STRATEGIC RISK
CONNECTING THE DOTS TO ERM

Indiana Bankers Association

September 12, 2016
## National Perspective

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## Indiana Perspective

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Enterprise Risk Management (ERM)

• ERM is really about forward-looking risk measurement as opposed to looking to the past.
• It really started with Interest Rate Risk guidance in 1996 – GAP to Simulation.
• This was reinforced in January 2010 – now we mean it!
• Liquidity was next with initial discussions in the Fall of 2007 followed by April 2010 guidance requiring a Contingency Funding Plan (CFP).
• Liquidity risk management now has two « Masters » - the backward-looking Ratio Analysis and the CFP.

• Next Up – Credit Risk forward-looking measurement (stress test).
• CCAR and DFAST – 80% of the industry assets.
Enterprise Risk Management (ERM)

- All three risks incorporate projecting into the future then reflecting on how we might mitigate the risks shown through that exercise.
- We sometimes refer to these measurement techniques as « Static » and « Dynamic » but the key is to recognize that risk measurement is evolving and each of us must decide whether to fight it or figure it out!

- The OCC has identified the risks they are concerned with – IRR, Liquidity, Credit, Compliance, Operational, Price, Market, and Reputational Risk.
- And, to their credit, they are providing the industry time to create customized solutions.
Enterprise Risk Management (ERM)

• Risk Management Forums in Indiana and Tennessee plus 10+ Conferences on ERM – what we believe today.

• Federal Reserve and OCC are more enthusiastic about calling it ERM and seeing a program in place.

• FDIC and State Banking Departments are less enthusiastic in using the term (ERM) and in seeing a program in place though the FDIC will say they want to see enhanced risk management process particularly in more complex institutions.

• Our advice – get beyond the first two risks which have been mandated.
Enterprise Risk Management (ERM)

• Supervisory Facts:

• FDIC: Employs some 6300 staff regulating about 3900 banks or approximately 64% of the total (Assets = $2.6 trillion)

• OCC: Employs some 3950 staff regulating about 1550 banks or approximately 23% of the total (Assets = $11 trillion)

• Federal Reserve regulates some 850 institutions covering approximately $2.2 trillion in assets.
• In our view, ERM is truly the major issue we face today and it is our view that until an institution can prove it has appropriate risk management process, our industry will be held to higher « cushion » requirements.

• Cushion = Capital/Assets + ALLL
  • National Cushion 12/31/15 = 11.28% + 1.36% = 12.64%
  • Indiana Cushion 12/31/15 = 11.43% + 1.25% = 12.68%

• Problem – Leverage Role in ROE

• What does this mean for our Strategic Planning Process?
Strategic Planning

• Examiners like to use your plan to understand your operating philosophy.

• They want to understand your Risk Profile through your plan.

• They want you to execute what is in your plan or, if changes are necessary, they want to see how you make those adjustments.

• They want to see periodic updates to your process making certain that what you say you will do is, in fact, what you do.

• They want you to live your plan!
Strategic Planning

Hot Topics Today

• Plans for Rising Rates
  • Investment portfolio, deposit outflow, credit risk impact.

• Cyber Security
  • Are you aware of your weaknesses?

• Vendor Management
  • Do you have a plan for this issue?

• Succession Planning
  • Do you have a plan for Management / Board succession?

• Growth
  • What is your desired asset growth plan?

• New Lending
  • Are you describing what new lending you desire and how you will support it?

• Capital Plan
  • Number one issue – how will you maintain your capital vs. your risk?
Strategic Planning

• Strategic planning is necessary because...
  • It demonstrates management’s intent to create shareholder value
  • Markets are changing
  • Technological advances are happening quickly
  • The Regulatory Agencies are demanding it:
    • Directors are responsible for selecting, monitoring, and evaluating competent management; establishing business strategies and policies; monitoring and assessing the process of business operations; establishing and monitoring adherence to policies and procedures required by statute, regulation, and principles of safety and soundness; and for making business decisions on the basis of fully informed and meaningful deliberation.

• Is your plan a good one?
Conduct a Reality Check

- IS THIS PLAN ACHIEVABLE?
- DO WE HAVE THE RESOURCES TO IMPLEMENT THE PLAN?
- DOES THE PLAN ADDRESS CUSTOMER NEEDS?
- IS THE MARKET RIGHT FOR THE PLAN?
Don’t spend a lot of time on these:

- Mission Statement
- Core Competencies
- Vision Statements

Spend your time on these:

- Budget
- Business Plan
- Strategic Initiatives
- Capital Plan
Questions To Ask Yourself

• Do we have confidence that we are measuring and managing what’s really important to our institution’s success?

• What are our current strategies?

  Are they working?

  Have they been documented?

  What can we do to improve our risk position and long term performance?
What Should a Good Plan Include

- SITUATION ANALYSIS
- SWOT ANALYSIS
- STRATEGIC OBJECTIVES
- COMPETITION
- FINANCIAL SITUATION
First focus on the big picture – the current business environment.

What factors outside of the company have the potential to affect the company and its performance?
This is potentially one of the biggest trip-up areas. Honestly evaluate the company by asking critical questions that will make your strategic plan more effective. Consider confidential surveys.

**STRENGTHS**
- Employee Culture
- Community Reputation
- Employee Efficiency

**OPPORTUNITIES**
- Expansion into other markets
- M&A
- Technology

**WEAKNESSES**
- Succession Planning
- Technology
- Concentration Risk

**THREATS**
- Regulatory Burdens
- Cyber Security
- Growth
Financial Situation

- Example metrics to discuss (compare and contrast the last 3-5 years results):

<table>
<thead>
<tr>
<th>Metric</th>
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<tbody>
<tr>
<td>Total Assets</td>
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<tr>
<td>Total Loans</td>
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<tr>
<td>Total Deposits</td>
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<tr>
<td>Equity Capital</td>
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<td>Net Income</td>
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<td>ALLL</td>
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<td>Non-Accrual</td>
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<tr>
<td>NPA Ratio</td>
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<tr>
<td>Tier 1 RBC</td>
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<tr>
<td>Total RBC</td>
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• Take a hard, long look at 3-5 of your main competitors, by market.
  • What are the top 3-5 reasons you lose business to your competitors?
  • Who are your competitors today and what are their strengths and weaknesses?
  • What rival product/service is most competitive with your product/service?
  • In what new directions are competitors moving and why?
  • What are the competitive trends? Why?
  • In what areas that customers care about are we stronger than our competitors?
Identify Strategic Objectives

• Take a step back and review all you have done to date, from strategic thinking, through the SWOT analysis.

  • Identify 4-6 strategic objectives that will incorporate your strategic thinking and address the SWOT analysis.

    • These objectives or initiatives should drive your plan for the year.

    • They should define the really big things you will attend to.
Strategic Objectives Examples

- Buy, Sell, Grow Organically
- Enhancing Locations
- New Lending Concepts
- Enhancing Business Services
- Enhancing Compensation Concepts
Set Goals for Each Strategic Objective

Concentrate on 3 – 5 Goals for each objective.

Ask Questions such as: (1) How will we know we have achieved this initiative, (2) How will we measure success, (3) What goals will stretch us, but still be reasonable, and (4) What is the timeframe involved – when must we achieve each goal?
Your strategic plan is an annual review and forward look at how you manage risk for enhanced profitability.

It contains information your Board, Shareholders, and Regulators can use to assess how you intend to manage that risk and how you intend to correlate that to enhanced shareholder value.

Your ERM Process will likely evolve over time but sound strategic planning is a « today » issue that guides your institution and motivates your employees to enhance both risk management and profitability.

Some Final Thoughts on your Strategic Plan.
Implementing the Strategic Plan

1. Keep it simple – and remember, implementation starts at the top
2. Have confidence you have identified your critical ‘impact areas’
3. Know what success looks like – begin with the end in mind
4. Have clear accountability and timelines
5. Know when you’re making progress – have clear measurement criteria
6. Know how you will report progress and periodically update the plan
7. Communicate – where we are headed, what is changing and how we are doing
Contact Information

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