Governance Guideline

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BC CREDIT UNIONS

British Columbia | Financial Institutions Commission

www.fic.gov.bc.ca

INTRODUCTION

The Financial Institutions Commission[1] (FICOM) holds the Board of Directors[2] (board) accountable for the stewardship of a credit union. FICOM relies on the board, as a core oversight function, to take all reasonable steps to ensure the safety, stability and sustainability of its credit union. The successful operation of a credit union contributes to maintaining and enhancing trust and confidence in the province's credit union system and the economy as a whole.

This Governance Guideline (guideline) outlines FICOM's expectations for sound governance practices at all British Columbia credit unions. It is intended to assist credit union boards in the exercise of their duties and obligations to protect the interests of credit union members. This guideline is designed to recognize the cooperative nature of credit unions and differences in size, scope and complexity within the credit union system.

This guideline sets out both ***Principles*** and ***Standards***:

Principles
Principles form the foundation for good governance expected by FICOM through its guidance. Principles communicate the spirit of FICOM's expectation without prescribing the form by which the principle is achieved.

Standards
Standards are the specific policies and procedures that achieve the objective of each principle. In most cases, standards are set at a level FICOM expects can be adopted and substantively implemented at each credit union.

FICOM'S APPROACH TO ASSESSING GOVERNANCE IN CREDIT UNIONS

Governance examination forms part of FICOM's overall risk assessment as set out in its Supervisory Framework[3]. Each board director should understand the supervisory process and the responsibilities and expectations placed on them as a director.

FICOM takes a number of approaches to assess the effectiveness of a credit union's governance practices and application of this guideline's principles and standards including: direct discussions with the board; continuous assessment; independent assessments[4]; and demonstrable evidence that governance practices exist, operate effectively and the board discharges its duties with care and conscience.

As with other areas of risk assessment, FICOM reviews a credit union's governance from two perspectives: characteristics and performance.

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[1] References to FICOM may include the staff, the Superintendent and/or the Commission.
[2] References to the board may include its committees.
[3] More detail on FICOM's Supervisory Framework, including Assessment Criteria, can be found at www.fic.gov.bc.ca.
[4] Independent assessments, if commissioned, report directly to FICOM with their findings shared with the board.

Characteristics

Characteristics demonstrate how a board structures, organizes and tasks itself, its committees and its directors to govern the credit union including the policies and procedures it has in place to effectively fulfill its oversight responsibilities.

To assess characteristics, FICOM reviews whether:

- the board's composition, structure, activities and reporting are aligned to the size, scope, strategy and risks of the credit union;
- directors have the appropriate skills, knowledge and experience to govern the credit union;
- roles and responsibilities are clearly set out, documented and accessible to members and stakeholders;
- the board has approved the policies and procedures that contribute to the effective identification, measurement, reporting and control of all material risks; and
- the board exercises the appropriate degree of transparency, reporting and assessment to ensure independence and accountability to its members and stakeholders.

Performance

Performance measures the quality and effectiveness of the board's oversight of a credit union's risks and financial and non-financial performance. Performance is a qualitative measure and necessarily requires a greater degree of judgment in its assessment.

To assess performance FICOM considers the board's:

- actions to control and set boundaries to the risks associated with the credit union's chosen strategy and business model;
- willingness and ability to remain independent from management and exercise control through the effective probing, reviewing and questioning of key assumptions and important decisions;
- success in establishing and maintaining a culture within the board, senior management, oversight functions and throughout the credit union that supports the board's effectiveness;
- commitment to continuous improvement through learning and training; and
- demonstrated accountability and disclosure by the credit union to its members, regulator and other stakeholders.

THE ROLE OF THE BOARD

A board's responsibilities include:

- defining and approving the credit union's ***risk appetite***;

- setting, approving and monitoring the credit union's ***strategy and performance*** and overseeing its ***planning process***; and
- ensuring that the credit union has the ***capability and culture*** to support its risk appetite and achieve its strategy, including;
  - oversight of the credit union and executive team;
  - choosing and evaluating the CEO; and
  - recruitment and renewal of the board.

To fulfill these responsibilities, a board:

- approves and implements a ***risk governance framework*** that effectively monitors activities and progress related to these responsibilities and initiates prompt corrective action when necessary; and
- implements a framework for ***accountability and disclosure*** that effectively informs the credit union's members and other stakeholders of its risks and progress toward achieving its objectives.

The board plays the key role of ensuring that the credit union effectively manages and mitigates risk through policies and procedures at three levels:

1. Operational staff[5] who understand and correctly fulfill their roles and responsibilities;
2. Independent oversight functions, including Internal Audit, who monitor policies and procedures with regard to risk and compliance amongst operational staff and test the design and effectiveness of internal controls to mitigate risks; and
3. The board[6] who regularly reviews business operations and the resourcing and independence of oversight functions to confirm they are performing at appropriate levels for risk tolerance and regulatory compliance.

The segregation of duties and independence among these levels enhances the effectiveness of the credit union's risk management system. More specifically, independent oversight functions should not be unduly influenced by management or operational staff and should report directly to the board or its committees. These three levels safeguard the credit union by working together to ensure a credit union operates within its risk appetite and compliance requirements.

The principles and standards set out in this guideline are organized around the responsibilities amongst these three levels within a credit union.

[5] Operational staff oversee the day-to-day operations of the credit union.
[6] References to the board may include the Audit Committee.

THE BOARD’S RELATIONSHIP WITH FICOM

FICOM gains confidence in the governance and risk management of a credit union when the board demonstrates that it is fulfilling its roles and responsibilities. During on-site reviews, FICOM meets with the board, separate from management as necessary, to assess how the board and its committees fulfill supervisory principles and standards.

FICOM monitors and regulates quantitative and qualitative aspects of a credit union’s performance with staff requiring a thorough understanding of a credit union’s strategy, risk management practices, leadership and culture to accurately gauge the health of a credit union. Communication between the board and FICOM can improve FICOM’s understanding of the credit union. For example, where a board believes a supervisory standard cannot be practically applied in the credit union, it should raise this with FICOM for discussion.

RISK APPETITE

PRINCIPLE

By approving a written risk appetite, the board ensures that the credit union only takes on risks that are within its capabilities to manage. A credit union's risk appetite outlines the amount and type of risk a credit union is willing to accept in order to pursue its strategic plan, provides tolerances and boundaries to the strategic planning and ongoing operations of a credit union, and drives the credit union's culture by embedding itself in functions and business activities at all levels.

STANDARDS

1. When defining and approving the credit union's risk appetite, a board should consider:
   - members' values and expectations;
   - its own capability to understand and oversee the credit union's risks;
   - internal constraints such as financial and operational capability; and
   - external constraints such as competitive and economic conditions.
2. The board-approved risk appetite forms the basis for a credit union's risk governance framework including its strategic, capital and liquidity plans.[7]
3. The board ensures the credit union has the systems, processes and capabilities to evaluate its overall risk profile, and the interrelationships among the individual risks are understood.
4. The board annually reviews the key risks, current and prospective, to the credit union and satisfies itself that the processes to identify and manage risk are appropriate and effective.
5. The board and its committees review risks on an enterprise-wide basis, as well as the steps taken to manage risks and the systems in place to monitor risks within the credit union's defined risk appetite. This includes reviewing the degree to which risk management is considered in decision-making.
6. The board ensures that the credit union uses qualitative and quantitative analysis (such as stress testing) to determine how robust or vulnerable the credit union is to a variety of internal and external factors. The degree of stress testing is dependent on the nature, scope and complexity of the credit union's risk. The board reviews testing outcomes on a regular basis and adjusts its risk appetite or strategy as necessary.
7. The board ensures that a credit union has a disaster management and recovery plan that is updated regularly.

[7] In addition to other plans as described in the Risk Governance Framework section of this guideline.

STRATEGY, PLANNING AND PERFORMANCE

PRINCIPLE

The board sets, approves and monitors the credit union's strategic plan and performance. The approval process involves a thorough discussion of the advantages and disadvantages of possible strategic directions and includes challenging assumptions and identifying risks for each option. The strategic plan is connected to a credit union's risk appetite and sets out goals, objectives, timelines and performance indicators that are clear and specific enough to allow for effective monitoring and reporting of credit union performance to members and stakeholders.

STANDARDS

1. When setting and approving its strategy, a board considers:
   - members' values and expectations;
   - internal constraints such as financial and operational capability;
   - external constraints such as competitive and economic conditions;
   - alignment with the credit union's risk appetite; and
   - any impacts of its strategy on the credit union system.

2. A credit union's strategy is forward looking and focuses on ensuring the credit union's long-term viability and success.
3. The board understands the credit union's mission, vision, business model, industry, markets and risks.
4. The board continuously monitors emerging issues or areas of concern, and adjusts the credit union's strategy as necessary. At a minimum, the strategic plan is reviewed in depth by the board on an annual basis.
5. The board oversees the format and information flow of reporting for frequent, timely and accurate information to the board on progress of the strategic plan and any variances.
6. The board approves an operating plan, ensuring it aligns with the credit union's strategy. An operating plan has a shorter timeframe (typically one year) and identifies the activities and objectives necessary to achieve the credit union's strategic objectives.
7. The board monitors the implementation of strategic, operating and capital plans and budgets on an ongoing basis.
8. The board ensures the credit union has the resources required to accomplish its goals. Its planning process identifies resources including capital investments, financing needs, staffing or other necessary resources.
9. Management regularly reports to the board on the credit union's performance, together with any actions to address areas of non-performance.
10. The board and management agree annually on a comprehensive set of performance measures for the credit union that reflect progress against the strategic, operating and capital plans.

RISK GOVERNANCE FRAMEWORK

PRINCIPLE

The board's role is not to minimize risk, but rather to fully understand the credit union's risk exposure and to ensure the processes and systems that are in place to control risk are appropriate given the credit union's strategic plan and operating environment.

A risk governance framework is the set of tools, policies and processes that a credit union has in place to identify, measure, manage and guide the amount of risk the credit union is willing to accept in the pursuit of its strategic objectives. The board's role is to ensure a credit union's risk governance framework is:

- *comprehensive;*
- *adequately resourced;*
- *forward looking;*
- *informative;*
- *strategic;*
- *responsive;*
- *effective; and*
- *monitored and communicated.*

> The risk governance framework addresses both risk governance and risk management:
>
> **Risk Governance**
> Involves setting the credit union's direction and tolerance for risk, providing oversight of risk management and ensuring that risk controls are effective. Risk governance is the role of the board.
>
> **Risk Management**
> Involves the identification, measurement, assessment, monitoring, reporting and mitigation of potential uncertain events or activities that could affect the ability of a credit union to achieve its strategic objectives. The risk management system and its oversight are the responsibility of management and independent oversight functions respectively.

STANDARDS

1. A risk governance framework reflects the unique business model and strategic plan of a credit union, and as such, the tools, policies and procedures within a framework vary among credit unions. At a minimum, a board ensures its risk governance framework includes:
    - a risk appetite;
    - a strategic plan;
    - an inventory and description of the credit union's risk exposures and an understanding and discussion of their interconnectedness[8];
    - a capital plan;
    - a liquidity plan;
    - an investment and lending policy;

[8] This is typically included in an Enterprise Risk Management framework.

- a comprehensive set of risk-adjusted performance metrics that will be used to measure progress towards achieving the credit union's strategic goals, adherence to its risk appetite, and consistency with capital and liquidity plans;
- a capital and operating budget;
- an inventory of independent oversight and internal control functions, their purposes and who is responsible;
- an inventory of risk governance reporting requirements including frequency and responsibility;
- a plan to test assumptions, controls and impacts (stress testing) of key risks; and
- a business continuity and disaster recovery plan.

2. The specific operating policies and controls requiring board approval will depend on the board's risk appetite, the credit union's business model and its strategic plan. At a minimum, a credit union has in place written policies that define the board's role in:
    - credit and investment limits and decisions;
    - internal audit;
    - pledging of the credit union's assets;
    - introduction of a new product or line of business;
    - establishing new methodologies or approaches for determining fees and charges;
    - acquisitions, mergers or divestitures;
    - setting appropriate compensation;
    - reviewing and responding to member feedback and complaints;
    - enacting contingency, continuity or disaster recovery plans; and
    - responding to the media.
3. The board should be free to obtain independent advice on its role in comparison to good industry practices and comparable credit unions.
4. The board ensures the risk governance framework remains dynamic; tools, policies and processes are reviewed by the board, at least annually, with framework adjustments directed by the board as necessary.
5. Each director is responsible for fully understanding the credit union's risk governance framework and how it links to the credit union's business model and strategic plan.
6. The board ensures that the risk governance framework articulates risk tolerance boundaries, internal controls and monitoring and reporting requirements clearly so that the credit union operates within the board's defined risk appetite.
7. Reporting expectations and accountabilities are set out in writing, including for management, independent oversight functions and the board.

8. Directors receive, and understand, clear reporting on the credit union's performance and risks with relevant internal and external comparative data. The board discusses, in-camera, the quality of the reporting the board receives on a regular basis and addresses any gaps with the CEO, other reporting management and the independent oversight functions.

9. Where a credit union chooses to outsource any part of its business that is either strategically or operationally significant or otherwise material to a subsidiary or a third party, it retains responsibility for managing the relevant risks associated with that function and has sufficient oversight in place.

10. The board undertakes an annual review of the credit union's compliance with relevant laws and significant contracts, the requirements of any regulatory bodies and its own governing documents, including its rules.

11. Board committees can be an effective way to allow boards to more efficiently undertake oversight responsibilities. Credit unions are required to have an Audit Committee, a Conduct Review Committee and an Investment and Loan Committee; however, boards should also consider additional committees that can support the board's oversight responsibilities.

12. Each committee has a clear statement of responsibilities and the board members serving on the committee are selected using a process that matches the skills, experience and personal attributes to the responsibilities of the committee.

13. Where the board or committee determines that it does not have the appropriate knowledge, expertise or experience to fully evaluate risks, it should seek advice or analysis from an independent third party. Approaches include retaining consultants, advisory boards, or non-voting directors. The board has processes in place to make resources available to retain external resources, such as consultants, advisory boards or non-voting directors.

14. The board also periodically commissions independent reviews to assess the effectiveness of oversight functions in the credit union with results reported directly to the board, senior management and FICOM as requested.

ASSEMBLING AN EFFECTIVE TEAM

PRINCIPLE

A credit union's success is determined by its talent and its culture. Talent is a function of education, skill and experience, and culture is a function of values and behaviors. Talent and culture at the board, management and staff levels reinforce each other to develop a strong credit union.

STANDARDS

1. The board ensures that the talent and the culture of the credit union support its risk appetite and the achievement of its strategic plan. The board fulfills this responsibility through the:
   - recruitment, development, compensation and evaluation of the board;
   - recruitment, selection, development, compensation and supervision of the Chief Executive Officer[9] (CEO);
   - selection and oversight of other senior staff with oversight responsibilities[10]; and
   - development of succession plans.
2. A board is deliberate in its own recruitment, development and succession planning by considering:
   - skills and experience that are most relevant to advancing the credit union's business model and strategic plan and to controlling its risks;
   - personal attributes, values and behaviors that will make the board functional;
   - leadership requirements of the board, such as the board and committee chairs;
   - diversity of backgrounds, perspectives and problem solving approaches needed to be most effective;
   - willingness and ability of the board to think and act independently;
   - degree to which the board composition reflects the credit union's members and its community; and
   - regularly evaluating the skills and qualities of the board relative to the strategy and risk appetite of the credit union.
3. The board[11] takes an active role in the director recruitment process by:
   - identifying required and desirable skills, experience and personal attributes that are directly aligned to the credit union's strategic plan and to its needs for risk oversight;

[9] References to CEO may include references to a General Manager (GM).
[10] For example, internal audit, chief risk officer, chief financial officer, etc.
[11] Either by committee or as a whole.

- ensuring candidates with the necessary skills and qualities are actively recruited;
- establishing a transparent and independent evaluation process to compare candidates to the necessary skills and qualities;
- communicating both the necessary skills and qualities and the evaluation process to members clearly and in advance of the election process; and
- recommending any number of candidates to vacant positions so long as each candidate meets the requirements established and disclosed by the board.

4. Each director is expected to[12]:

    - be financially literate as demonstrated by his or her ability to understand and interpret the credit union's financial performance and the relationship between its strategic plan and financial outcomes;
    - understand risk as demonstrated by his or her ability to identify and describe the range of risks the credit union is exposed to and how each is controlled;
    - understand the cooperative business model and its unique strengths and limitations, particularly as it applies to financial services;
    - understand the business of delivering financial services, the opportunities and risks, and the competitive forces and industry trends;
    - demonstrate integrity by acting ethically, respecting confidentiality and the solidarity of board decisions, disclosing perceived conflicts of interest and acting in the best interest of the credit union and its members at all times;
    - be familiar with the regulations and legal framework under which the credit union operates; and
    - think critically and independently, as demonstrated by his or her willingness to ask questions and challenge assumptions.

5. The board, as a whole, is expected to:

    - possess specific skills and experience in those areas of strategic importance to the credit union's business model, strategic plan and risk profile[13];
    - have specific financial skills and experience in the area of accounting, preparation of financial statements or audit;
    - have current and relevant knowledge of, or experience in, the markets and businesses that the credit union serves or seeks to serve;
    - recognize when it needs additional expertise or third party advice; and
    - operate as a highly functioning team, demonstrating the willingness and ability to

[12] Where a director does not meet a supervisory expectation, the director and board should develop a plan for the director to receive the relevant training and education to meet expectations in a reasonable amount of time.
[13] For example: credit, insurance, wealth management, leasing, technology, etc.

deliberate on key decisions, challenge each other constructively, reach consensus wherever possible and support board decisions.

6. The Board Chair and each committee chair is expected to:

   - possess the facilitation and leadership skills to ensure the board carries out its responsibilities effectively and management is held to account;
   - set meeting agendas, determine information flow, chair meetings and in-camera sessions effectively, manage meeting schedules, coach and develop and lead by example;
   - in the case of the Board Chair, act as the primary liaison between the board and the CEO;
   - in the case of committee chairs, act as the primary liaison between the board and the committee; and
   - support succession planning for their own position.

7. The board approves standards for ethical and sound business conduct for itself, as well as the employees of the credit union. The standards provide guidance in the areas of confidentiality, integrity and responsibility at the individual and credit union levels and include provisions that provide for fair treatment of members by the credit union, its intermediaries and its partners.

8. Selecting a CEO is one of the board's most crucial decisions and it should consider the same attributes essential to board recruitment as well as:

   - ability for the board and CEO to build mutual trust;
   - development of an environment where the board is comfortable and encouraged to challenge and probe the CEO and management; and
   - confidence to support the CEO and management in its decisions.

> **Role of the CEO**
>
> The role of the CEO is critical to good governance; the board relies on the CEO and management team to prepare and present information in a way that enables the board to exercise sound judgment and make thoughtful decisions.
>
> A good CEO brings forward the right issues at the right time with enough information and analysis to allow the board to exercise its judgment and make sound decisions. A good CEO empowers the board to do its job well.

9. The board is responsible for attracting, selecting, compensating and retaining a CEO that can implement its strategic plan. The board is also responsible for supervising the CEO and should set out goals, objectives and performance metrics that the CEO is responsible for meeting, and complete a performance evaluation at least annually. This includes:

- establishing overall CEO compensation[14], which is reviewed and approved annually, concurrent with the CEO's performance evaluation and adjusted for risks; and
- having in place a board-approved succession plan that accounts for both the planned and unplanned departure of the CEO or other key persons in the credit union.

10. The board exercises oversight of the selection and compensation of other key executive positions, particularly those with direct reporting relationships to the board such as independent oversight functions, compliance and internal audit.

11. The board exercises oversight of the overall compensation program in place in the credit union and pays particular attention to any variable or incentive compensation programs used by the credit union. The board ensures compensation programs are aligned with the credit union's risk appetite and strategic plan and do not incent behaviors or outcomes that are not in the interest of the credit union or its members. The board can direct an independent review of the compensation of material risk takers within the credit union.

12. The board has in place policies and procedures, and a supporting budget under its control, to address its own performance, development and succession, including:
    - expectations of board members;
    - meaningful orientation and education requirements that reinforce the strategy, business model and key risks of the credit union;
    - continuing education requirements;
    - standards for attendance and performance of directors;
    - regular and meaningful performance evaluation at the board, committee and individual level with an improvement action plan regularly tracked;
    - defined terms for directors;
    - a director compensation policy; and
    - any independent reviews.

[14] Including pay, bonus, deferred or incentive compensation, benefits, perquisites and severance.

ACCOUNTABILITY & DISCLOSURE

PRINCIPLE

Credit unions are unique among financial institutions in the cooperative principles that underpin their formation and inform their decision-making. Among these principles, democratic values, member accountability and community engagement are balanced with economic priorities to ensure a strong credit union. A credit union's democratic control structure can either create or reduce risk depending on the degree to which the members take an active interest in the safety, stability and sustainability of the credit union as owners.

The board encourages members to engage with the credit union as owners by promoting disclosure and governing the credit union with a mind to the values represented by its members. Engagement with members as owners can create goodwill, contributing to a stronger member bond and a more resilient credit union.

STANDARDS

1. The board ensures that member accountability is demonstrated by:
    - addressing member needs and values when setting the credit union's risk appetite and strategic direction;
    - communicating with members at a frequency and in a format that provides for meaningful comparison and evaluation; and
    - disclosing to members information that, as owners, they should reasonably expect to receive including an overview of the governance framework of the credit union and the director election process.
2. A credit union's annual report to members includes the following:
    - a management discussion and analysis report that provides information on the credit union's financial and operating results including meaningful comparative data, its principal risks and contingency strategies, a fair accounting of the credit union's activities and a commentary on the credit union's expected future performance;
    - director attendance records for board and committee meetings and educational activities;
    - board and committee chairs and memberships;
    - senior management and independent oversight functions;
    - for each director, background information and experience, total compensation paid by the credit union, total expenses including education and other costs paid by the credit union, length of board tenure, interlocking directorships with other directors and a list of other board appointments held in his or her capacity as a director of the credit union;

- the total amount and form of compensation paid to the CEO;
- the rules of the credit union;
- a description of credit union policies and practices for compensation; and
- a breakdown of profit allocations including policies governing dividends and community allocations, and corresponding dollar amounts and rationales.

3. The credit union provides members with the opportunity, at least annually, to participate in a forum with directors and senior management to ask questions and receive answers about the credit union.
4. The credit union has a policy in place to address member feedback and complaints that clearly defines the role of the board and means of direct contact in this process. This policy and means of contact are accessible to members.

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