Supervisory Committee
Emerging Credit Union Risks of the Future

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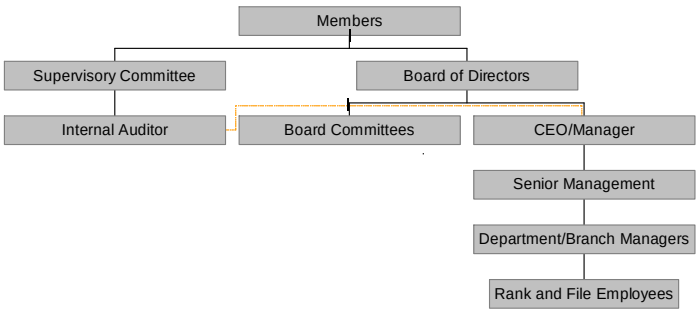
Credit Union Organizational Reporting/Supervision Chart



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Fiduciary Duties

Same as for directors and officers:

- DUTY OF CARE
- DUTY OF LOYALTY
- DUTY OF OBEDIENCE TO THE LAW

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Liability for Actions

- Business Judgment Rule - In most jurisdictions, board members and officers are protected from liability to shareholders for their decisions under what is known as the Business Judgment Rule. This Rule generally protects a disinterested director from liability where the director:
  - Acted in good faith;
  - Was reasonably informed; and
  - Rationally believed the action that was taken was in the best interests of the entity.

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Specific Duties (NCUA SCG)

Supervisory Committee must ensure:

- Management's financial reporting objectives have been met.
- Management practices and procedures safeguard member assets.

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Specific Duties (NCUA SCG cont'd.)

Supervisory Committee must determine whether credit union managers have:

- Established effective internal controls.
- Promptly prepared accounting records and financial reports to accurately reflect operations and results.

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Specific Duties (NCUA SCG cont'd.)

Supervisory Committee must determine whether credit union managers have:

- Properly administered plans, policies and control procedures established by the board.
- Established policies and procedures that safeguard against error, carelessness, conflict of interest, self dealing and fraud.

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General Duties

- Duties and Obligations (see NCUA SCG)
  - Generally the same as those of directors and officers – expanding rapidly!
  - Additional duty to monitor the activities of the board and management to ensure safety and soundness of the credit union.
  - Ensure board is functioning.
  - Ensure management is properly carrying out board policies and directives.

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Board and Management Performance

- Main Questions:
  - What should they be doing?
  - Are they actually doing it?
  - Are they doing it well?
  - Is there room for improvement?

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Board and Management Performance

Board Performance

- Is the board a good board or bad board?
- Are policies regularly reviewed and up to date?
- Is board ensuring that management is performing its function pursuant to its directives?

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Board and Management Performance

Board Performance (cont'd.)

- Is the board addressing security (especially data security) in a responsible manner?
- Is there a succession plan for both the board and management official?
- Is the board up to date with regard to finance, technology and regulatory compliance?
  - If not their own knowledge, are they properly advised?

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Board and Management Performance

- Review and verify:
  - Member Accounts - at least every 2 years.
  - Related party transactions.
  - Loan approval and funding.
  - Investments.
  - Security Plan.

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Board and Management Performance

- Review and verify:
  - Separation of duties.
  - Access to employee/family member accounts.
  - Expense reimbursement and policies.
  - Cash in vaults and teller drawers.
  - Loan and other loss reports.

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Board and Management Performance

- What if you find a problem?
  - First verify with appropriate documentation.
  - If fraud is ever raised as an issue, consult with counsel before proceeding.
  - If the problem is at management level, take it to the board.
  - If problem is at board level, take it to board chair or consult counsel.

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Board and Management Performance

- What if you find a problem (cont'd.)?
  - Make sure executive management and/or the board develop an action plan to address the issue promptly.
  - Follow up to ensure plan has been executed.
  - Hold them accountable to execute the plan.
  - If appropriate, make sure bond carrier is notified.
  - If appropriate, make sure NCUA is notified.

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Board and Management Performance

What if you find a problem (cont'd)?

- Supervisory Committee has authority to suspend any executive officer, credit committee or board member.
  - Must hold a special meeting within 7 – 10 days at which suspended person shall have the opportunity to be heard.
  - This power should be used with discretion and only with regard to serious matters.

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Data Security!

- Everyone is under attack constantly!
- Must be part of the credit union's security plan.
- Board must be involved (but not in the weeds).
- Credit union's efforts to combat cybercrime must be part of the Board's annual review and regular reports.
- National Association of Corporate Directors Report:
  - 14% of public company directors have high understanding of risks.
  - 17% have no understanding.

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Data Security - Who Cares?

- NCUA
  - Uptick in IT matters in Exam Reports and DORs.
- State Regulators
  - Especially the State of New York!
- Insurers
  - Haven't seen anything as of yet but with increasing liability expect it.
- State AG's
  - Often investigate large breaches to determine possible liability.
- Members!

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Types of Data Security Claims

- Breach (penetration) of Your Systems
- Intentional/Unintentional Disclosure by Employees
- Theft of Information by Third Party
- Breach of Someone Else's System

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2017 Data Breaches – Banking/Credit/Financial

- 1,579 breaches in the US in 2017 – Up 22.4%
- 134 breaches were in Banking/Credit/Financial Industry.
- 66 – Hacking (phishing, ransom/malware, etc.).
- 18 – Insider theft.
- 15 – Employee error, negligence or improper disposal.
- 11 – Accidental web/internet exposure.
- 9 – Exposure by subcontractors third parties.

*Source – ITRC 2017 Annual Data Breach Year-End Review

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Data Security - Cost

- Average Cost of a data breach in 2016 = $3.8M.
- Average Cost per record =$158.
- Malicious Attacks cost far more to remediate.
- 26% chance of occurrence in your CU in next 24 months.

*Source - IBM Phenomenon 2016 Study

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Data Security – 2017 Top Five Breaches

- Yahoo – 1.5B records.
- Equifax – 145.5M records.
- America's Joblink Alliance – 5.5M records.
- Sonic Drive-In - 5M records.
- Dow Jones & Co. – 2.2- 4M records.

*Source – Credit Union Times 1/24/18

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Data Security – What to do.

- Management should report to the board at least annually on the following:
  - Risk assessment process, including threat identification and assessment
  - Risk management and control decisions, including risk acceptance and avoidance
  - Third party service provider arrangements
  - Results of testing
  - Security breaches or violations of law or regulations and management's responses to same
  - Recommendations for updates to the IT security program

*Source – FFIEC Information Technology Examination Handbook, September 2016

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Data Security – Questions to ask.

- What information do we maintain?
- Where are we vulnerable?
- What safeguards do we have in place?
- How does that compare to our peers?
- Is that sufficient?
- What is our response plan?

*Source – Multistate AG Investigative Inquiry, January 2015

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Data Security – Necessary Policies

- Annual comprehensive risk assessment.
- Employee use of social media.
- Employee training regarding e-mail usage, passwords, etc.
- Security Policy Review and Updates.
  - Technology and threats are changing constantly – so must policies.
- Vendor Compliance – remember Target!
- Clean Desk.

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Data Security – Necessary Policies (cont'd.)

- Integration of Merger Policy.
  - If you are the surviving credit union, what are you inheriting?
  - If you are the merging credit union, what are you exposing your members' assets to going forward?
- Review all existing policies to determine if related IT security issues are addressed or need improvements.

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Data Security - Insurance Issues

- Do you understand your coverage?
- Have you shopped around?
  - Cost may depend not only on provider but on how much info you have, systems, etc.
- Is there class action coverage?
- Does it include Response? If so, how much?

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Approach to Fintech Relationships

- Same as any other vendor/partner.
- Due Diligence is key!
- What is the product?
- How does it benefit the members?
- Does the board/executive management understand it?
- What agreements are in place?

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Approach to Fintech Relationships (cont'd.)

- How does the product relate to existing products?
- What regulatory scheme applies to the product?
- What are the risks to the credit union?
- Can the product be integrated with our systems?
- What are the costs of implementing/integrating the product?
- Should it be done in a CUSO?

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Reputation Risk Response

- Does your credit union have a plan for managing reputation risk resulting from:
  - Data Breach
  - Employment Issues (think me too!)
  - Natural/Man-made Disasters
  - Internal Fraud/Criminal Activity at the Credit Union

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Reputation Risk Response

- How (through what channels) will you respond to an event that has the potential for reputation risk:
  - E-mail
  - Newsletter
  - Credit Union Web Page
  - Media/Social Media
  - Mobile App

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Reputation Risk Response

- Considerations in developing a response plan:
  - When does the message start?
  - What personnel (marketing, IT, C-level, etc.)
  - Is it part of the disaster recovery plan?
  - Who owns it?
  - Consistency will be key.

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