



# Community Bank Risk Management

Key Elements of Board Reporting



# Table of Contents

- Key Elements of a Board Risk Report ..... 3
- Best Practices in Board Risk Reporting ..... 4
- Align to Strategic Objectives ..... 5
- Shape the Board Risk Report ..... 6
- Strive for Less is More Approach ..... 7
- Create Forward-looking Metrics ..... 8
- Tell a Story ..... 9
- Give them the “Why” ..... 10
- Keep it actionable ..... 11
- Create Inclusive Reporting..... 12
- Develop Supporting Infrastructure ..... 13

# Key Elements of a Board Risk Report .....

*Report should be comprehensive, linked to external reporting, and forward-looking*

## **Cover enterprise-wide risk areas**

- Identify how risks can be interconnected
- Risk areas include: Credit, Liquidity, Strategic/Business/Reputation, Market, Operational, Compliance/Legal/Regulatory, Financial and Capital Adequacy

## **Use metrics that are linked to externally reported information and are:**

- Forward looking to give Board an understanding regarding future results
- Material to overall results to help enable Board to focus on most critical issues

## **Link metrics to internal business metrics such as plan/budget and finance reporting**

- Utilizing balanced scorecard approach may help achieve this<sup>1</sup>

## **Identify emerging risks that could develop into realized risks**

- May be in narrative form or
- Through a deeper dive analysis of an area of particular concern

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<sup>1</sup> Kaplan, Robert S.; Norton, D. P. (1996). *The Balanced Scorecard: Translating Strategy into Action*.

# Best Practices in Board Risk Reporting .....

*Reporting should start from the top down and tell a concise, actionable story*

## **Align to Strategic Objectives**

- Anchoring reporting on top-down, strategic objectives will create better engagement with the Board

## **Shape the Report**

- Engage with stakeholders to help shape/modify the report

## **Less is More**

- Limit Report to critical information to help Board focus on most important factors to consider

## **Forward Looking**

- Use forward looking impacts vs static assessment to give opportunity to evaluate actions that are being taken

## **Tell a Story**

- Describe why the risk is important and how it is being addressed

## **Actionable**

- Be clear about actions that are being taken and/or risks that are being accepted

## **Sufficient Infrastructure**

- Ensure talent and technology are in place to design and execute risk reporting

# Align to Strategic Objectives .....

*Reporting should identify risk to achieving agreed-upon Strategic Objectives*

## **Structure the report to align with company-wide strategic objectives**

- Provides context to the Board of Directors
- Aids in determining which risks are most critical
- Should create better engagement with the Board

## **Identify risks to business strategy and operations**

- Helps to assign accountability for action/risk acceptance
- May result in further deep dive analysis or stress testing approaches to determine which scenarios could negatively impact results
- Gives opportunities to review control environment where improvements would mitigate risks

## **Align with risk appetite<sup>2</sup>**

- Will identify areas where current and emerging risks could potentially exceed the company's previously determined risk appetite



<sup>2</sup> RMA's Risk Appetite workbook can be used to help establish/enhance Risk Appetite statements

# Shape the Board Risk Report .....

*Reporting requires collaboration and input from key stakeholders*

## **Changing the Board reporting will impact the Board, so engagement is critical**

- Board members are accustomed to existing reporting and changing the report will require board members to understand changes in order to facilitate their review process
- Changes to Board reporting may be modest and only impact a small portion of the report based on feedback (e.g. adding a summary page to the report)
- Engaging with executive management and selective board members will create alignment and ownership in any changes
- For significant changes in reporting, training/explanation may be needed to ensure Board can interpret the new report appropriately

## **Different methods can be used to get input from executive management and Board members including, but not limited to:**

- Interview
- Survey<sup>3</sup>
- Written feedback

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<sup>3</sup> RMA Reporting survey may be used to gather feedback from stakeholders

# Strive for Less is More Approach .....

*Reporting on significant and critical areas of risk will help Board focus*

## **Focus on critical areas of risk**

- Limit length of report by being thoughtful and only including most important metrics
- Use inherent and residual risk to determine critical areas of risk
- Set Board escalation thresholds (limits) to determine in advance what is required to report to the Board

## **Reduce clutter to focus on important issues**

- Avoid using small font to report every detail. Reader may be overwhelmed with detail and potentially miss the bigger picture
- Evaluate use of dashboards to ensure key takeaways are apparent. While dashboards are comprehensive, the message can be lost by including too much information
- Heat maps are useful only when thresholds for changing color designations are agreed-upon with executive management and the Board

**For higher risk areas, more detail may be provided by putting detail in an appendix**

**Limit duplication with other reports by creating a balanced scorecard that reports risk along-side finance and operating results**

# Create Forward-looking Metrics .....

*Developing forward-looking metrics is an art vs. a science*

Risk Category	Examples of Publicly Reported Metrics	Examples of Forward- Looking Metrics
Commercial Credit	<ul style="list-style-type: none"> <li>• Charge Offs (\$ and %)</li> <li>• Current balance of non-performing loans</li> <li>• Current ALLL balances</li> </ul>	<ul style="list-style-type: none"> <li>• Trends in Special Mention, Substandard, Doubtful and Loss loans (\$'s and as a percent of total loans)</li> <li>• Commercial real estate lease expirations, by year</li> <li>• ALLL as percent of loans, by loan type (e.g. small business, commercial)</li> </ul>
Consumer Credit	<ul style="list-style-type: none"> <li>• Charge Offs (\$ and %)</li> <li>• Current ALLL balances</li> </ul>	<ul style="list-style-type: none"> <li>• Trends in 60 day delinquencies (%) by loan type (e.g. credit card, mortgage, personal loan)</li> <li>• Roll rate of delinquent loans from 30 to 60 and 60 to 90 days delinquent</li> <li>• ALLL as percent of loans, by loan type</li> </ul>
Market Risk	<ul style="list-style-type: none"> <li>• Impact of 100 bp change in rates on net interest income</li> <li>• Composition of debt maturities</li> </ul>	<ul style="list-style-type: none"> <li>• Impact of expected shifts in yield curve on net interest income</li> <li>• Impact of repricing of maturing debt on net interest income</li> </ul>
Operational Risk	<ul style="list-style-type: none"> <li>• Not often reported publicly, unless there are significant unresolved compliance issues</li> </ul>	<ul style="list-style-type: none"> <li>• Cyber: Number of unresolved patches by level of criticality</li> <li>• Third party: Top ten third parties with open issues (such as compliance weaknesses, loss incidents etc)</li> <li>• Operational loss incidents: Trends in number and amounts of losses by type</li> </ul>

# Tell a Story .....

*Story telling, based upon data will create better understanding of key issues*

## **Concisely telling a story will increase engagement**

- Develop a summary of risks and actions as the first page of the report to provide a high-level story to the Board regarding key risks and actions being taken to address
- Each page of the report should tell a story: articulate point of view and contain what is at stake in one sentence or phrase
- A summary statement or key takeaway can be placed at the top of each reporting page to help Board members interpret data and other information
- Data should be used to support key takeaway, where possible

## **Use data to tell a story**

- Helps Board understand context
- Choose an effective visual to support story

## **Different graph types can be used to illustrate trends**

- Examples are contained in the accompanying Risk Summary Example document.
- There are several books available on this topic<sup>4</sup>

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<sup>4</sup> One example is: Knafllic, Cole Nussbaumer (2015), Story Telling with Data: A Data Visualization Guide for Business Professionals

# Give them the “Why” .....

*Be overt in the reason why this matter is being brought to the Board’s attention*

## **Describe the “so what”**

- Identifying a risk is not enough – risks should be mitigated or explicitly accepted
- Describe why the risk is important and how it is being addressed

## **Identifying trends are step one**

- Historical trends are interesting but may not be enough to determine whether recommended actions are appropriate
- Board may request additional work such as conducting a deep dive into the subject to evaluate recommended actions
- Board may request scenario stress tests to size risks and determine how important mitigating actions may be



# Keep it actionable .....

## Ensure that your status terminology is consistently agreed upon and applied

- Risk programs often use Red/ Amber/Green or “RAG” status to report risks, but different executives may define those terms differently. Ensure agreement for when these conditions are met or changed. Consider more clear terms for thresholds like “Target, Floor, Ceiling”

## Make a recommendation
















- Executives and Boards will make decisions, but as the resident risk management expert, you should give your recommendation when appropriate. Consider these verbs:
  - **Improve:** high-risk exposure where mitigation actions are not adequate. Needs additional resources.
  - **Monitor:** high-risk exposure where mitigation actions are sufficient. For awareness, no action needed.
  - **Tolerate:** low-risk exposure where mitigation actions are inefficient. Consider additional resources if available.
  - **Operate:** low-risk exposure where mitigation actions are sufficient. No action needed.

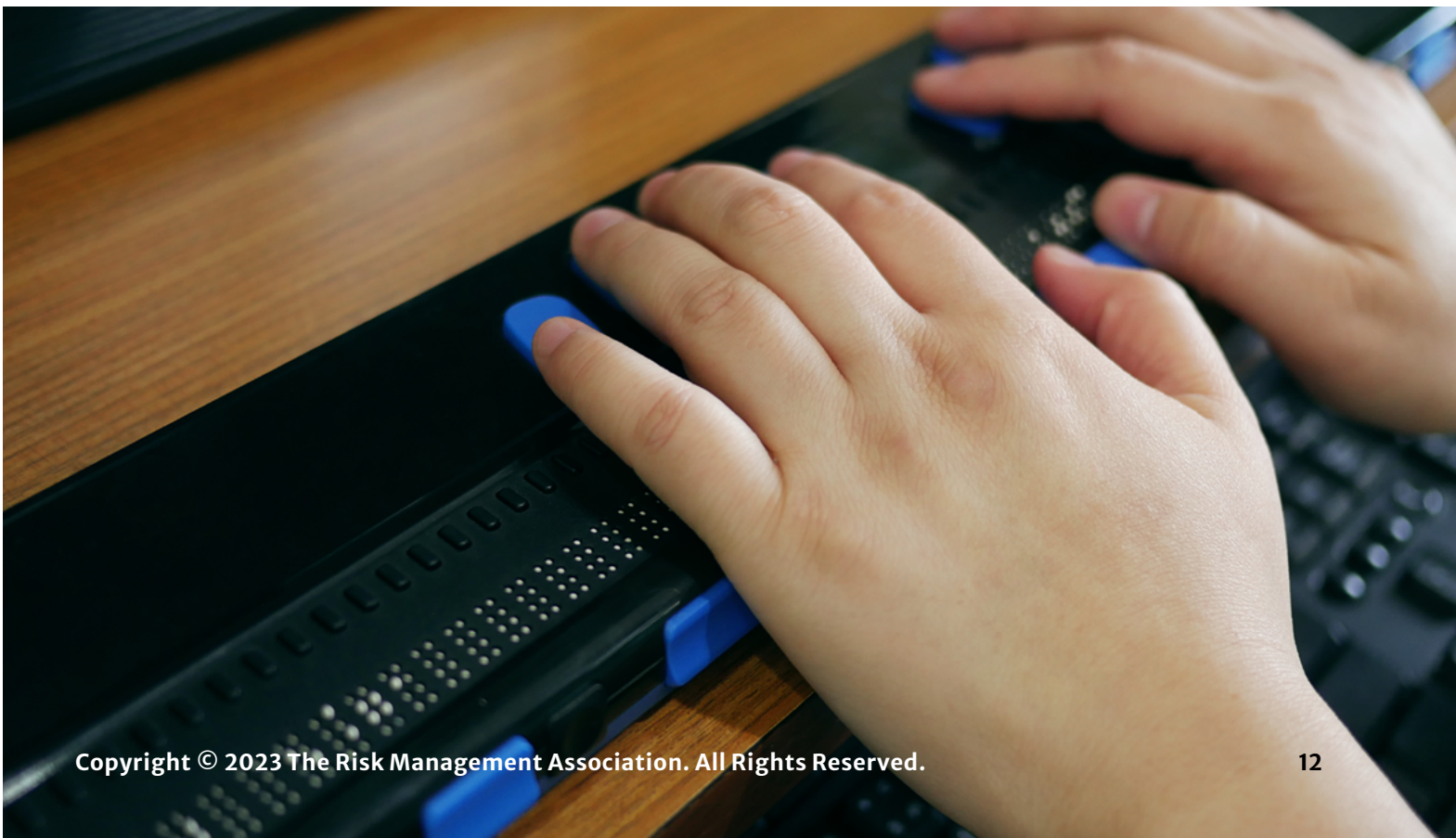
# Create Inclusive Reporting

Consider other's abilities, like color blindness, when presenting graphs and data

## Reporting should be accessible and user-friendly to all

- Use both colors and symbols
- Use patterns and textures to show contrast

Common color perception	Example perception by someone with color blindness	Alternative Examples		
		Add labels	Use different shapes or icons	Use Patterns or Textures
				
				
				



# Develop Supporting Infrastructure .....

*Ensure there appropriate Talent and Technology Infrastructure is in place to design and execute risk reporting*

## Determine whether appropriate talent is in place

- If not, hire new and/or develop existing talent
- Depending on current Talent levels, ensure realistic expectations are in place with Executive Management as Talent is upgraded

## Take a phased approach to automating reporting

- **Phase 1:** Consolidate data received from multiple sources manually and store current and historical data in secured databases and spreadsheets
- **Phase 2:** Require businesses to input data in secured central data repository for use by Risk Management in developing reports
- **Phase 3:** Automatically access data from underlying systems and store in central data repository for use by Risk Management in developing reports





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## About Risk Management Association (RMA)

Founded in 1914, the Risk Management Association is a not-for-profit, member-driven professional association whose sole purpose is to advance the use of sound risk management principles in the financial services industry. RMA promotes an enterprise approach to risk management that focuses on credit risk, market risk, and operational risk. Headquartered in Philadelphia, Pennsylvania, RMA has 1,600 institutional members that include banks of all sizes as well as nonbank financial institutions. They are represented in the Association by 41,000 individuals located throughout North America, Europe, Australia, and Asia/Pacific.

Guided by RMA's mission of advancing sound risk management principles, RMA brings financial institutions high-quality, cost-effective model risk management services delivered by a team of industry practitioners with more than 25 advanced degrees.

