



## ***Managing Outsourcing Risk***

*Accelerate your Credit Union's Performance*

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AUSTIN, TEXAS • [www.cuaccelerator.com](http://www.cuaccelerator.com)

# Introductions – Alan White

- Founder & President, CU Accelerator (formerly Vital Insight) and Quetzal GRC
- Over 20 years of risk management, performance management, and business advisory experience, conducted hundreds of risk assessments and control reviews.
- Former Senior Manager at Ernst & Young, with responsibility for over ten SOX engagements for fortune 1000 companies
- Executive in Arthur Andersen's Technology Risk Consulting practice (Washington, DC), with local leadership responsibilities for Technology Process & Strategy risk service lines.
- Published author on Vendor Management, ERM, and Strategic Risk Management
- B.S. (Industrial Engineering), Carnegie Mellon University
- MBA (Finance), University of Texas at Austin

# About CU Accelerator

<u>Service Line</u>	<u>Available Services</u>	
<b><i>Performance Management</i></b>	<u>Process Improvement</u> <u>Project Management</u>	<u>Metrics &amp; Controls Monitoring</u> <u>Revenue Assurance</u>
<b><i>Strategic Planning</i></b>	<u>Strategic Initiative Analysis &amp; Financial Modeling</u> <u>M&amp;A Analysis &amp; Integration</u> <u>Governance &amp; Incentive Planning</u>	
<b><i>Business Development</i></b>	<u>Social Media</u> <u>Sales Training &amp; Development</u>	<u>Branding &amp; Web Presence</u> <u>Outbound Member Contact</u>
<b><i>Risk Management</i></b>	<u>Operational Risk Assessments</u> <u>Financial Risk Modeling &amp; Metrics</u>	<u>Strategic Risk Analysis</u> <u>IT Risk Management</u>
<b><i>Outsourcing &amp; Vendor Management</i></b>	<u>Vendor Selection</u> <u>Audits &amp; Risk Management</u>	<u>Due Diligence &amp; Compliance</u> <u>Contract Management</u>

# Why We Are Here

- Credit unions are pursuing various strategies to spur growth in membership, revenue, and profitability
- Many of these initiatives require partnering with various outsourcers to implement new products and technology
- Some of these initiatives include entering businesses that are not traditionally credit union strengths (various CUSO's, eMedia and marketing, sales culture development)
- ***It is critical that credit unions understand, manage, and monitor the uncertainty in these initiatives***

# Today's Sessions

- Session 1: A Framework for Understanding Goals, Objectives, and Risks of Co-sourcing/Outsourcing
- Session 2: Technical Analysis of Vendor Control Documentation (Including the SOC)
- Session 3: A Real World Vendor Risk Management Model and Key Vendor Risk Management Lessons Learned

# Agenda – Outsourcing Risk Management

- Goals & Objectives for Outsourcing of Business Processes and Technology
- Advantages and Disadvantages of Outsourcing
- Vendor Risk Management Model: Controls for Four Very Different Types of Outsourcing Risks

# An Interesting Perspective

"The time to take counsel of your fears is before you make an important battle decision. That's the time to listen to every fear you can imagine. When you have collected all the facts and fears and made your decision, turn off all your fears and go ahead".

— George S. Patton Jr.

# When to Consider Outsourcing

- The vendor knows something that we don't know or can do something we can't do
  - Operational knowledge, equipment, or expertise
  - Access to a market or customers
- The vendor has a significant cost advantage
  - Further along the learning curve
  - Automation
  - Scale
- Transfer of risk and/or exposure
  - Compliance/legal
  - Creation of “real option”/operational flexibility
- Short-term project resources
  - AKA - “crap work” that we don't want to do ourselves



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# Business Perspective on Outsourcing

- Advantages to Outsourcing
  - Allows focus on core competencies
  - Can improve productivity
  - Share and spread risk
  - Take advantage of economies of scale
  - Minimum investment
- Disadvantages to Outsourcing
  - Can lose control over key issues
  - Breach of confidentiality
  - Loss of key personnel
  - Additional charges/hidden costs
  - Difficulty of bringing process back in house

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# What is Risk?

*The **possibility** of an event occurring that will have an impact on the achievement of objectives.*

**A Prerequisite to any risk discussion in an organization:**

**You must know**

**.....the organization's objectives**

*Risk is measured in terms of impact and likelihood.*

*The Institute of Internal Auditors (IIA)*

# What is Risk?

*Alan's Definition*

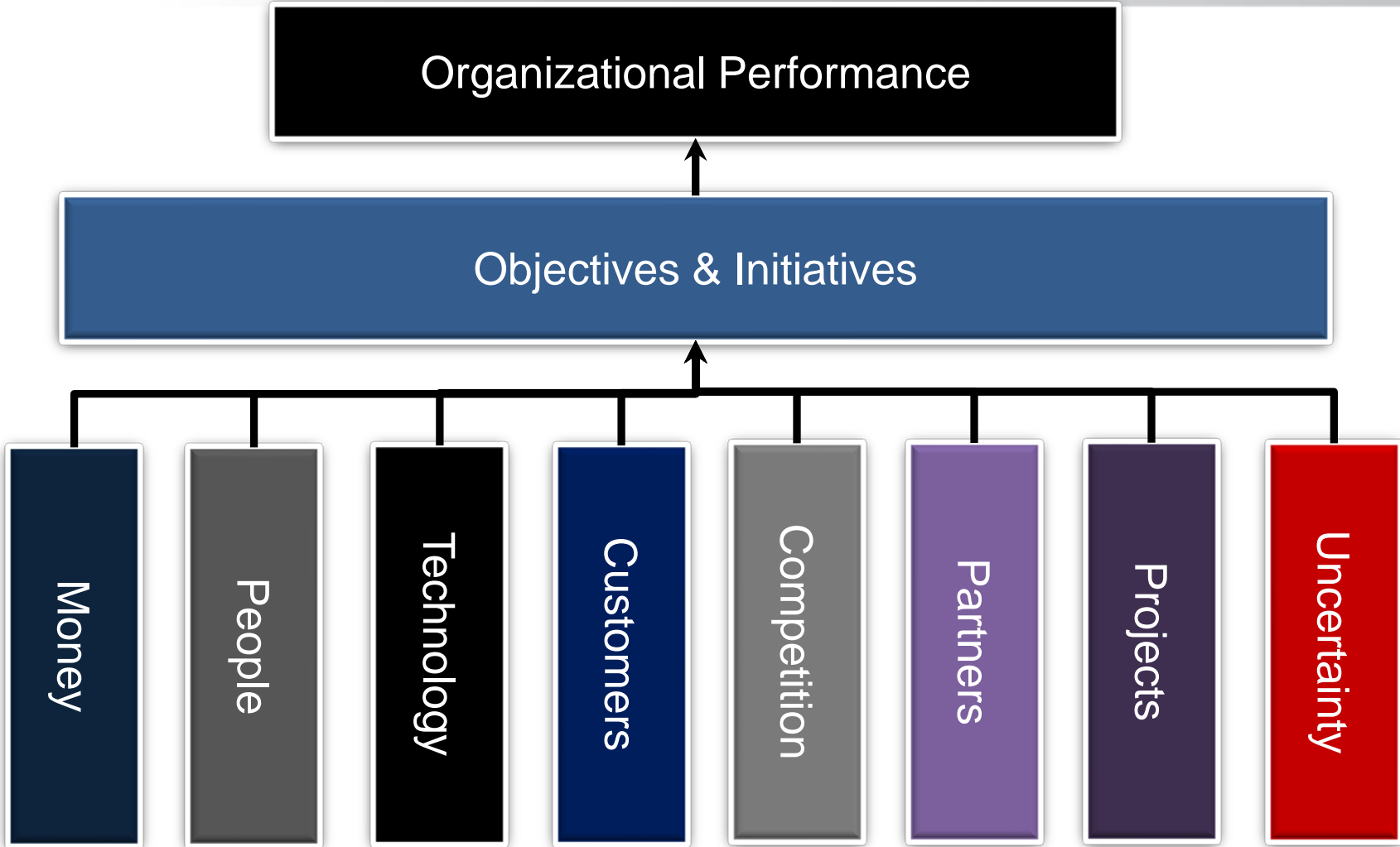
*Risk = Uncertainty*

# What is Risk Management?

*Alan's Definition*

*Managing the uncertainty side of  
performance*

# Managing Performance



# What is Risk Management?

*Alan's Definition*

*Managing the uncertainty side of  
performance*

*Or....*

*Managing the horse race between Greed &  
Fear*



# The Biggest ERM Lesson I've learned

Different Types of Risk Require  
Different Management Methods

*“When all you have is a hammer, everything  
looks like a nail.”*

# Managing Three Levels of Risk

## Entire Credit Union Movement

External to the Credit Union. Not directly controllable. Complex and varied assessment methodologies. Managed through metrics and contingency plans.

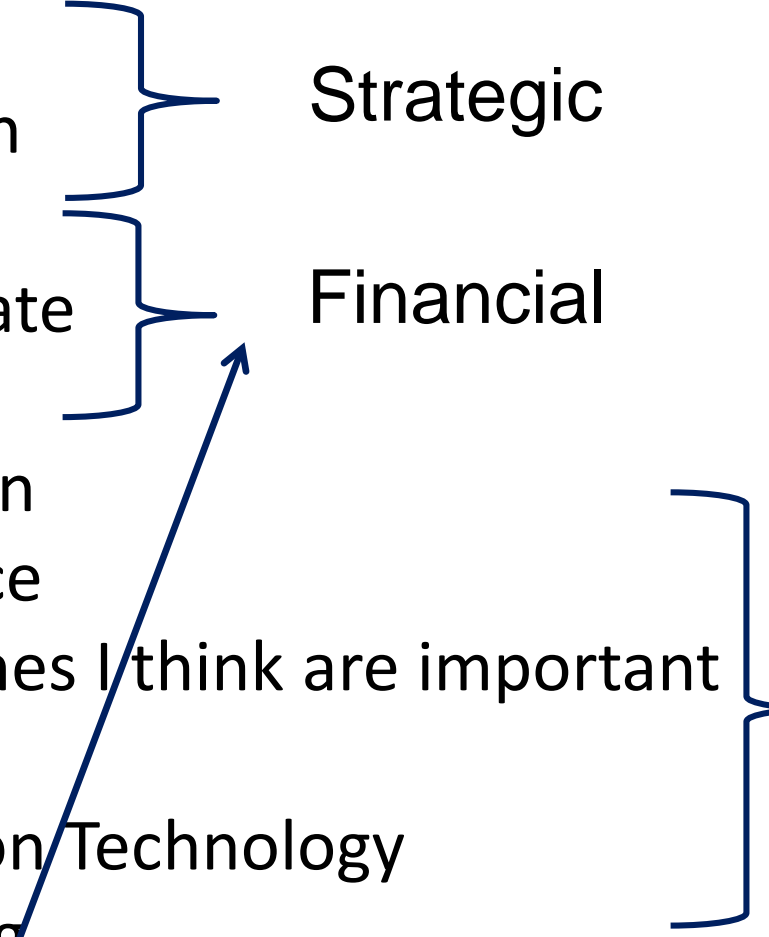
## Entire Credit Union

May be internal or external. May not be directly controllable. Complex assessments using sophisticated tools. Managed through governance, policies, metrics, and executive actions.

## Individual Departments/ Transactions

Internal to the Credit Union. Managed With Internal Controls. Difficult to Quantify. Dispersed and Small Impacts. Risks ranked with simple H/M/L likelihood & impacts/

# Risk Types

- NCUA Categories
    - Strategic
    - Reputation
    - Credit
    - Interest Rate
    - Liquidity
    - Transaction
    - Compliance
  - Additional ones I think are important
    - Fraud
    - Information Technology
    - Accounting
- Strategic
- Financial
- Operational
- 

# NCUA to CU Accelerator Risk Type Mapping

Risk Type	Strategic	Reputation	Credit	Interest Rate	Liquidity	Compliance	Transaction	Fraud	Technology
Operations			✓			✓	✓	✓	✓
Strategic	✓	✓	✓			✓			✓
Financial			✓	✓	✓	✓			
<b><u>Impacts:</u></b>									
Department			✓			✓		✓	✓
Credit Union	✓	✓	✓	✓	✓	✓			✓
Industry				✓			✓		

# ERM Components

## *Operations Risk*

- Risk that operations are not designed or executed effectively
- NCUA categories Transaction and Compliance
- Also Fraud, Technology & Outsourcing Risk
- Managed through effective business processes and controls
- Often over or under managed
- Requires prioritization of efforts and activities to manage effectively

## *Financial Risk*

- Relates to risk that is present in the credit union's investments and loan portfolio
- Includes NCUA categories Interest Rate, Liquidity and Credit risk
- Also includes Accounting and Concentration risk
- Usually Managed actively through the ALM, Budgeting, and Financial Reporting processes.
- Often includes executive and board level involvement

## *Strategic Risk*

- “Macro” risks, strategic decisions, economic trends and planning
- Includes NCUA categories of Strategic, Reputation, and Credit Risk
- IT Risk is also strategic
- Typically managed through the Strategic Planning process
- All significant strategic risks should be managed due to large impact

# ERM Components

## *Operations Risk*

Includes Five Sub-Risk Areas:

- Compliance
- Technology
- Fraud
- Transaction Processing
- Outsourcing/Vendor Management

Best Managed with solid business processes and simple controls

# Beware of Geeks Bearing Formulas (GBF's)

- Modeling can be useful, but they are inherently flawed:
  - Management's mind is often made up regardless of the results of the Risk Assessment (models are often used as methods for justifying decisions rather than making them)
  - Focus on Managing the risk rather than quantifying it
- Use the models to evaluate differences in options and sensitivities to inputs
- For Operational Risks, simple ratings are much more useful -
  - High, Medium, Low
  - These are easier to gather and analyze
  - Easy to tie to actions

# Appropriate Responses

Likelihood	Impact	Response
Low	Low	Accept
Low	Medium	Monitor
Low	High	Monitor and/or Insure
Medium/High	Low	Prevent
Medium/High	Medium	Prevent and Monitor
Medium/High	High	Prevent, Detect & Insure



# Key Outsourcing Risk Areas

- Business Risks
  - Alignment with Strategy
  - Alignment of incentives
- Contract Risks
  - Enforceability
  - Real options (how do I get out of this?)
- Operational Risks
  - Day to day criticality
  - Processing of transactions
  - Over-reliance on operations (lack of alternatives)
  - Information Security Risk
- Reputation, Compliance & Legal Risk
  - If they are acting on your behalf, you are still responsible!

# Four Key Vendor Risk Areas

- Operational Reliance
  - What would you do without them?
  - How long would it take to switch?
  - Can it be brought in house?
  - How important are we to them (can they decided to drop us)?
- Transaction Processing
  - Accuracy
  - Service Level
- Management of Confidential Data
  - What is the nature of the data the vendor manages?
  - What access to they have?
  - It is stored at their data center or yours?
  - What do they outsource to yet another vendor?
  - Do you have requirements to satisfy from other business partners (usually applies to auditors, consultants, etc.)?
- Billing/Financial
  - High dollar value
  - Complex/inconsistent billing practices

# Vendor Risk & Response Summary

Risk Source	Appropriate Response
Operational Reliance	Review of Financial Position Service Level Agreements Dual Sources Identified Perform In-house
Transaction Processing	SOC Reports/Process Audit Enhanced Internal Controls
Management of Confidential Data	Encryption/Security SOC Reports/Security Audit Enhanced Internal Controls
Billing/Financial	Contract Terms/Real Options Monitoring of Invoices/Billings

# Questions & Contact Information

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