

Enterprise Risk Management

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**RISK
VERSUS
REWARD**

Three Benefits of ERM that can Help Most Banks

- 1. Risk Appetite Statement**
- 2. Key Risk Indicators**
- 3. Focus on Organization and Culture Risk**

Lingo

Key Performance Indicators (KPI)

Key Risk Indicators (KRI)

Risk Tolerance

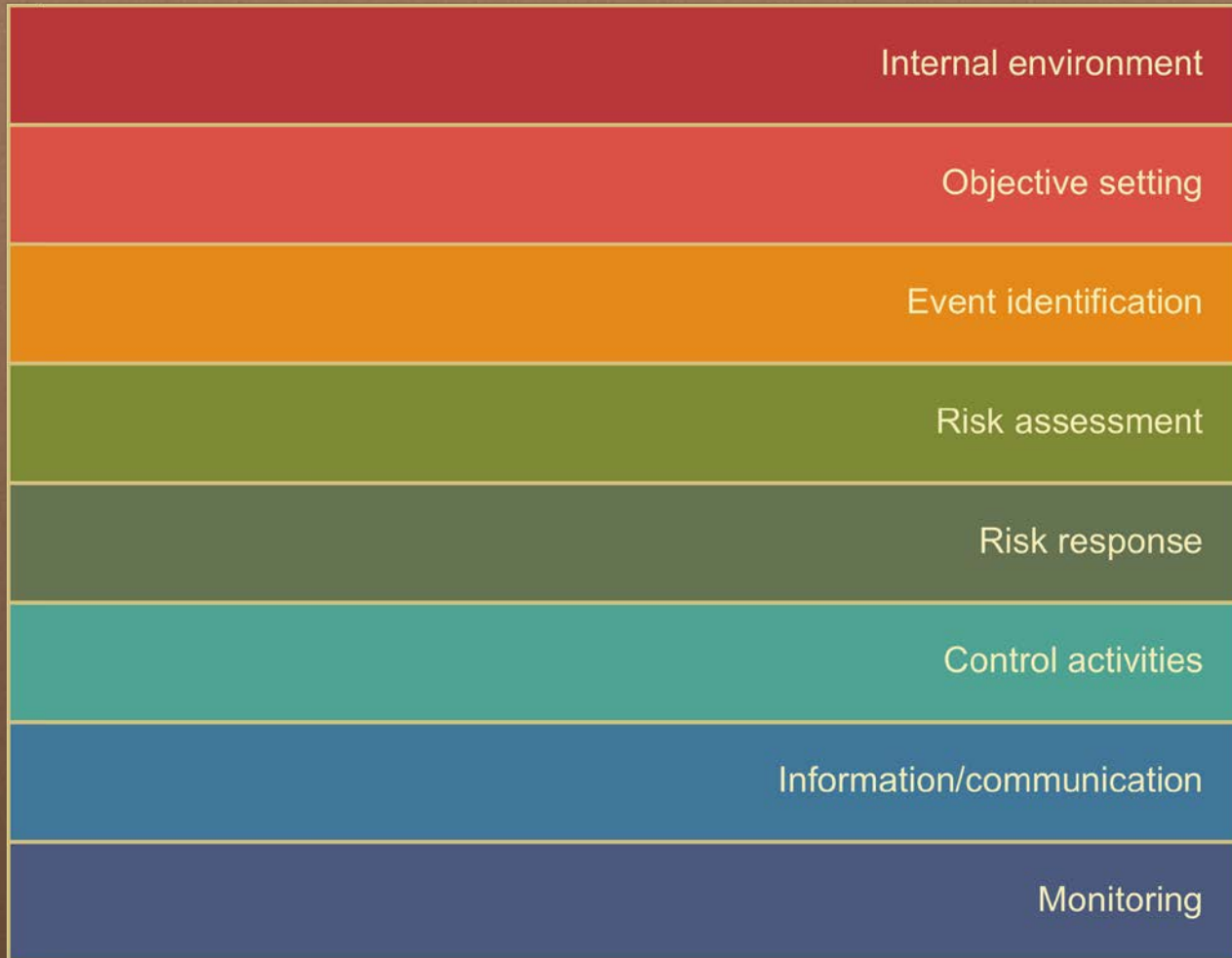
Risk Appetite Statement (RAS)

Risk Assessment System (RAS) (RA)

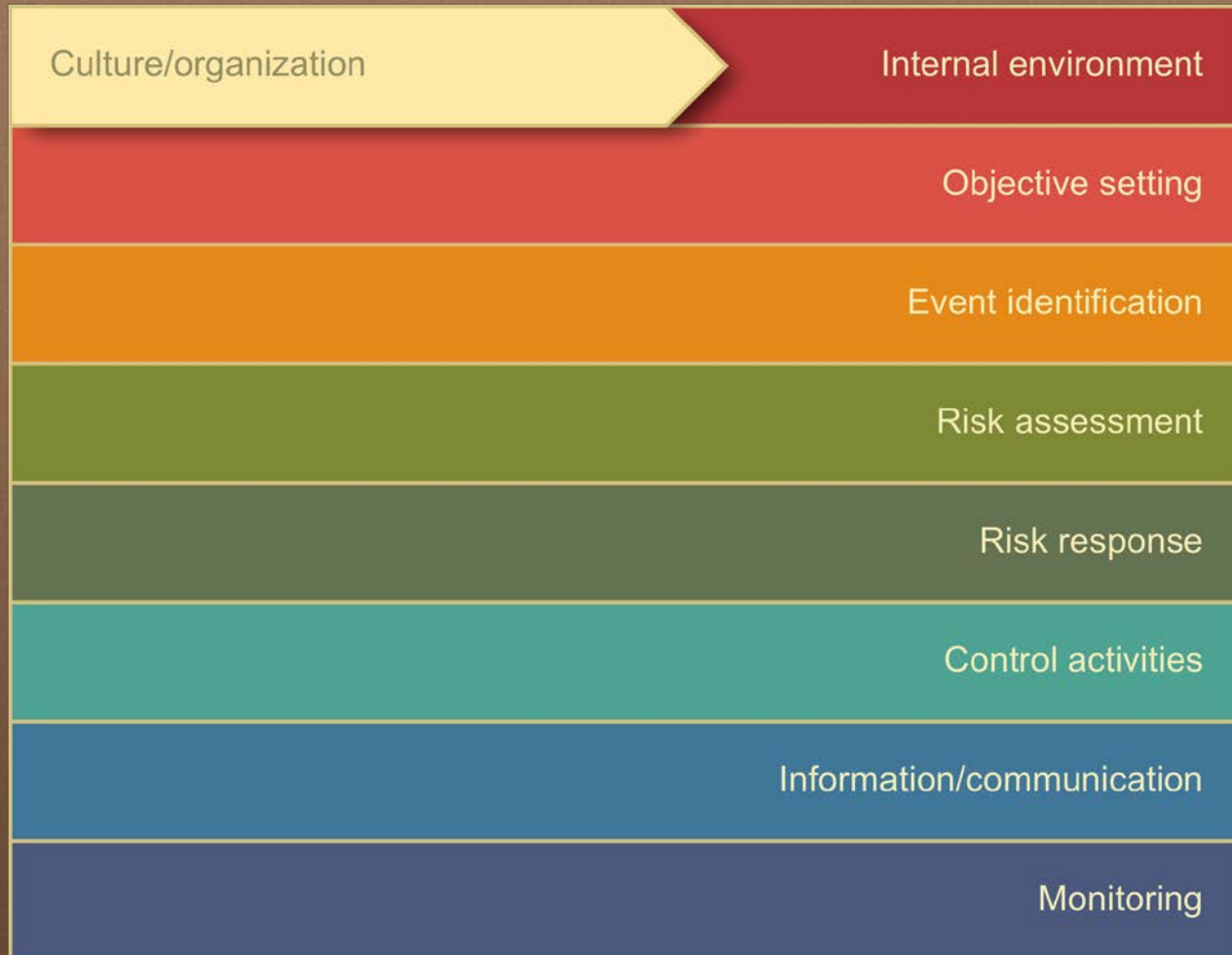
Enterprise Risk Management

COSO

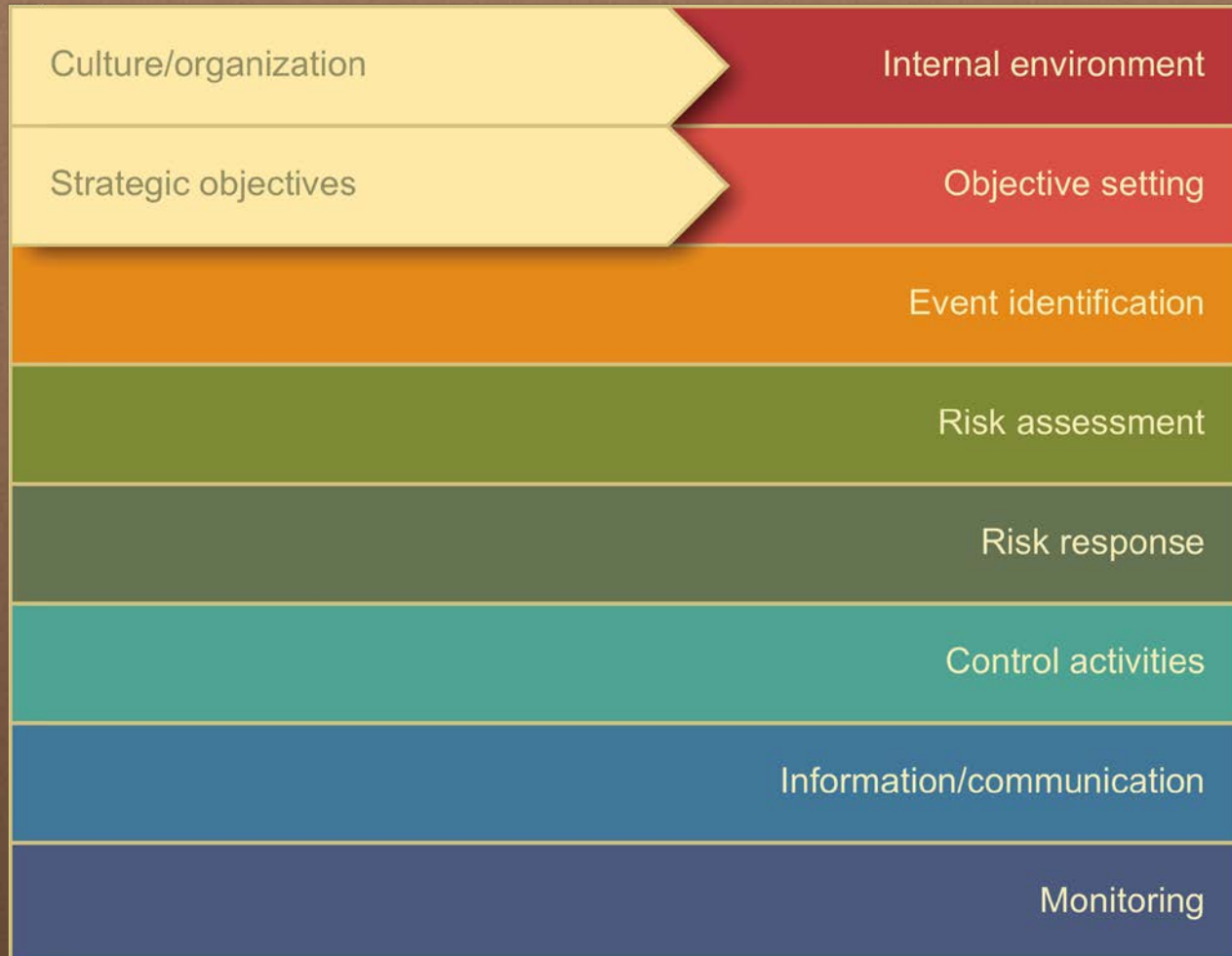
COSO Framework



COSO Framework



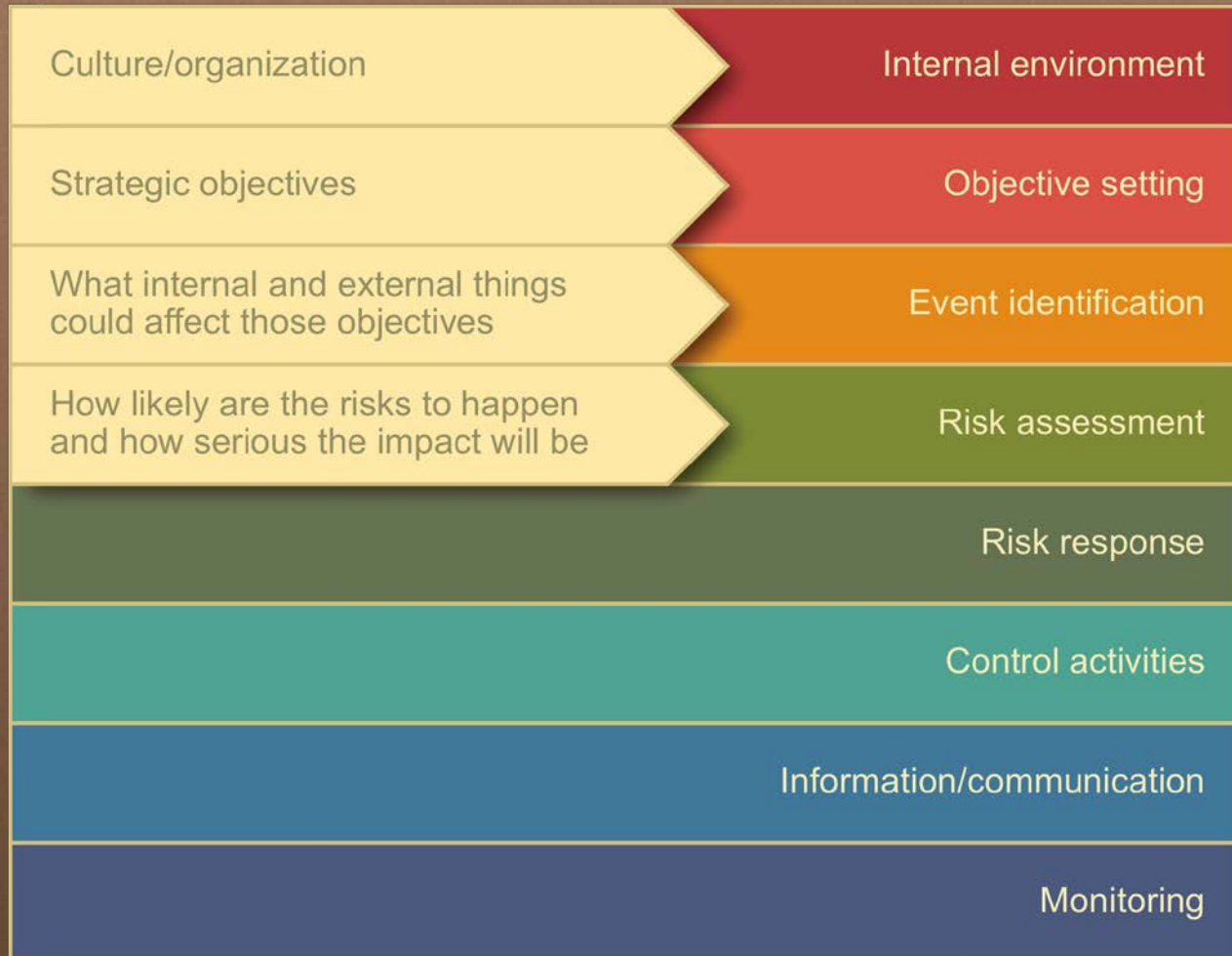
COSO Framework



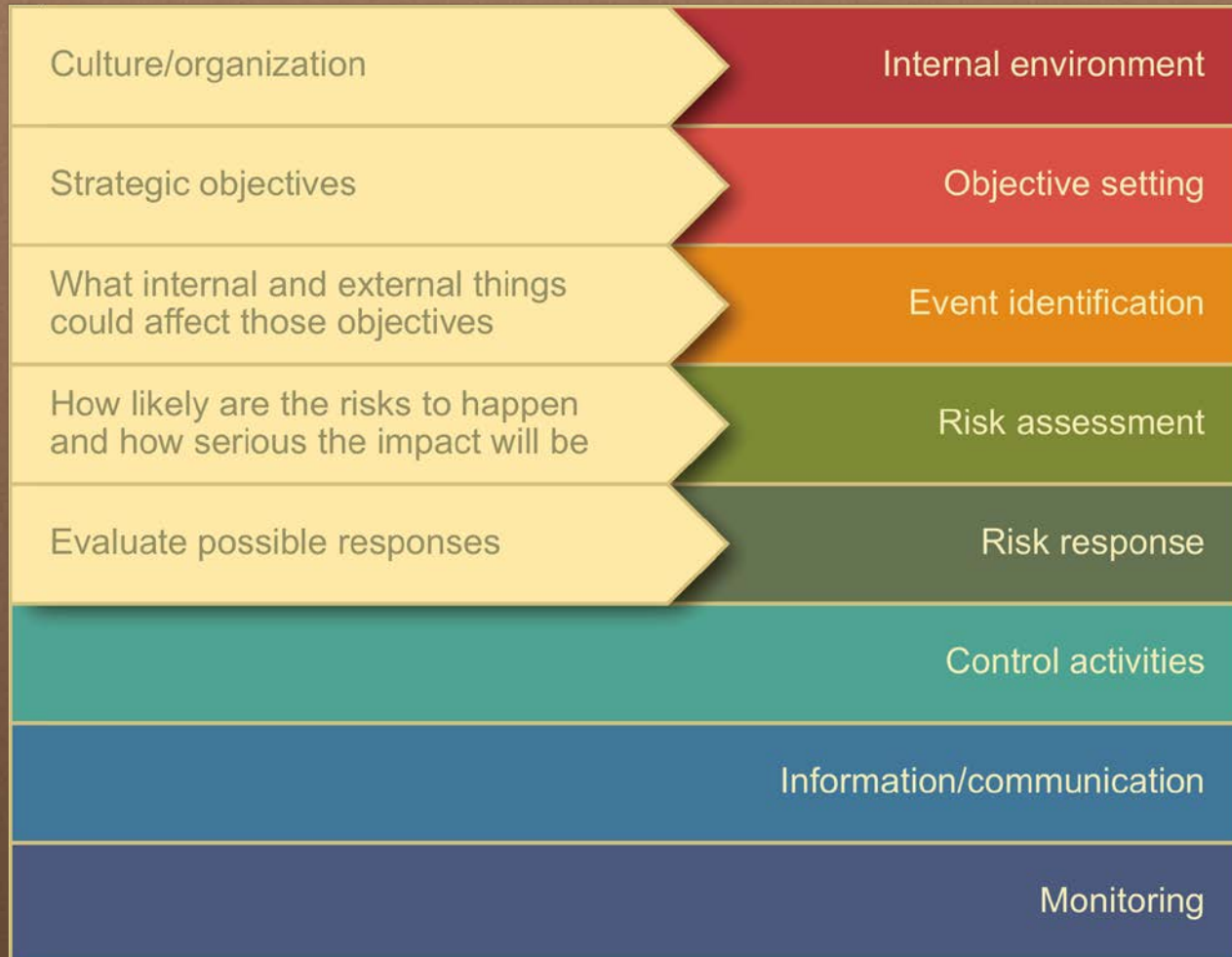
COSO Framework



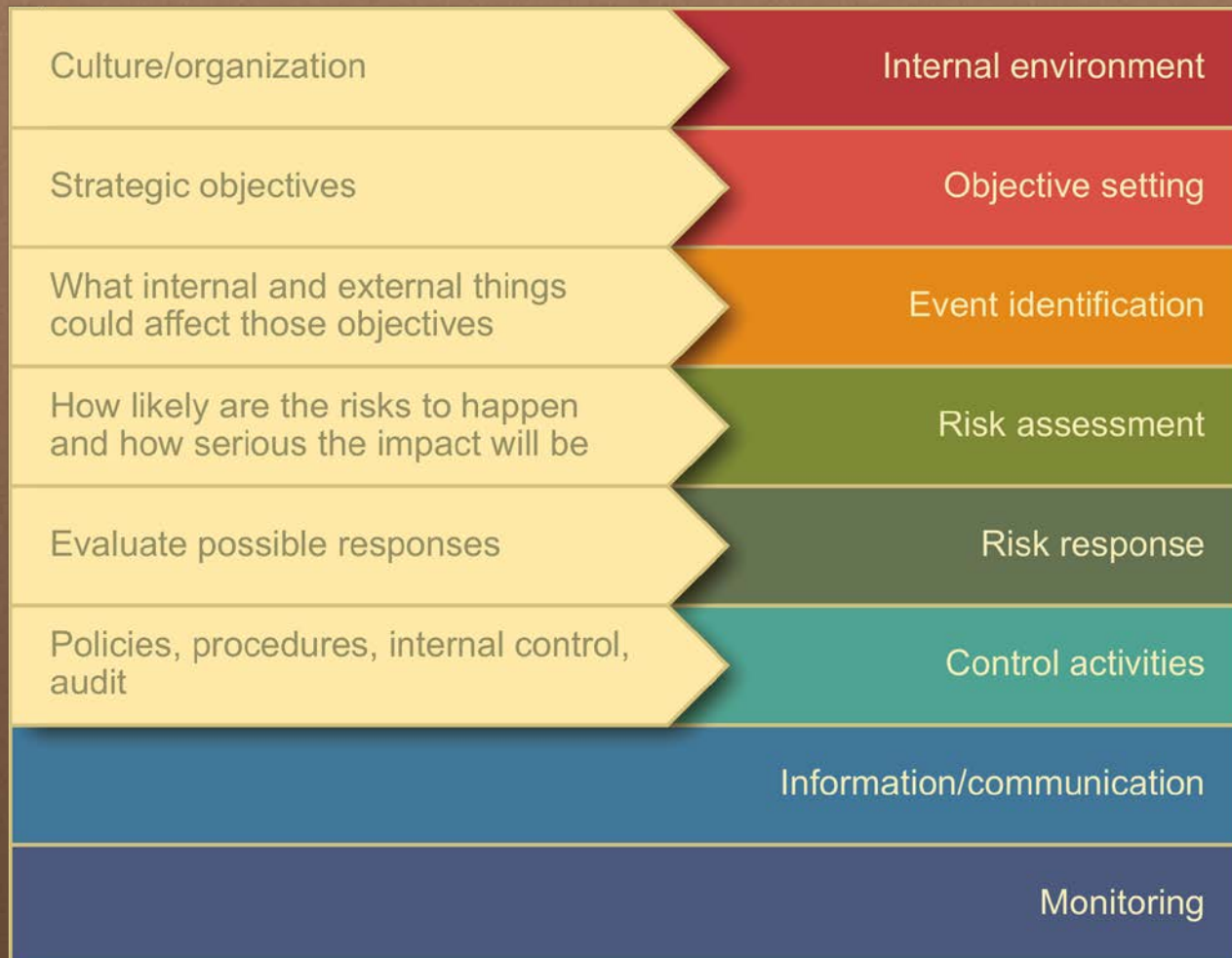
COSO Framework



COSO Framework – Risk Response



COSO Framework



COSO Framework



COSO Framework



Benefit #1 Board Adopted Risk Appetite Statement

- **Focuses board on strategic issues instead of transactions**
- **Improves board reporting**
- **Embodies an upfront agreement on risk tolerance**
- **Strengthens discussion of risk**

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Rothko

Developing the RAS (In ERM lingo)

- **Identify Strategic Risks**
- **Identify the Key Performance Indicators (KPI)**
- **Many KPIs are already included in your policies and board reports**
- **Define risks levels**
- **Set risk tolerance**

Identifying Strategic Risks



A RISK APPETITE STATEMENT

		Low	Medium	High
Strategic Risks	Organization/Culture Risk			
	Asset Quality			
	Earnings			
	Liquidity			
	Operations			
	Technology			
	Compliance			
	Reputation			
	Regulatory			
	Capital			

Note: This sheet is completed in summary form based on the detailed back up.
The colored boxes are examples only.

A RISK APPETITE STATEMENT

		Low	Medium	High
Asset Quality				
Key Performance Indicators	Classified assets to capital			
	Collateral and credit exceptions to total loans			
	External downgrades			
	Policy exceptions to total loans			
	Past due %			
	NPAs			
	Concentrations			

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Asset Quality				
Key Performance Indicators	Classified assets to capital	0 - 20%	20 - 35%	35 - 50%
	Collateral and credit exceptions to total loans	0 - 2%	2 - 5%	> 5%
	External downgrades	0	1 - 2	More than 2
	Policy exceptions to total loans	1.5%	1.5 - 3%	More than 3%
	Past due % by portfolio	0 - 2%	2 - 4%	More than 4%
	NPAs Ratio	0 - 1%	1 - 1.5%	More than 1.5%
	Concentrations as a % of tier 1 capital	10 - 15%	15 - 20%	25 - 40%

Complete based on where the board and management WANT to be –
in other words the risk appetite

Let's Try It

**P. S. Key Performance Indicators -
Quantitative and Qualitative**

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Liquidity				
Key Performance Indicators	Liquidity Ratio	> 20%	15 - 20%	< 15%
	Net Non-core Funding Dependency (\$250M)	< 15%	15 - 20%	> 20%
	Brokered Deposits as a % of Average Assets	0	0 - 1.5%	< 1.5%
	Loan to Deposit Ratio	< 80%	80 - 90%	> 90%

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Earnings				
Key Performance Indicators	Return on Assets (ROA)	> 1%	.6 - 1%	< .6%
	Net Interest Margin (NIM)	> 4%	3 - 4%	< 3%
	Efficiency Ratio	.60 - 65%	.65 - 75%	> 75%
	Provision Expense as a % TA	< .1%	.1 - .2%	< .3%
	Earnings Coverage of Net Loan Losses	> 15	10 - 15	< 10
	Earnings Volatility - % change between quarters	10%	10 - 20%	more than 20%

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Operations				
Key Performance Indicators	Vendor Management			
	- % of Capital at Risk	< 10%	10 - 20%	> 20%
	- Comprehensive vendor management policies and procedures developed	Yes	In process	No
	- Critical vendor reviews completed on schedule	Yes	In process	No
	Assets per Employee	within 10% of peer group (40 - 60 pct)	within 20% of peer group (30 - 70 pct)	outside range
	Audit Reports Rated Satisfactory or Better	Yes	Criticisms noted; corrected in a timely manner	Unsatisfactory ratings

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Technology				
Key Performance Indicators	Regulatory rating for core system provider	1	2	3
	Disaster recovery program meets regulatory standards	Yes no criticisms	Yes but few minor exceptions	Yes but few significant exceptions, quickly rectified
	Comprehensive technology ERM developed complete with monitoring requirements	Yes on schedule	Yes and somewhat current	Yes but significant exceptions

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Capital				
Key Performance Indicators	Tier 1 Capital	> 12%	10 - 12%	< 12%*
	Risk Based Capital	> 13%	12 - 13%	< 12%
	Equity Growth Rate less Asset Growth Rate	> 1.5%	1.5 - .5%	< .5%

* Capital risk increases as other risk categories (for example, asset quality) increase. These ranges need to be reviewed on an ongoing basis.

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Reputation				
Key Performance Indicators	Employee morale - trends in turnover rates*	low and decreasing	steady and moderate	increasing
	Customer satisfaction measured using customer complaints**			
	- Response time	1 day	2 - 5 days	> 5 days
	- Issues unresolved	0	1	> 1
	Social media			
	- Negative posts/month	0	1	> 1
- Response time to negative posts	1 day	2 - 5 days	> 5 days	
Contingency plans developed to address negative media event	Yes	Some	No	
Financial health	meet financial KPIs	out of tolerance on some KPIs	out of tolerance on key KPIs	

* Turnover rates are used as only one indicator of morale. When risk assessment is out-of-tolerance with risk appetite, additional criteria are needed.

** A complete customer complaint log is in place.

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Compliance				
Key Performance Indicators	Compliance Program - Regulatory Rating	1	2	2 - 3
	Consumer Complaints related to consumer protection laws, rules and regulations as a % of all consumer complaints	< 1%	1 - 3%	> 3%
	# of violations of laws, rules, regulations or regulatory guidance			
	- at last exam	0	1 - 2	> 2
- during last external review	0	1 - 2	> 2	
- during last internal review	0	1 - 2	> 2	

Sample Community Bank RAS – Key Performance Indicators (KPI)

WILLINGNESS TO ACCEPT RISK

		Low	Medium	High
Regulatory				
Key Performance Indicators	Composite Rating	1	2	2 - 3
	Enforcement Actions	0	0	MOU
	Compliance Rating	1	1 - 2	2*
	Technology Rating	1	1 - 2	2*
	CRA Rating	1	1 - 2	2*

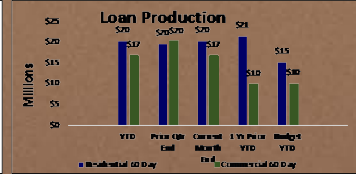
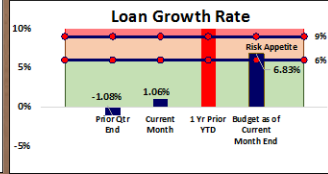
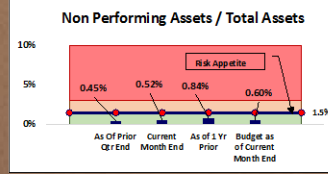
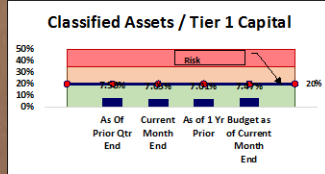
* When receiving regulatory ratings of 2, review reports carefully for potential future downgrades and take action to address concerns.

Monitoring your Risk Appetite

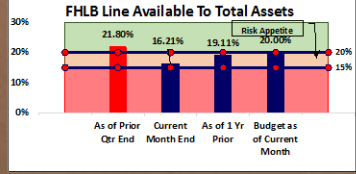
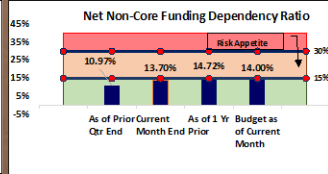
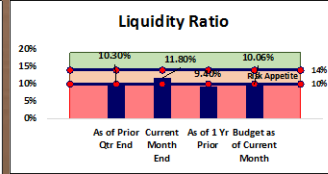
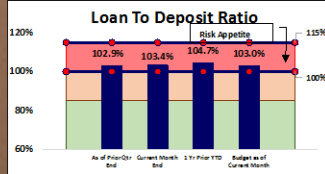
STRATEGIC RISKS	RISK APPETITE LEVEL			CURRENT RISK LEVEL	OUT-OF-RISK TOLERANCE	RISK TREND
	LOW	MEDIUM	HIGH			
Organization/Culture					Yes	Decreasing
Asset Quality					No	Stable
Earnings					No	Stable
Liquidity and Asset Liability Management					Yes	Increasing
Operations					Yes	Decreasing
Technology					Yes	Decreasing
Compliance/Audit					No	Decreasing
Regulatory/Legal					No	Stable
Reputation					No	Stable
Capital					No	Stable

ERM Dashboard

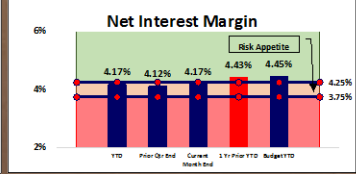
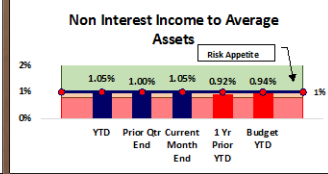
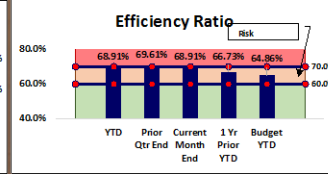
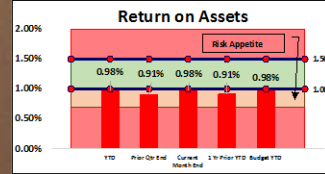
Asset Quality



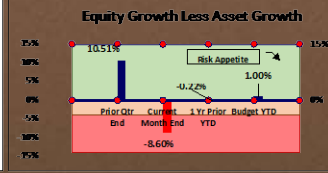
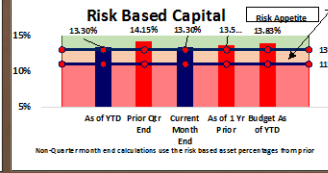
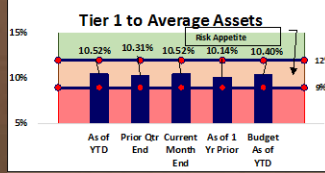
Liquidity



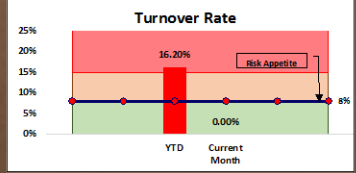
Earnings



Capital



ORGANIZATION / CULTURE

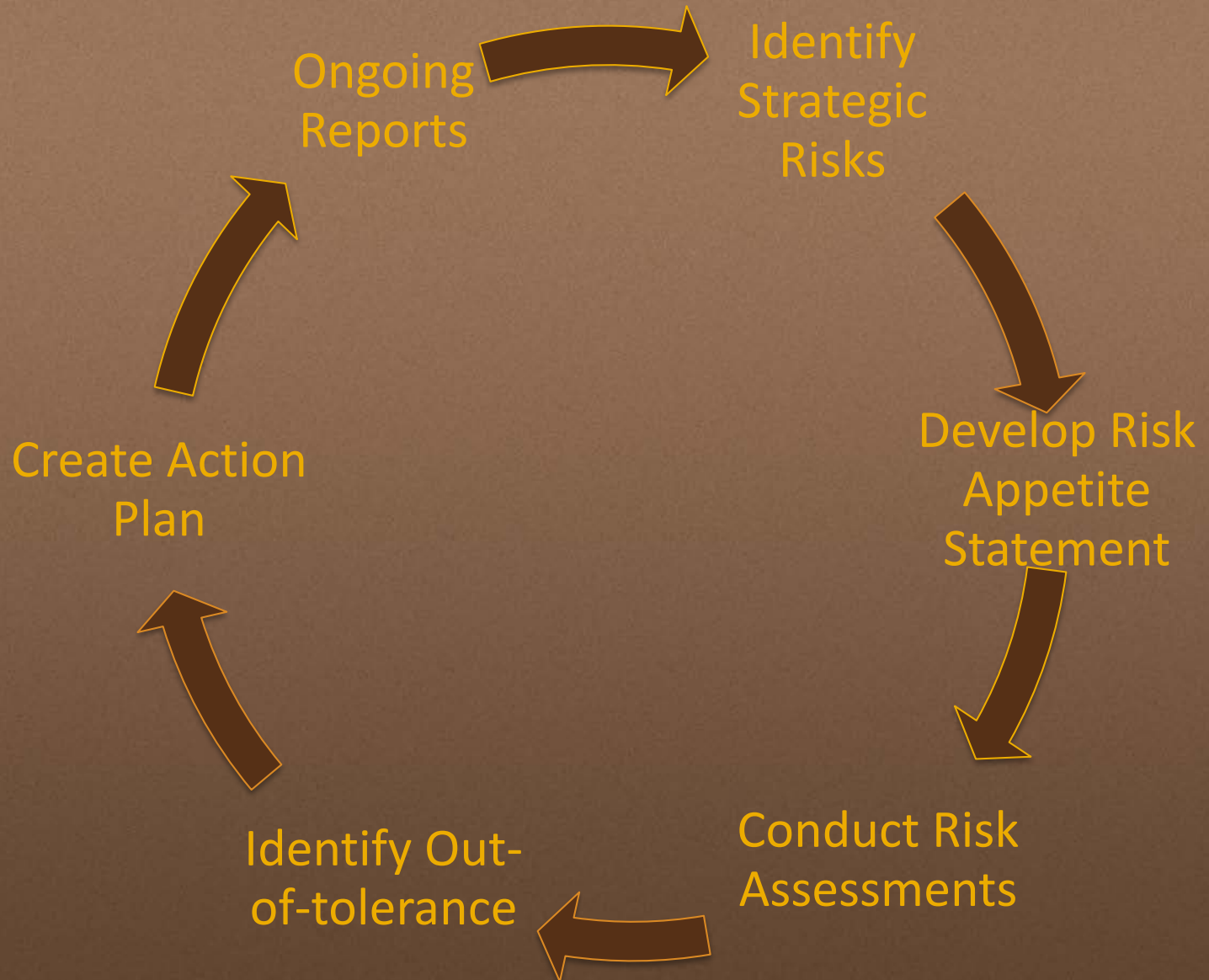


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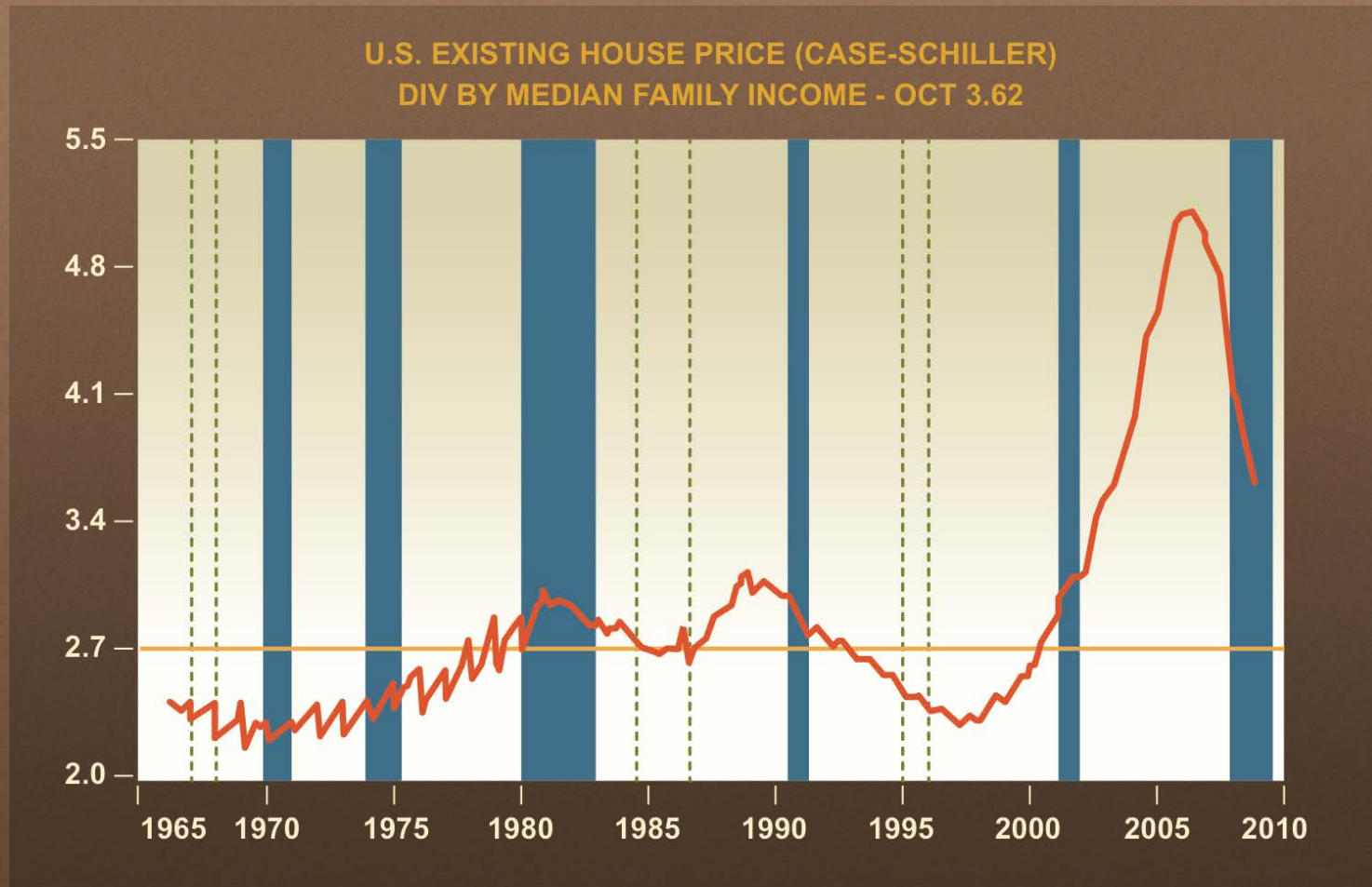
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It's a Process



Benefit #2 - Key Risk (Future) Indicators



Let's Try It

Benefit #3 - Organization and Culture Risk



Cher Cartwright

Organization/Culture Risk

- **Bad news network**
- **New products and services**
- **Silos**
- **ERM Committee**

Organization and Culture Risk

		Low	Medium	High
Organization/Culture Risk				
Key Performance Indicators	Tone at the top	<ul style="list-style-type: none"> - Aware of risks - Open - Ethical 	- Occasional group think on potential risks	- Denial of risk
	Clarity of reporting lines	- Org. chart current, distributed, and discussed	- Org. chart generally current, distributed, and discussed	- No Org. chart
	Clarity of roles and responsibilities	- Position descriptions accurate, current, and discussed	- Position descriptions mostly up-to-date, understood by employees	- Some confusion on roles and responsibility
	Bad news network	- Risk management is everyone's job, and risks openly reported	- Some siloing	- Siloing of risk management responsibilities
	ERM committee	- Effective	- In place, meet quarterly	- Not established
	RAS	- Developed and shared with all employees	- Developed	- Not in place

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**Key
Ideas**

Enterprise Risk Management

1. Make sure the process adds value
2. Identify, mitigate, control, and monitor risk to gain reward
3. Develop a Risk Appetite Statement
4. Think about external indicators (KRI)
5. Strengthen organization and culture

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