Addressing Risk in the Cooperative
Part 2 of 3: What is ERM?

Key Highlights

- Continual changes in the electric industry and external environments present evolving risks.
- If appropriately implemented and maintained, Enterprise Risk Management (ERM) can address risks and provide a comprehensive view of impacts on cooperatives.
- The focus is a systematic, scalable, continuous, and comprehensive approach.
- This series of advisories explains risk and ERM. The entire series can be found on NRECA's website cooperative.com: https://www.cooperative.com/programs-services/consulting-services/governance/Pages/enterprise-risk-management.aspx

Introduction

This series takes a high-level look at risk through Enterprise Risk Management (ERM), a risk management tool that provides a process of risk identification, assessment, management and reporting. Through this process, the cooperative gains valuable insight into their risk profile to help determine which risks pose the greatest threats and which can be addressed with enhanced mitigation strategies.

Our 3-part advisory series on *Addressing Risk in the Cooperative* includes:

1) Part 1: An explanation of risk and how it impacts cooperatives. Available here: https://www.cooperative.com/programs-services/consulting-services/Documents/Secure/Advisory-ERM-Pt-1-Defining-Risk-Dec-2021.pdf

2) Part 2: An explanation of a risk management tool: Enterprise Risk Management (ERM).

3) Part 3: An introduction to the five-part risk cycle.

Why is Risk Management Important?

Risks are coming at the cooperative in increasing numbers and from multiple sources. The rapid electric industry and external environment changes can create managerial and oversight challenges for cooperatives.

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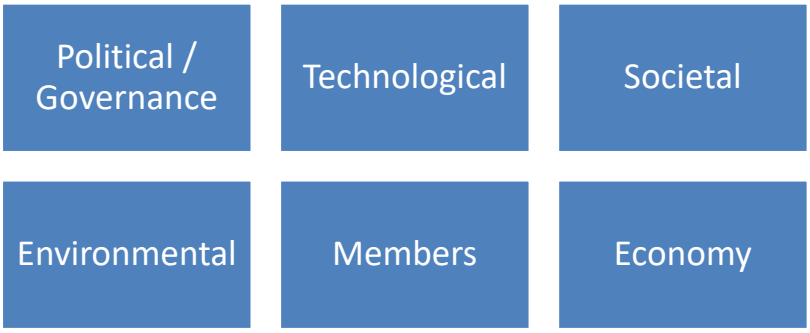
The first advisory in this series discussed six major drivers of risk to the modern electric cooperative:



These risk drivers are broad, but additional risks may apply to cooperatives. Each driver can create or change risk. Frequently, these drivers work together. Overseeing new and increasing risk requires a comprehensive and systematic approach. One solution to consider is ERM.

What is Enterprise Risk Management?

Are there solutions to address the evolving risk electric cooperatives face? Yes. While risk can never be eliminated, ERM – one possible solution – is a management tool that:

- Looks at risk across the cooperative.
- Provides insights to assess and manage the identified risk.
- Uses simple and comprehensive method to assess, track and help ensure that risks are addressed, if appropriately implemented and maintained.
- Allows management to oversee the continual creation of value on a complete, integrated, cooperative-wide level.
- Examines risks strategically from the perspective of the entire cooperative.

To visualize, think of risk as a thunderstorm, with rain and lightning surrounding the cooperative. ERM is like a huge golf umbrella covering the entire cooperative. ERM helps prepare a co-op for "risk rainstorms."

ERM is both:

- A *management tool* that provides the cooperative a means of understanding and developing a response to risk, and
- A *process* to identify, categorize, address, track, and monitor risk across the cooperative.

Risks tend to be "siloed" in individual departments. ERM provides the board, CEO, and management team a complete view of the cooperative's needs, risk threats, opportunities, and solutions. The process is tied to the cooperative's strategic vision and direction. This enhances decision-making and assists in meeting the cooperative's strategic priorities.

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ERM also encourages regular board reporting. This helps the board to readily understand the risks and be comforted in knowing that risks are being monitored and addressed throughout the cooperative. In addition, the regular risk reporting allows the board to make more informed governance and strategic decisions.

ERM works through a simple but comprehensive five-part cycle. (Part 3 of this advisory series provides more information on the five-part ERM cycle.)

Is ERM Beneficial for All Cooperatives?

ERM provides an enhanced view of threats and opportunities to benefit any size cooperative. ERM is often viewed as only for large businesses, however it is not "just for the big guys."

As another visual, think of risk as a giant, marauding elephant. There is a very old joke that comes to mind: "*How do you eat an elephant? One bite at a time."* It can seem overwhelming to think of all the risks that need to be reviewed. NRECA's ERM program for electric cooperatives is designed to be "bite-sized," as well as scalable, systematic, comprehensive, and continuous. A cooperative can implement ERM in a series of sensible, measured steps. The program can be implemented at any cooperative that seeks improved risk management in this rapidly changing industry.

ERM Myths

There are many myths about ERM. Four common myths are addressed here:

1. *Myth 1: ERM is only for the really big distribution cooperatives or a generation and transmission (G&T) cooperative. It's too big and expensive to implement at our cooperative.*

   ERM concepts have been around since the 1980s and were targeted at larger businesses. But, the idea that ERM is only for big business is wrong. Every business, large or small, faces risk every day and can choose to address it using ERM.

2. *Myth 2: ERM is costly and complex – and takes a lot of time and effort.*

   Risk management can be costly and complex, but it does not have to be. Strategies can minimize staff time and effort and allow ERM to grow at a reasonable and measured pace. NRECA's ERM program is "scalable." The cooperative can grow ERM as the cooperative becomes acclimated. This approach values staff time and resources to create a viable ERM program geared to the particular cooperative's individual needs.

3. *Myth 3: We have to hire a "risk officer," and that could be pricey!*

   Many large organizations do have specific risk officers and they serve well. Having a risk officer is not required, however. An ERM program can be very well managed – and research shows that it can work well – without a risk officer. One solution is a slightly different take on a risk committee, comprised of senior management and chaired by the CEO, to create a functioning ERM program.

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There is no need to add a new employee. NRECA's ERM program can be implemented in manageable, bite-sized chunks. The program can then "scale up" to meet more and more risks the cooperative may face.

4. *Myth 4: Yea! We will eliminate all risks through our ERM.*

   We appreciate the enthusiasm, but there no way to eliminate all risk. As was explained in Part 1 of this advisory series, new risks generally come along from new laws, regulations, and other issues. While ERM doesn't eliminate risk, it can help the cooperative address, manage and plan for risk across the cooperative in a systematic manner.

ERM Benefits

ERM can bring a variety of benefits to the implementing cooperative. Among the common benefits are:

1. *A beneficial approach to management with integrated planning and improved measurement*.

   ERM can provide the board and management a program that fosters comprehensive risk oversight and planning. There will be a growing comfort that the cooperative is ready for what may come.

2. *Increased progress toward strategic goals and objectives.*

   ERM can provide an improved understanding by leadership and the board of the relationship between strategic directions and risk planning. The continual ERM review, based on strategic direction, helps to ensure greater progress toward achieving strategic goals and objectives.

3. *A comprehensive view of the progress and needs of the cooperative.*

   Management benefits from a comprehensive view of the cooperative. ERM is a continuous and comprehensive process that reviews and plans for threats and opportunities.

4. *Improved communication on all levels – between the CEO and board, within departments, among employees, and to the membership.*

   In the modern world, communication is paramount. As the ERM program grows, there is a natural increase in understanding and tracking of both problems and solutions. Tracking and reporting create opportunities for improved and comprehensive communication. This leads to the many and varied benefits of communication, in and out of the cooperative.

5. *Improved governance and decision-making.*

   The board can benefit from ERM. The board communication benefits are a great asset. As ERM is implemented and risk reporting become more routine, these communications to the board give visibility into how the cooperative is managing those risks and moving forward in meeting the cooperative's strategic goals. This helps facilitate improved governance and decision-making. For more information, please see the board article in the Appendix on page 6 of this advisory.

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6. *Improved resource allocation and use, maximizing efforts and resources for the members' benefit.*

   Resource use and allocation can improve with ERM. The cooperative's ability to identify and maximize resources can improve as plans are directed toward the cooperative's strategic goals.

7. *Culture improvement and advancement in the cooperative.*

   The modern cooperative may be faced with new demands, including the cooperative's culture. Culture is generally becoming an increasingly important issue to address, as many organizations strive for a culture that is both dynamic and inclusive. Creating a culture through ERM that is both risk-aware and values increased communication about risks the cooperative faces can naturally improve the culture within the cooperative.

These are only seven of ERM's benefits. Each implementing cooperative may experience all of these and more.

Additional Information and Resources

This is the second of a three-part advisory series addressing risk in the electric cooperative. In the first article, *What is Risk?,* we looked at how pervasive risk has become in a changing electric industry. This advisory looks at ERM as an asset to manage risk. The next and final advisory will provide an overview of the five-part ERM cycle.

There is more to know and explore about Enterprise Risk Management. NRECA's Consulting Services group offers programming to assist in understanding and implementing ERM. The program follows the four fundamentals of ERM: it is scalable, systematic, comprehensive, and continuous.

Contact for More Information and Questions

For more information on ERM or if you would like to proceed with implementing ERM, please contact:

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APPENDIX

Enterprise Risk Management: A Board Risk Perspective

Perhaps you are new to a cooperative board. If so, congratulations and welcome! Or perhaps you are a seasoned veteran. If you feel lost, overwhelmed, or even frustrated at times – you're not alone. Such feelings are understandable and common for directors. The past few years have seen rapid changes at the distribution, transmission, and generation levels.

No matter your experience or tenure, as a trusted board member at your electric cooperative, you have heavy responsibilities. If you are long tenured, you are trying to keep up with all the changes coming down the pike. If you are a new board member, you may feel as if you are "drinking out of a fire hose" – you may be trying to stay aware of industry changes, as well as learning a complex and rapidly changing business and balancing the needs of your membership.

What you're experiencing is likely a normal reaction to the new risks that electric cooperatives may face.

Drivers of change can be difficult to manage, let alone control. Some are internal, others external. Internal drivers include turnover among employees and the board, new skills needed, and integrating new technologies. The external drivers can be the most difficult to control and may fall into the categories of:

- Political / Governance
- Societal
- Environmental
- Technological
- Member
- Economy

These external drivers often merge to form an incomprehensible "web" that accelerates change. Trying to sort out the inter-relationships can be complicated.

For example, business risks may include such things as service interruption, cyber-crime, supply chain disruptions, financial, reputational, and operational risks. These risks may fuel governance risks, such as board instability resulting in regulatory, societal, and political actions that trigger additional risks.

Some broad examples may include:

- New risks emerging from political, legal, and economic arenas as technological change accelerates. While innovation transforms and modernizes, it can have a dramatic impact on a cooperative's strategic plans and prospects for sustainable, long-term value creation.

- While many cooperatives enjoy a not-for-profit status, they are not insulated from the effects of tax reform, which can create change in the business operations of secondary suppliers and related businesses. This results in new challenges and opportunities for cooperatives.

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- Consequences that flow from weak governance, poor internal controls, or managerial misconduct serve as a reminder that corporate operations are fraught with risk, which may cause member unrest, as well as new legal, regulatory or governance requirements.

- Social and environmental issues, including heightened focus on diversity, equity, and inclusion, as well as increased awareness of other social issues, are transforming corporate culture as societal scrutiny increases and new legal requirements are considered or implemented.

- Shifting views on environmental issues, such as climate change and natural disasters, have taken on a new salience in the public sphere. Companies are wise to exercise the utmost care in addressing legitimate issues to avoid public relations crises and mitigate liability. Many large companies are implementing environmental, social, and governance policies (ESG), some of which actively weed out any participation with other companies (perhaps including cooperatives) not mandated to adhere to the standards that company policy establishes. Regulatory agencies are beginning to consider or implement similar standards. The effect of these standards may be immediate or gradual. Here are two examples:

    - An investment firm may refuse to provide funding to companies who have not established a "carbon neutral standard' by a certain date. While this may not immediately impact electric cooperatives, the effects may gradually be felt.

    - A company establishes strict diversity standards and refuses to work with or provide funding to a cooperative that does not have or meet a diversity standard. In a dramatic example, the Security and Exchange Commission has established diversity, inclusion, and equity standards for board membership with companies overseen by the Commission. Eventually, unregulated businesses, such as electric cooperatives, may feel a "cascade effect" from a standard they are not required to meet.

Both of these examples highlight how a cooperative may have future challenges obtaining funds, receiving grants, working on projects, or taking advantage of opportunities without sufficient, demonstratable risk management in place. CFC has discussed the problems with both these scenarios at various conferences.

Among an electric cooperative board's major functions include: providing direction, overseeing, and advocating on behalf of the membership. In providing oversight, the board can promote an effective, on-going risk aware culture by expecting a robust risk management program. This generally includes having regular board/CEO conversations about the specific risks faced by the cooperative. As the board's risk understanding increases, and risk is addressed, board governance can improve. A board with a good risk awareness may be more comfortable with accepting risk, explore more opportunities, and make higher quality decisions.

A board may wish to set an expectation that the CEO will implement a comprehensive risk oversight process for the cooperative. This expectation may include integrating broad integral risk awareness. At the same time, the Board may need to ensure adequate resources to grow a program.

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There is no one-size-fits-all risk management program for any organization. But, in general, an effective risk management system will include the following components:

- A robust, comprehensive program to gather, review and assess risk.
- A clearly defined risk appetite measurement process. Risk tolerance levels should be agreed upon by the board and management.
- Appropriate risk management strategies to respond to the cooperative's known and anticipated risk profile.
- A mechanism to regularly communicate risk information to the board.
- Risk responses and management that focus on the cooperative's strategic direction.
- A broad employee and board risk awareness training program.

Specific types of actions that the board may consider in risk management oversight include:

- Regularly reviewing the board's expectations for oversight and management of specific risks to ensure a shared understanding of roles and accountabilities.
- Ensuring the cooperative's strategic plan values risk awareness.
- Crafting risk-aware expectations for the CEO, including:
    - Establishing and enforcing an expectation holding the CEO accountable for building and maintaining an effective risk management framework and providing the board with regular reports on the status of various risks.
    - Regularly reviewing with the CEO the quality and comprehensiveness of the risk information provided to the board. Risk elements should be included in all board presentations, especially of new programs or initiatives.
    - An expectation to review the CEO's planning and implementation of the cooperative's risk programs, policies and procedures, to assess whether they are effective.
- Providing resources to ensure the risk program remains viable.
- Supporting the CEO's efforts to establish a comprehensive "risk aware" cooperative culture. A risk aware culture is both "top-down" and "bottom-up." This can be achieved by:
    - Establishing "a tone at the top" that reflects the cooperative's core values and the expectation that employees act with integrity and promptly escalate risk and non-compliance.
    - Creating an expectation that employees at all levels understand the cooperative's approach to risk, as well as its risk-related goals; this creates an environment that fosters a bottom-up risk culture with communication and a positive attitude towards decision-making that reinforces the cooperative's desired risk management behavior.
    - Actively and fully participating in risk appetite assessments to ensure that risk programs and strategies are aligned with the board's needs and directions.
- Expecting the board to be "risk aware." Board members should fully review, actively discuss, and raise questions on various risk reports.

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- In connection with the above, the board may wish to consider regular reviews of the cooperative's risk management system, including a review of any committee-level risk oversight policies and procedures.

There is, of course, a caveat. Risk is pervasive and, by its very nature, continually and unexpectedly changing. The board must be aware that the cooperative, even with a stellar risk management program, cannot eliminate risk. Nor can risk management ensure complete success in all activities. A valuable risk management program works in a cycle to review both success and failure to better plan future responses.

Risk aware boards are cognizant that annual reviews differ from a cooperative-wide program that regularly assesses, plans and monitors cooperative operations and processes, reviews and learns from past failure or mistakes, and continually ensures that current practices enable and maximize the cooperative to function and move in strategically determined directions.

It can seem overwhelming, but implementing and cultivating an enterprise-wide risk management program can be highly beneficial. Implementing an effective risk management program takes time and effort. The board may worry that about staff time and effort. Those issues can be addressed by a program that understands and values the electric cooperative business model. NRECA's ERM program is scalable, systematic, continuous, and comprehensive. The cooperative works with a small number of risks until they are ready to move into more comprehensive risk review. This "bite-sized" approach maximizes the effect and places value on staff time as they work to become more risk-aware and then risk-ready. With a risk awareness and focus, the board can become more comfortable with risk oversight.

Yes, risk is growing. It is natural to feel unsure. You are not alone in your concerns in an electric industry that is changing rapidly. While implementing an enterprise-wide risk program may seem daunting, it can be accomplished in a scalable and comprehensive manner. A risk program with associated reporting can help address concerns and ease your fears.

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