Does a credit union intervention signal an ERM failure?

Personal article by Ross McDonald

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John Lennon penned ‘we get by with a little help from our friends’.

Credit unions can need help too, say when placed under regulatory intervention. Does such an act signal ineffective Enterprise Risk Management practices of the related credit union?

REGULATION

Regulators have the legislative power to impose an intervention on, or to ‘stage’, a credit union. A regulatory intervention seeks to minimize potential depositor losses and related insurance exposure. Dependent on the perceived severity of circumstances then there are multiple potential intensities of intervention. These can range from an early-warning to imminent insolvency. Specific information related to the number; identity; issues; and matters related to interventions are not in the public domain.

Just like their small business members then credit unions need to balance growth rate, cashflow and earnings. Over time then aggressive growth, capital investments or declining membership may strain capital adequacy, stretch liquidity, erode margins or surface other adverse effects.

Like their business members then credit unions need to offer a reasonable value proposition. Service offering, product range and operational footprint should be commensurate with the customer/member needs; economic climate; organization size; and competitive landscape. Over time then any related deficiencies may yield declined market/wallet share; elevated risk appetite; unsustainable operating efficiency; outdated management; inadequate governance practices and/or broader strategic challenges.

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CREDIT UNION INTERVENTIONS

Interventions can be costly. The primary direct expense to a credit union is a higher premium for deposit insurance. This will impact the bottom line, potentially materially. Indirect costs may also be significant as executive and Board time is likely redirected to execute remedial requirements and to manage an elevated regulatory relationship.

Interventions are driven by specific perceived deficiencies. These may relate to a specific risk type (e.g. credit, liquidity); a specific inadequacy (e.g. oversight, policies); an atypical theme (e.g. growth, strategy) or other matters in the credit union.

There is no single remedy for credit union interventions. Perhaps akin to a doctor’s assessment of a multiple patients then there may be various apparent symptoms and underlying causes. But there may be generic themes of diagnosis, say driven by prevailing externalities. And there may patient specific matters, such as medical history and current lifestyle. For staged credit unions then the escalation to intervention may suggest that the remedial prescription will probably be more intense, and less palatable, than a hearty hot toddy.

Remedial resources vary by province. For example, BC credit unions may receive confidential consultative advisory services that are executed, and funded, by Stabilization Central Credit Union.

ENTERPRISE RISK MANAGEMENT

Risk is the lifeblood of any financial institution. For credit unions then taking deposits, extending loans and executing other services inherently involves risk. Entity-level oversight of risk - or Enterprise Risk Management - typically assesses credit, interest rate, liquidity, transaction, strategic, strategic, compliance and other risks as appropriate. Just the sort of topics that are likely relevant to an intervention. In my personal view then whether a credit union intervention signals an ERM deficiency may rest on two questions.

First, to what degree were management and the Board surprised by the intervention and regulatory concerns?

CEOs and Board Chairs may relish surprises delivered by Santa Claus. Not so much by their regulator. If intervention concerns draw gasps then there may well be misunderstanding of regulatory expectations; inadequate risk oversight; and/or poor ERM execution. Surprises may suggest challenges that extend beyond ERM. For example, if a Board first learns of statutory compliance breaches from the regulator then risk culture and governance practices may be awry.

Second, are the risk competencies and oversight appropriate for the current organization size and complexity?

Progressive organizations typically grow over time. Academics suggest that gradual evolution of organizational size is typically accompanied by periodic step-changes in capabilities. For credit unions then there are arguably levels of size and complexity that may trigger internal step-changes, and perhaps external expectations, in regards appropriate maturity of risk oversight functions. As a ballpark then a recently published Oliver Wyman report notes that in 2016 'risk functions will account for about 4 percent of the operating costs of an average bank'. This benchmark may not be appropriate credit unions of all sizes and complexities but peer comparison of the maturity of risk managment function may be insightful.

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STAKEHOLDER ENCOURAGEMENT

To a Board Chair of a staged credit union then I urge due concern. The regulator may have identified one or more specific, material, time-sensitive threats to the membership that the Board is elected to represent. Board agenda should reflect this reality. As appropriate then seek advice or assistance. Consider review of Board composition, competences and governance practices. And ultimately remember the arguably most important Board role is CEO selection.

To a CEO of a staged credit union then I encourage a deep breath. You are probably not going to enjoy this experience. The future will likely be required to be significantly different than the past. You may not agree with some perceived concerns. Expansive strategies and favoured initiatives may now deferred. Any 'too difficult box' may be prised open with gusto. The foreseeable future likely holds plentiful, potentially difficult, work; rather lower profitability; elevated levels of scrutiny; and no small measure of change. But it is hopefully an opportunity to question accepted norms, and to seek and embrace best practices that will - in time - yield organizational betterment and enhanced member service.

To regulators then I implore use of the motivation 'carrot' in addition to the penalty 'stick'. Identifying the need for an intervention is an important function, indeed duty, of any regulator. The motivational reward of a potentially reduced intervention stage rating and/or composite risk rating - and resultant normalized deposit insurance premium - may be powerful to credit union executives and to Boards. Therefore as remedial actions are completed, trust is restored, and depositor loss risk is demonstrably lessened then any onsite assessment and/or intervention appraisal should be undertaken in a timely manner.

Unlike the Beatles then a staged credit union may not be feeling much love. But cooperation amongst cooperatives is a core credit union principle. And the industry is stronger together. So there are likely friends willing, even eager, to help. Let it be.

REFERENCES

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ABOUT THE AUTHOR

Ross McDonald is a financial services executive and consultant with experience in strategy, finance, risk and regulation. He has held Director, VP and SVP level roles in multiple organizations including Citigroup, Salomon Brothers, Ernst & Young and recently completed an interim contract role as Director Credit Union Centrals at FICOM. He holds MBA, CA & BAcc qualifications. Ross was a member of the 2012-3 Board Governance Task Force on Director Pay of Coast Capital Savings Credit Union. Ross is a current member of Coast Capital Savings Credit Union and of BlueShore Financial Credit Union.

The author welcomes related feedback, ideas, connections and experiences. Public email via ross_www@mac.com

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