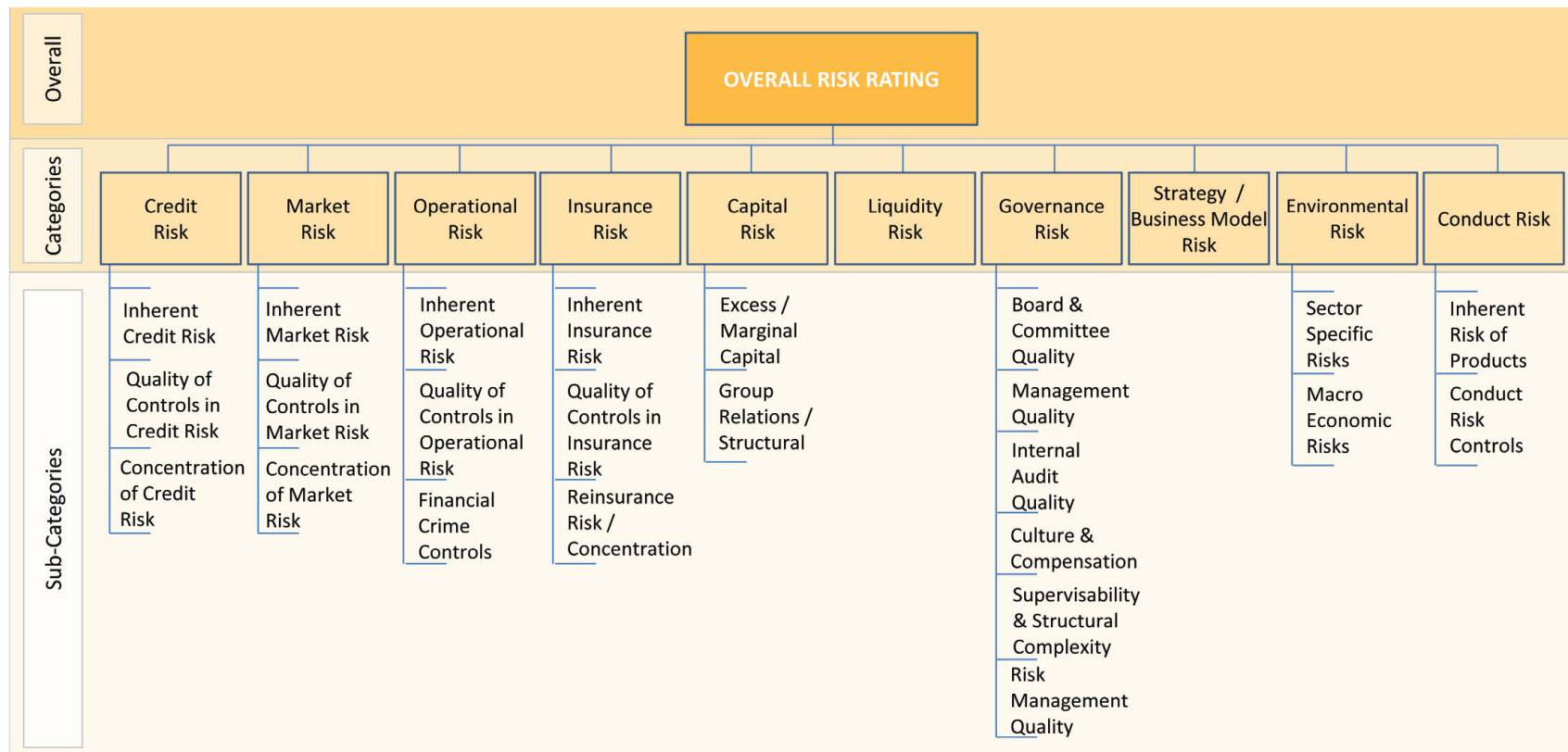
Risk identification should provide a comprehensive 'credit union-wide' view of risk across all material risk types relevant to a credit union.

Risk Management

Identify....

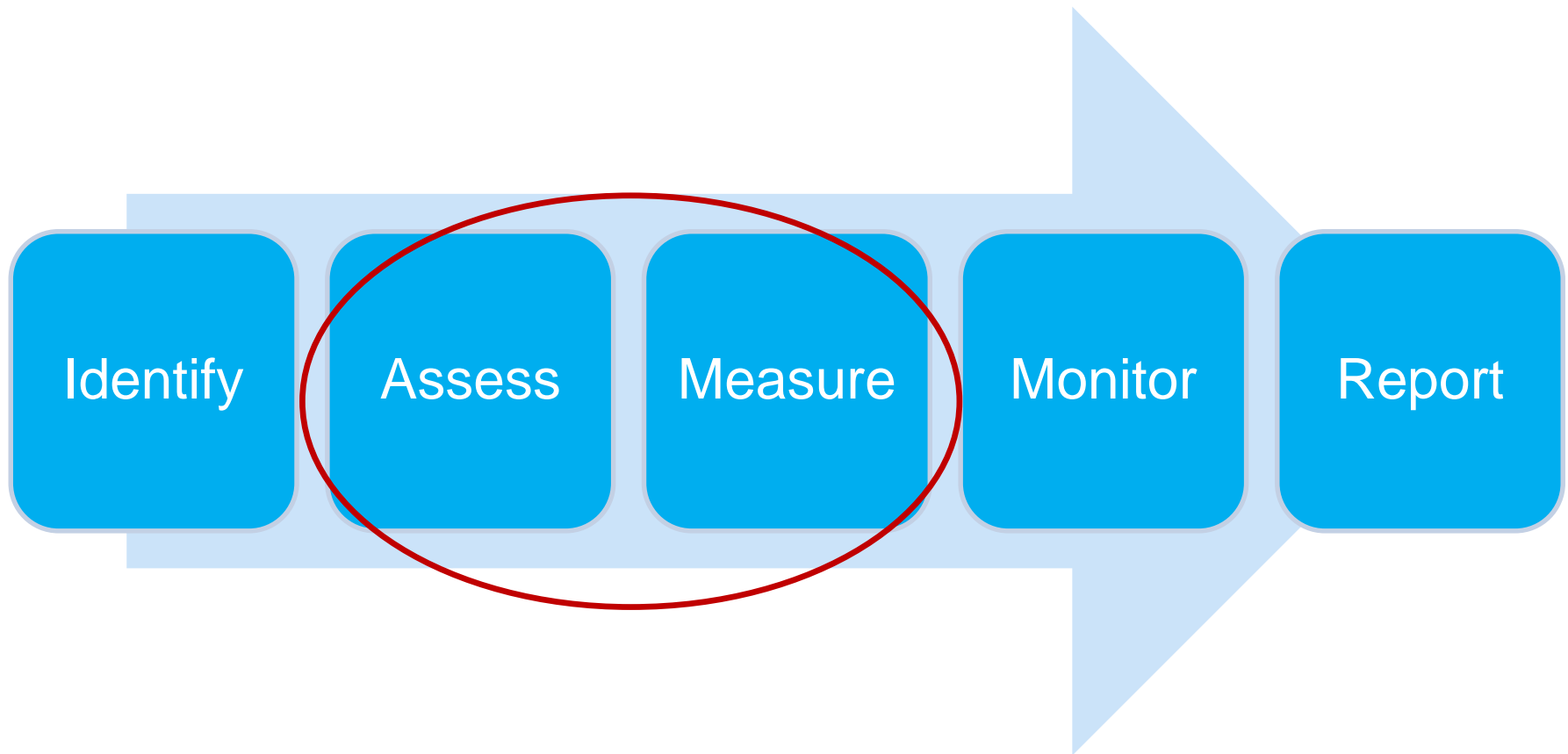


Develop a risk register based on PRISM risk types...



Risk Management

Assess and Measure.....



Risk Management Assess



CBI Handbook:

Risk assessment and measurement includes considering the likelihood of a risk occurring and the potential impact of the risk on the credit union.

SYSC 7.1.2 (Guidance):

A (credit union) should establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which identify the risks relating to the firm's activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm.

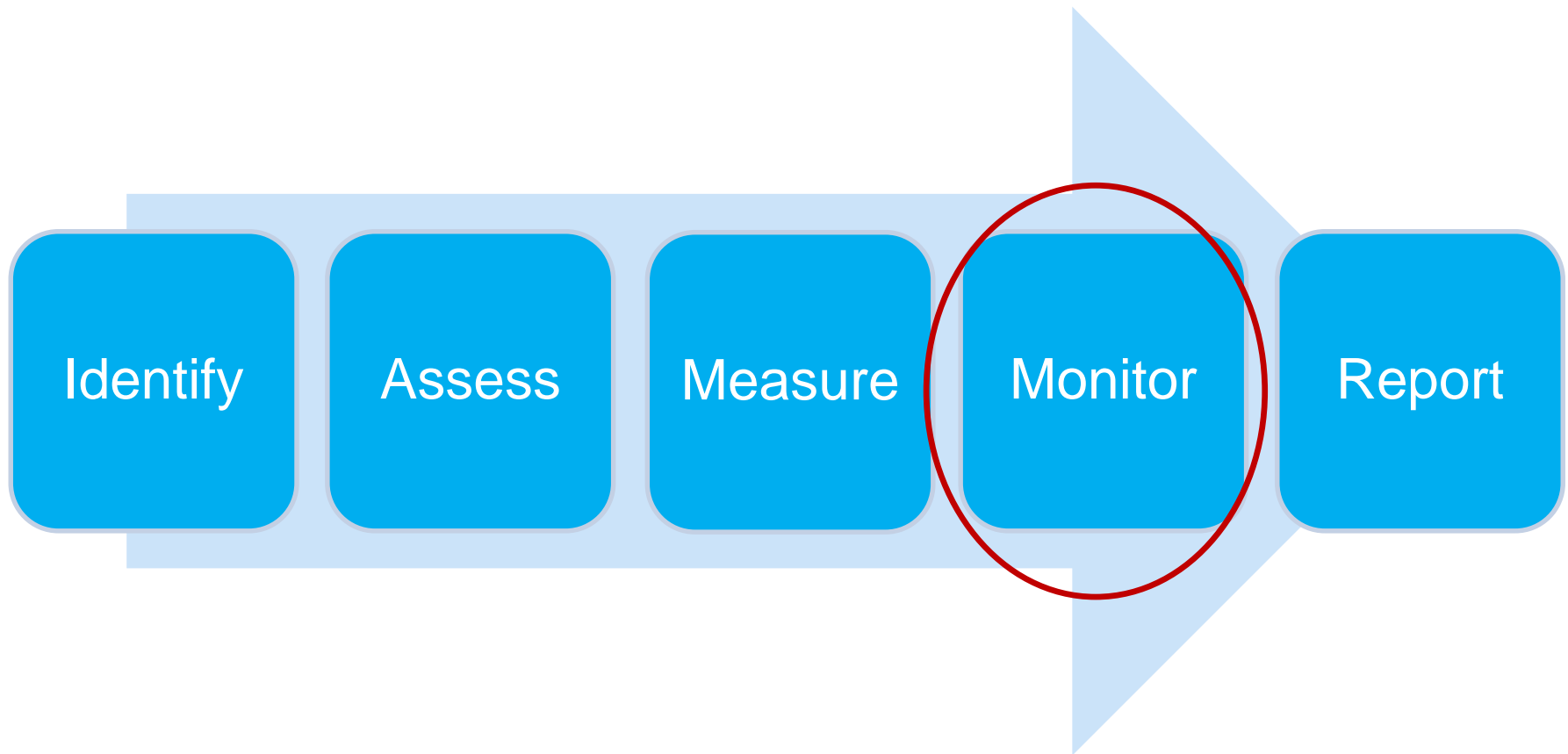
Risk Management Assess



<div>↑</div>	Constant	Probability	5	10	15	20	25
	Daily		4	8	12	16	20
	Weekly		3	6	9	12	15
	Occasional		2	4	6	8	10
	Seldom / Rare		1	2	3	4	5
			Impact				
			Minor loss	Medium/	Multiple Medium	Serious loss	Catastrophic
			<div>→</div>				

Risk Management

Monitor.....





CBI Handbook

The credit union should monitor significant risks on an ongoing basis to ensure that risks are actively managed and should ensure that timely action is taken, where appropriate, to reduce risk to acceptable levels.

SYSC 7.1.4 (Guidance)


The (board) of a (credit union) should approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the firm is or might be exposed to...

Risk Management

Monitor.....



Risk Reg Number	Risk Description	Inherent Probability	Inherent Impact	Inherent Rating	Control	Control Owner
3	Inadequate verification of member's net disposable income	4	4	16	Prescriptive credit policy setting clear requirements	Board of Directors

Risk Reg Number	Risk Description	Inherent Probability	Inherent Impact	Control Strength	Residual Risk Rating	Corrective Action Needed	Monitoring Responsibility
3	Inadequate verification of member's net disposable income	4	4	0.5	 8	Compliance Checks	CEO

Risk Management Report.....



Identify

Assess

Measure

Monitor

Report

Risk Management Report.....



CBI Handbook

The risk management officer should provide reports on a monthly basis to the board of directors (or risk committee where one exists). Copies of these reports should be provided to the manager.

Risk Management Report.....



Risk Report

- *Significant risks*
- *Risk events*
- *Deviations in tolerances*
- *Trends*
- *New risks*
- *Emerging risks*



2. Compliance



Credit Union Act, 1997 (as amended)

“A credit union shall have in place the oversight, policies, procedures, practices, systems, controls, skills, expertise and reporting arrangements to ensure compliance with the requirements set out in this Part”

CREDS 2.2.29 (Guidance)

“Depending on the nature, scale and complexity of its business, it may be appropriate for a credit union to have a separate compliance function.”

Compliance

Credit Union Act, 1997 (as amended)



Compliance Programme

Compliance
Policy

Compliance
Plan

Annual Review

Compliance

Compliance Plan



Compliance Plan

- *Objectives*
- *Organisational arrangements*
- *Work programme*
- *Resources*
- *Reporting arrangements*
- *Review of plan*



3. Embedding a culture

Embedding a Culture

“Embed”



“EMBED”

- The Oxford Dictionary:
“...fix something firmly and deeply....”
- Institute of Risk Management
“Making an intrinsic part of the day-to-day activities of the business”

Embedding a Culture

“Embed”



“EMBED”

- Institute of Risk Management
- Levels of embeddedness....

5	Approaches to managing risk are fully embedded in day today business processes and strategies
4	Approaches are adopted and improving but not fully embedded
3	Implementation has been completed in key areas
2	Implementation is planned but not delivered
1	There is an awareness or understanding but no action has been taken



Embedding a Culture

“Embed”



“EMBED”

- Where are Irish Credit Unions ?

5	Approaches to managing risk are fully embedded in day today business processes and strategies
4	Approaches are adopted and improving but not fully embedded
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Credit Unions
In the future?
Now ?
Now ?
New Act ?
CU Commission?

Embedding a Culture

“Culture”



CULTURE

- London School of Economics Research Paper:

“There have been many efforts to define risk culture and this multiplicity tells us something, namely that it is conceptually rather fuzzy”

Embedding a Culture

“Culture”



CULTURE

- Pettigrew, 1979:

“In order for people to function within any given setting, they must have a continuing sense of what that reality is all about in order to be acted upon. Culture is the system of such publicly and collectively accepted meanings operating for a given group at a given time ... The offspring of the concept of culture are symbol, language, ideology, belief, ritual, and myth.”

Embedding a Culture

“Culture”



CULTURE

- Kundu, 1992:

“When applied to organisational settings, culture is generally viewed as the shared rules governing cognitive and affective aspects of membership in an organisation, and the means whereby they are shaped and expressed.”

Embedding a Culture

“Culture”



CULTURE

- Alvesson, 2002:

“Culture is not primarily ‘inside’ people’s heads, but somewhere ‘between’ the heads of a group of people where symbols and meanings are publicly expressed, e.g. in work group interactions, in board meetings but also in material objects.”

Embedding a Culture

“Culture”



CULTURE

- Institute of Risk Management, 2011:

“Risk culture is complex and multi- faceted. At its simplest it is how risk management is factored into decision making...”

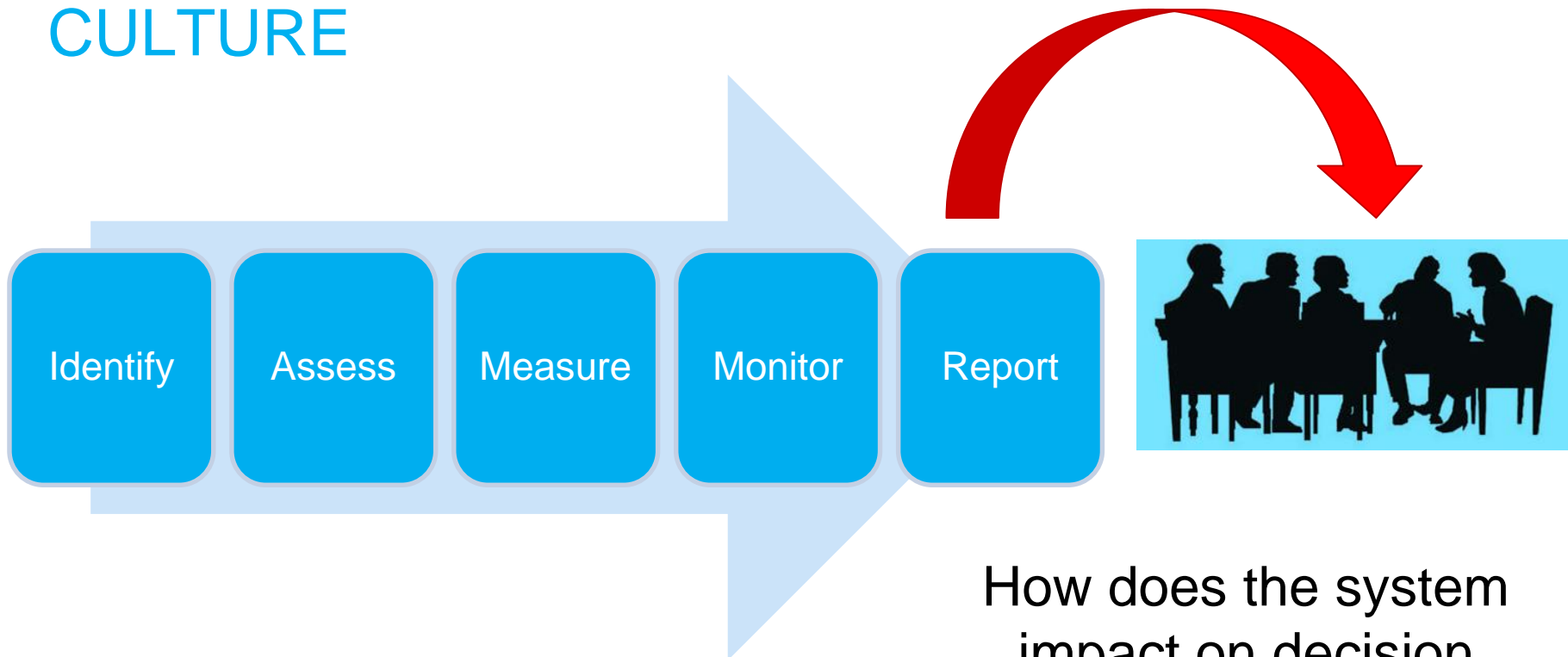
Best and most simple definition ?

Embedding a Culture

“Culture”



CULTURE



Defined by culture.....

Embedding a Culture

“Culture”



Put another way:

- A credit union has objectives
- Risks are things that prevent a credit union reaching its objectives.
- Risk management is about informing decision making to give credit unions best opportunity to make strong decisions
- The measure of risk management is how risk management informs decision making

Embedding a Culture

“Culture”



Lets retro-fit an example.....

- Year: 2005
- Credit union objective: provide for members socio-economic needs
- How:
 1. By expanding into bridging property lending
 2. By investing in higher yielding riskier bond products
 3. By developing new premises

Embedding a Culture

“Culture”



2005

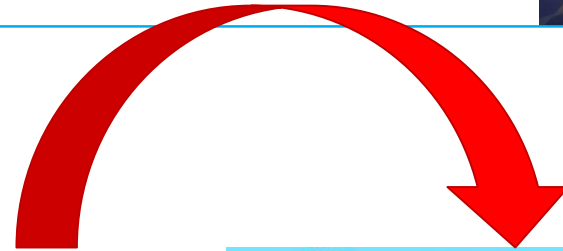
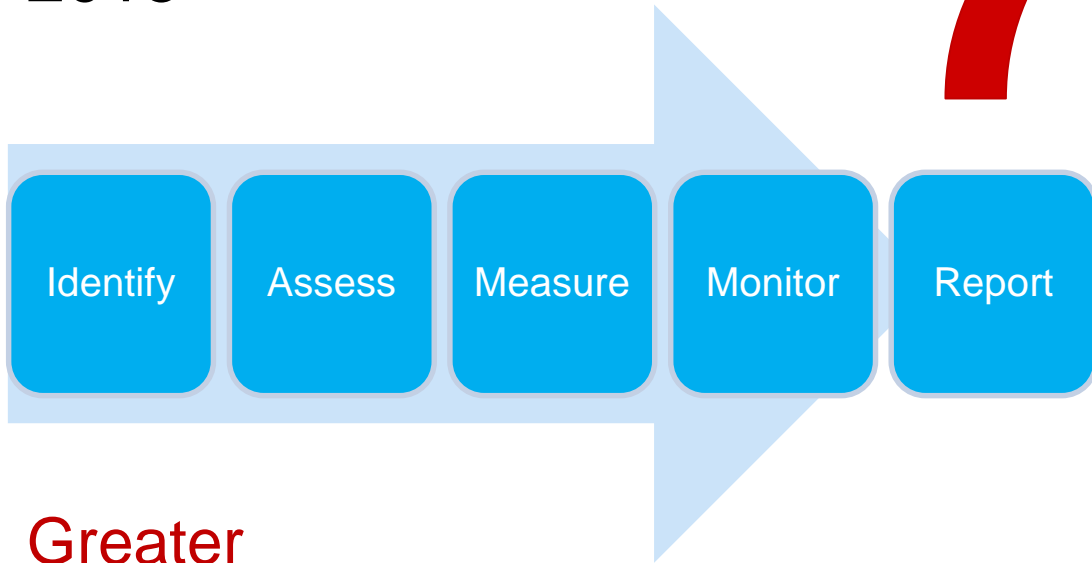


Do we engage in bridging lending?
Do we invest in riskier bond products?
Do we expand our premises?

Embedding a Culture “Culture”



2015



Greater
infrastructural
support...

Do we engage in bridging lending?
Do we invest in riskier bond products?
Do we expand our premises?

Embedding a Culture

“Culture”



- Difficulty is that risk management may be seen as a legal box to be ticked for credit unions
- Or responding to regulatory pressures
- Not a way to lead to better decision making.

Embedding a Culture

“Culture”



- London School of Economics conducted Survey of Financial Institutions
- Question: “The main drivers of the ‘risk culture’ change programmes were ...”. Score 1 to 7.

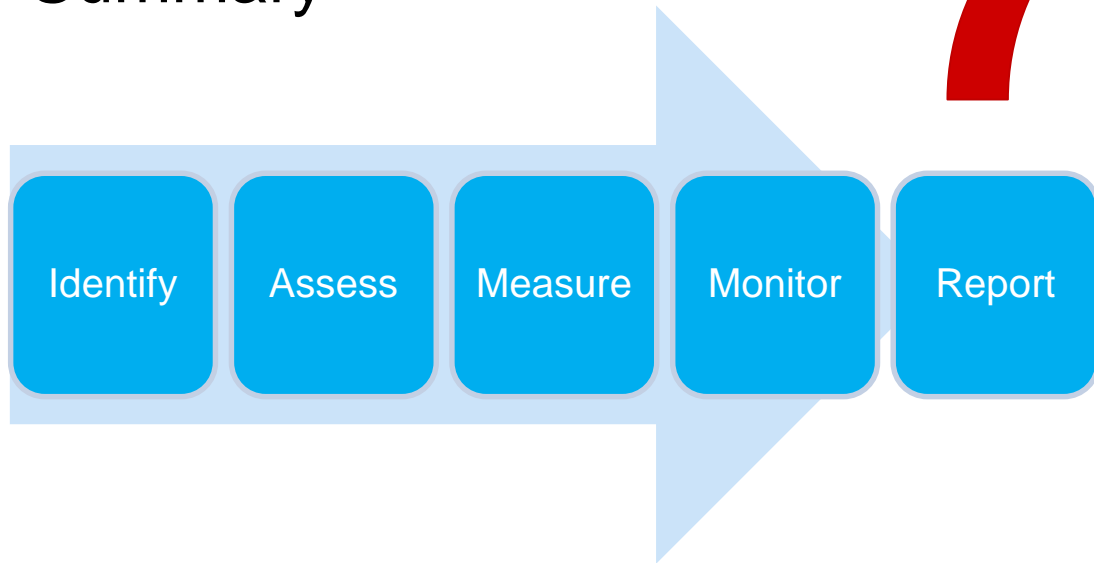
Reason	Score
Regulatory requirements	5.2
Expectations of regulators	5.2
Critical events and/or near misses	4.5
Expectations of financial analysts	4.4
Expectations of shareholders	4.5
Losses and/or organisational crises	4.2

Embedding a Culture

“Culture”



Summary



Institute of Risk Management, 2011:

“Risk culture is ...how risk management is factored into decision making”

Not just a legal/ regulatory requirement.....

4. How do you assess if culture is embedded?

Assessment

General



- If embedding risk culture is “fuzzy”, how do you know if your credit union has embedded?
- Techniques needed for evaluating risk management embedding
- Institute of Internal Auditors issued a paper December 2010 – “*Assessing the adequacy of risk management using ISO 31000.*”
- Provide a useful framework for assurance on risk management

Assessment

IIA Framework



- This identifies 3 approaches to providing assurance:
 1. Process Element Approach
 2. Key Principles Approach
 3. Maturity Model Approach



1. Process Elements Approach

- Approach checks whether each element of the risk management is in place.
- In line with ISO31000, there are 7 elements of a risk management process
- You therefore assess risk management by reference to the 7 elements
- Very much a formulaic approach i.e. tick the box

Assessment

IIA Framework- Process Elements



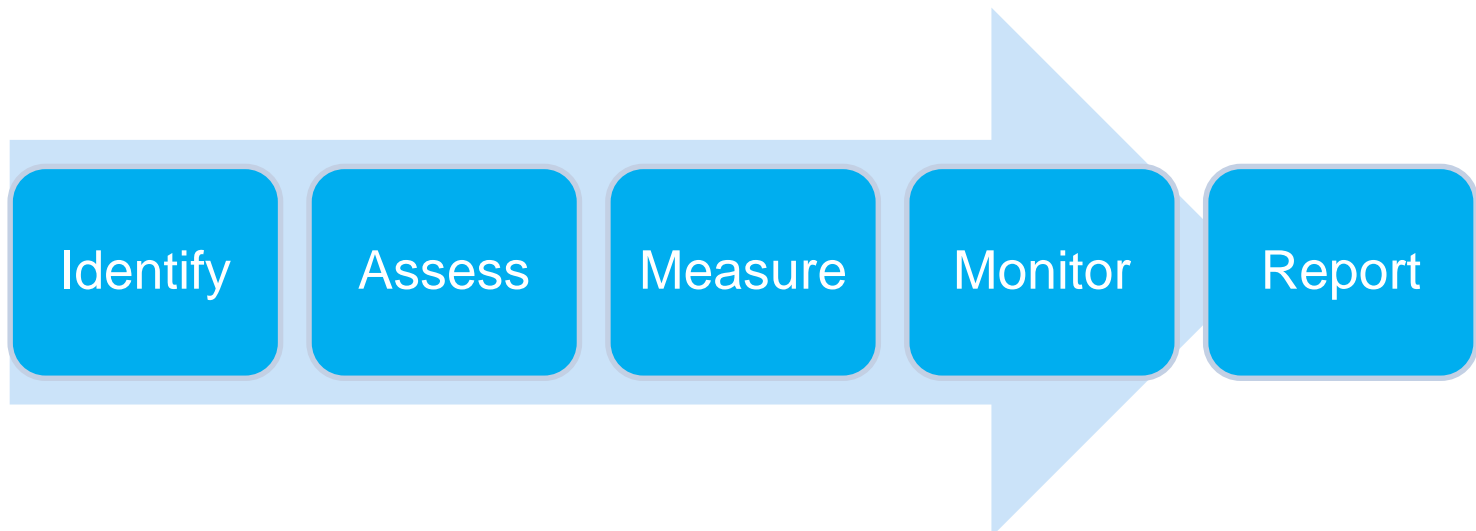
1. Process Elements Approach

Element	Area
Element 1	Communication
Element 2	Context/ Environmental Awareness
Element 3	Risk Identification
Element 4	Risk Analysis
Element 5	Risk Evaluation
Element 6	Risk Treatment
Element 7	Monitor and Review



1. Process Elements Approach

- But, current legal and regulatory requirement aligned to these 7 elements in any event:



- Therefore, these elements should already be in place in Irish credit union.....

Assessment

IIA Framework – Key Principles Approach



2. Key Principles Approach

- Based on principle that to be effective, a risk management process must meet certain principles.
- 11 principles
- You benchmark credit union against 11 principles

Assessment

IIA Framework – Key Principles Approach



2. Key Principles Approach

Number	Principle
Principle 1	RM creates and protects member wealth
Principle 2	RM is integral part of credit union process
Principle 3	RM is part of decision making
Principle 4	RM explicitly addresses uncertainty
Principle 5	RM is systematic, timely and structured
Principle 6	RM is based on best available information
Principle 7	RM is tailored
Principle 8	RM takes human cultural factors into account
Principle 9	RM is transparent and inclusive
Principle 10	RM is dynamic, iterative, responsive to change
Principle 11	RM facilitates continual improvement

Assessment

IIA Framework – Key Principles Approach



2. Key Principles Approach

- Much less formulaic
- More judgemental
- More qualitative
- Very useful set of principles
- Principle 3 Key – “*Risk Management is part of decision making*”



3. Maturity Model Approach

- Built on assertion that risk management process should mature with time.
- Immature systems yield little return
- Additional value comes with maturation
- => Find where you are on the maturity curve, and define expectations....

Assessment

IIA Framework – Maturity Model Approach



- Where are Irish Credit Unions ?

5	Approaches to managing risk are fully embedded in day today business processes and strategies
4	Approaches are adopted and improving but not fully embedded
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Credit Unions
In the future?
Now ?
Now ?
New Act ?
CU Commission?

5. Conclusions

Embedding a Culture

Conclusions



- Essential elements of risk and compliance are in place in Irish credit unions

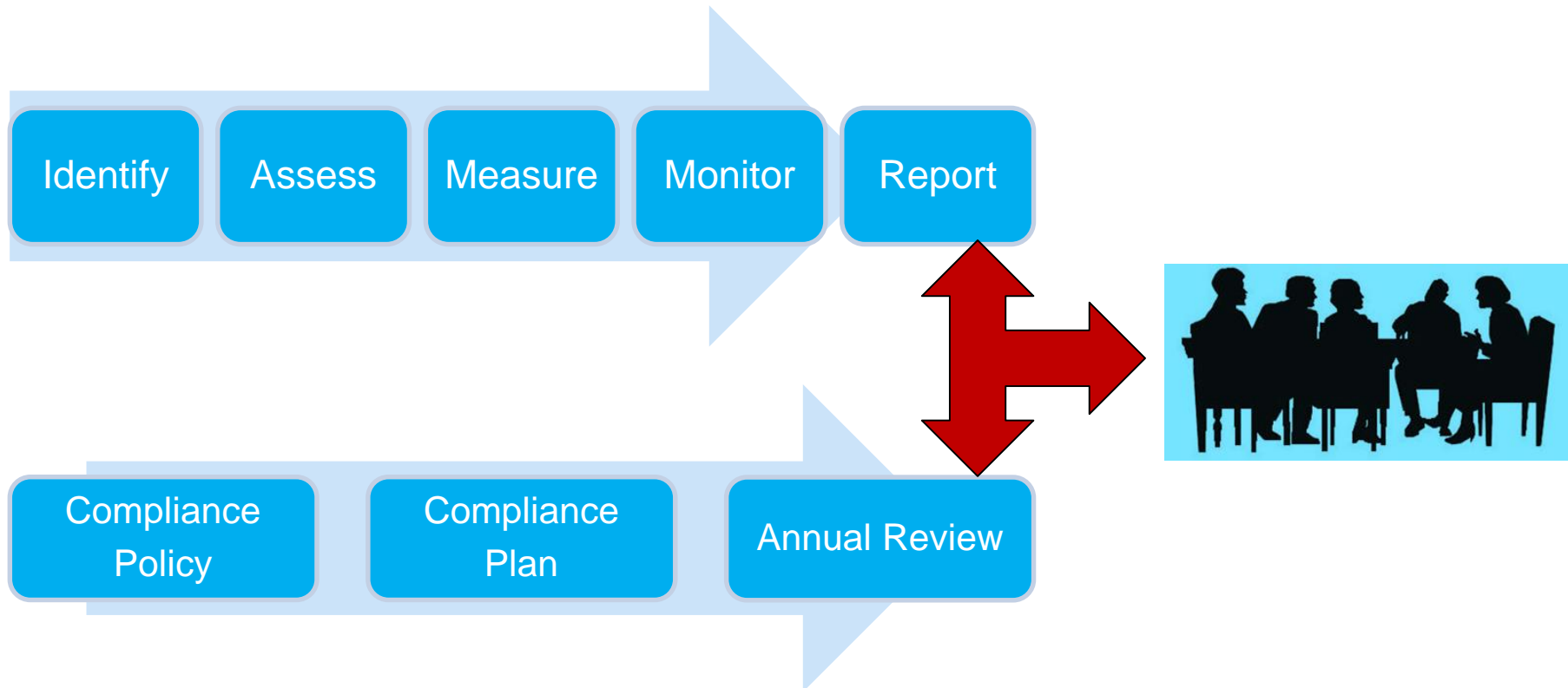


Embedding a Culture

Conclusions



Institute of Risk Management – key measure = do they factor in decision making?



Embedding a Culture

Conclusions



- Think of any major decision made by credit union over the past few months
- Did Risk or Compliance Function feature in decision making ?
- If not, then maybe more work in embedding a culture is required.....
- And more faith may need to be put in Risk and Compliance.....
- It offers more than just a response to legal and regulatory requirements.....

Embedding a Culture

Conclusions



- But this is an age-old challenge....
-and a global challenge
- A particularly difficult challenge
- However, embedding better risk and compliance cultures can enable credit unions to better inform decision making
- And better provide for the 3 million members' socio-economic needs
- And lay foundations for continuation of the strong impact the movement has in Irish society.....



Context of Slides and Limitations



Our assessment of risk and compliance is, of necessity, subjective and dependent on the exercise of individual judgement. These slides represent an illustrative account of some relevant issues and considerations, intended for an educational context. These slides do not necessarily represent the considered opinion of Moore Stephens Nathans, as they are intended to provide a balanced account of judgemental matters in an educational environment.

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