Advancing Governance

Report of the British Columbia Credit Union Governance Task Force

January 31, 2012

Table of Contents

Preface

Credit unions have a proud history serving the financial needs of British Columbians. Through their community focus and cooperative structure, credit unions have leveraged their distinct characteristics to compete with other financial institutions. In the past two decades, the operating environment for credit unions has become more challenging.

To remain competitive in a complex regulatory and economic environment, credit unions are offering increasingly varied and sophisticated products and services to their members. For credit unions to continue to thrive in British Columbia, boards of directors must then exercise more effective control and oversight, and their directors must be capable of meeting these rigorous responsibilities.

In recognizing the importance of good governance it is clear that credit unions must go beyond just meeting the minimum governance standards set in the *Financial Institutions Act* (FIA) and the *Credit Union Incorporation Act* (CUIA). To meet the challenge of changing conditions, some credit unions have adopted practices that are consistent with those found in publicly traded companies while others have adopted practices that they feel are more suited to their cooperative roots. Irrespective of the approach they have decided to take, all credit unions should be continually taking steps to improve their governance.

With the ongoing need for improvements in governance in mind, the Superintendent of Financial Institutions established the Task Force on Credit Union Governance. In her instructions to the Task Force she defined the mandate to include "the solicitation of input and ideas, and seeking fresh perspectives will ensure regulatory processes remain current and relevant." She further noted, "it is in this area that the Task Force can add great value."

Members of the Task Force were selected to ensure a broad perspective. Representatives included board chairs, directors and CEOs from credit unions of different asset classes and regions as well as persons from outside the credit union system with significant governance expertise.

Through a series of meetings, the Task Force considered practices that have been recognized as contributing significantly to good governance. In addition to the experience and knowledge brought by the members, the Task Force reviewed and discussed governance principles recommended by organizations such as the Canadian Cooperative Association, Organization for Economic Cooperation and Development, the Canadian Coalition for Good Governance, financial institutions regulators, the Filene Institute and the Institute of Corporate Directors. Each of these organizations has issued reports within the last five years dealing with emerging governance practices.

The Task Force then considered major areas of responsibility that are particularly important for credit union boards of directors and developed a series of recommended governance practices, which, if practiced throughout the credit union system, will support the system's continued solvency, resiliency and growth.

The Task Force completed its work in January 2012. This report reflects these discussions and represents its final submission. Throughout the report, the Task Force has **highlighted in bold type** its recommended governance practices for credit unions.

Recommended Governance Practices

The Task Force recommends the following governance practices which are relevant to all credit unions regardless of their size, location or bond of association. With that said, the Task Force is mindful of the need for individual credit unions to determine how to integrate these practices into their governance framework.

Individual credit unions are encouraged to assess their current governance practices against this list of recommended practices and to make appropriate adjustments.

Chapter 2 – Assembling and Developing an Effective Board

2.1 The board (or a committee on its behalf) takes an active role in the director recruitment process by screening and recommending director candidates who most closely match the required skills, experience and personal attributes.

2.2 The board has a succession planning process whereby it considers the specific skills and experience to be added to the board in upcoming elections and conveys these needs to its membership. The "needs" of the board include a consideration of:

- personal attributes
- specific skills and experience relevant to the credit union's strategies and risk profile and the board's responsibilities
- the leadership requirements of the board (e.g., board chair and committee chairs)
- diversity - diversity of backgrounds, perspectives and problem solving approaches and reflection of cultural and gender diversity relevant to the community served by the credit union.

2.3 The credit union publishes, on its website and as part of its election information package, a statement of director responsibilities so that individuals interested in serving on the board are aware of the required skills, expected standards of behaviour and time commitment required of directors.

2.4 The board appoints a nominating committee that is delegated responsibility for identifying and recommending new candidates for director positions.

2.5 The nominating committee recommends candidates it feels will best meet the credit union's requirements and recommends only that number of candidates needed to fill the number of open positions on the board.

2.6 All new directors receive a comprehensive orientation about the credit union's business and its operations, the role of the board, committees and the expectations for individual directors.

2.7 The board develops a director education policy along with an appropriate budget, both of which are disclosed to the credit union's members.

2.8 All directors are required to undertake continuing education that is relevant to governance and the credit union's business and strategies.

2.9 All board members have a basic financial literacy, including the ability to interpret the credit union's financial statements, or commit to acquiring these skills through education or training within the first year of service.

2.10 Remuneration is adequate to attract and retain the directors the credit union requires and reflects the professionalism that they are expected to bring to their position.

2.11 The credit union has a board renewal policy which outlines the board's approach to renewing and strengthening itself to meet the credit union's strategy and oversight needs.

Chapter 3 – Committees

3.1 The board establishes the appropriate committees to assist the board with its work, including legislated mandatory committees (conduct review, audit, investment and loan) and other committees as required to address the risk oversight, governance and human resource responsibilities of the board.

3.2 Careful consideration is given to the skills required to ensure an effective committee structure. These are made apparent during the annual review of the skills, competencies and attributes matrix. The nomination committee considers these when recruiting members to serve on the board.

3.3 The chair of the audit committee and a majority of its members are financially literate and at least one member has accounting or related financial management expertise.

Chapter 4 – Board Effectiveness

4.1 The board has a comprehensive set of governance policies that outline the credit union's governance framework and articulates how the board carries out its responsibilities. This includes:

- terms of reference for the board, committees, directors, the board chair and the CEO
- a code of conduct that sets out the standards of business ethics and conduct which govern the actions and activities of directors and employees of the credit union, including conflict of interest
- guidelines that address how the board will bring forward, discuss and resolve issues at its meetings
- policies that outline how the board carries out its responsibilities with respect to important areas such as CEO evaluation, succession planning, strategy, risk, performance monitoring, accountability and assessment.

4.2 The board and each committee establishes an annual calendar or work plan based on its terms of reference and the credit union's strategic goals to guide their deliberations and ensure they meet their responsibilities over the course of a year.

4.3 The board and each committee hold in-camera sessions at each meeting.

Chapter 5 – Hiring, Compensating and Evaluating the CEO

5.1 The board has a formal process in place for measuring the CEO's performance at least annually against specific goals and objectives, and for reviewing and approving changes in compensation.

5.2 Compensation programs are specifically linked to the achievement of the objectives the board considers essential to the success and stability of the credit union.

5.3 Incentive plans are prudent, tied to long-range goals, align with the credit union's strategic plan and reflect the values of the credit union.

5.4 The board ensures that the CEO has a succession plan in place for the development and replacement of top executive and other key positions.

5.5 The board has developed, and reviews annually, a succession plan to respond to a planned or unplanned departure of the CEO.

Chapter 6 – Strategy and Planning

6.1 The board takes an active and ongoing role in developing the credit union's strategy and fully debates and approves the strategic plan brought forward by the CEO.

6.2 The board reviews and approves policies that ensure the credit union maintains adequate capital to support operations, enterprise risk, growth and remain in compliance with applicable regulations.

6.3 The board ensures liquidity planning is addressed as part of capital planning.

6.4 The board is responsible for approving the operating plan and confirming it advances the credit union's strategy. The board approves any changes made to the plan and to the supporting operating and capital expenditures budgets that are outside of policy.

6.5 The board and management agree annually on a comprehensive set of performance measures for the credit union that reflect progress against the strategic and operating plans.

6.6 Management regularly reports to the board on the credit union's performance, together with any actions planned for areas that are not meeting expectations.

Chapter 7 – Risk Oversight

7.1 The board reviews and approves a level of risk tolerance that ensures the credit union only takes on risks within its capacity to manage.

7.2 The board-approved level of risk tolerance and key risks are factored into the credit union's strategic, capital and liquidity plans.

7.3 The credit union has an enterprise risk management system that ensures the totality of its risks is evaluated and the interrelationship of the risks is understood.

7.4 The board ensures that a complete assessment of risks is made and that these are considered in the development of the strategic plan.

7.5 The board, at least annually, reviews the key risks to the credit union, and satisfies itself that the credit union's processes to identify and manage risk are appropriate and effective.

7.6 The board and each committee undertakes a review of the risks inherent to their areas of oversight and the steps being taken to manage them, the systems in place to monitor risk taking within the credit union's defined appetite for risk and the degree to which risk management is considered in decision making.

7.7 The credit union regularly utilizes scenario analysis models to determine how robust or vulnerable the financial structure is to a variation of key factors and assumptions (i.e., stress testing).

7.8 The board ensures that the credit union has a disaster management and recovery plan for unforeseen disaster or the loss of key persons and that it is updated regularly.

Chapter 8 – Monitoring

8.1 The board has a policy that sets out its responsibilities to monitor the credit union's affairs, the issues it will monitor and the manner and frequency with which it will do so.

8.2 The board monitors the execution of the strategic, operating and capital plans, as well as budgets.

8.3 The board reviews the credit union's internal and external environment on an ongoing basis and makes adjustments to its strategic, operating and capital plans and budgets as required to respond to any changes.

8.4 The reporting on financial and operational performance is comprehensive and includes sufficient information and discussion of the credit union's financial performance relative to its competitors.

8.5 The board ensures that the credit union has sufficient policies, systems and procedures in place to ensure it remains in compliance with its statutory and contractual requirements along with appropriate systems to identify and report to the board on areas of non-compliance. These policies are reviewed and updated annually.

8.6 At least annually, the board ensures the organization is compliant with relevant laws, the requirements of any regulatory bodies and its own governing documents (including its Rules).

Chapter 9 – Accountability and Disclosure

9.1 The board publishes (e.g., on the website) at a minimum:

- the credit union's Rules
- an overview of the director election process
- an overview of the credit union's governance framework, including the board's mandate and committee structure
- its policies governing dividends and other allocations to the communities it serves.

9.2 At the annual general meeting, there is an opportunity for credit union members to ask questions of the directors and/or senior management.

9.3 As part of its annual report, the credit union discloses:

- director attendance records and the amount of compensation paid to each director
- a management discussion report covering financial and operating matters, principal risks, how these have been managed and commentary on the credit union's expected future
- its executive compensation policy and the remuneration paid to the credit union's three highest paid officers
- its profit allocations.

Chapter 10 - Governance Assessment

10.1 The board takes the necessary steps to remain abreast of emerging governance standards and ensures that the credit union's governance meets best practices.

10.2 The board annually assesses the performance of the board, committees, the board chair, each committee chair and individual directors against their respective mandates or position descriptions.

10.3 The board periodically reviews the effectiveness of its governance practices and procedures to determine where improvements may be needed, and implements necessary actions to make those improvements.

Chapter 1 – Governance and Governance Practices

Directors, acting as the board, are ultimately accountable for credit union governance. In meeting this responsibility, directors are bound by their fiduciary responsibilities and their duty to exercise the standards of care set out in the legislation, regulations and common law.

What is Governance?

The Task Force observed that there is no shared definition of governance in the British Columbia credit union system. To focus its deliberations and inform this report, the Task Force defines governance as:

> governance is the framework of responsibility and accountability through which a credit union is directed and controlled, manages its business practices, makes effective decisions and reports to members and other stakeholders.

Governance Practices

Governance practices are the policies and procedures that make up the governance framework. These practices vary within the credit union system. In part, this is due to the fact that each credit union faces its own unique risks and has developed its own business and strategic plans. The level of sophistication of governance practices is also driven, in some respects, by the size of the credit union and the complexity of its operations.

The Task Force has developed a series of recommended governance practices, which, if practiced throughout the credit union system, will support the system's continued solvency, resiliency and growth. These practices are organized under nine areas of board responsibility:

- purposefully assembling and developing a team of individuals to serve on the board who have the appropriate skills, knowledge, experience and personal attributes to contribute to the credit union's success (Chapter 2)
- making effective use of committees (Chapter 3)
- establishing terms of reference, policies and procedures to guide chairs, directors, the board and its committees (Chapter 4)
- hiring, compensating, evaluating and, if necessary, replacing the CEO (Chapter 5)
- approving a strategic plan that recognizes the credit union's mission, vision and values, and the risks that must be managed (Chapter 6)
- monitoring the credit union's risk management program (Chapter 7)

- monitoring and overseeing the credit union's operations and performance (Chapter 8)
- overseeing the processes for accountability and disclosure to members, regulators and other stakeholders (Chapter 9)
- formally assessing the effectiveness of the board, its committees and individual directors. (Chapter 10)

Chapter 2 – Assembling and Developing an Effective Board

As stewards, directors have responsibility for ensuring the success and long-term sustainability of the credit union. These responsibilities underpin the board's mandate for governance and leadership. It is therefore essential that the board is made up of individuals that possess the appropriate skills, knowledge, experience and personal attributes to contribute to the credit union's success.

The board (or a committee on its behalf) takes an active role in the director recruitment process by screening and recommending director candidates who most closely match the required skills, experience and personal attributes. (2.1)

Board Composition

The effectiveness of any board starts with the quality and capability of directors and their shared responsibility to see the credit union succeed.

A key first step is to identify the skills, competencies and attributes the board requires and to develop a list of them for board review and approval. This list is based on the board's broad range of oversight responsibilities and could include expertise in information technology, legal, accounting, treasury, commercial lending and human resources.

Once identified, many credit unions utilize such a list to develop a "skills, competencies and attributes matrix". The matrix is a grid with columns and rows used to compare a director's skills and potential to the board's needs. Typically, the names of individuals are listed on one side and the skills, competencies and attributes are at the tops of the columns. Each individual's attributes can be marked in the appropriate columns and the results used to identify any gaps in the board's composition. The matrix should be reviewed and revised as necessary, subject to ongoing reassessment where the credit union's operating environment, its principal business risks and, most importantly, its strategic objectives are considered.

The matrix can also be used as a tool to identify education opportunities for the board; however, education sessions will not produce the same level of knowledge and experience as recruiting individuals with the skills and competencies required in a particular area of expertise.

Determining the required skills, competencies and attributes of board members is a valuable exercise for all directors and should be undertaken by the full board. In situations where a governance committee has been established, it will complete an assessment and provide its recommendations to the board. It is important that each of the requirements identified through the assessment are given full consideration.

The board has a succession planning process whereby it considers the specific skills and experience to be added to the board in upcoming elections and conveys these needs to its membership. The needs of the board include a consideration of:

- **personal attributes**
- **specific skills and experience relevant to the credit union's strategies and risk profile and the board's responsibilities**
- **the leadership requirements of the board (e.g., board chair and committee chairs)**
- **diversity - diversity of backgrounds, perspectives and problem solving approaches and reflection of cultural and gender diversity relevant to the community served by the credit union. (2.2)**

Technical skills are an important consideration but their value will not be realized if the directors are not fully aware of the commitment they are making. As such, all prospective directors need a clear understanding of the governance responsibilities they are undertaking and must be prepared to commit the time, talent and energies required to be effective and to meet the ethical standards to which the board aspires.

The credit union publishes, on its website and as part of its election information package, a statement of director responsibilities so that individuals interested in serving on the board are aware of the required skills, expected standards of behaviour and time commitment required of directors. (2.3)

Nominating Committee

The board appoints a nominating committee that is delegated responsibility for identifying and recommending new candidates for director positions. (2.4)

The board is responsible to ensure that the committee is properly structured and includes members who can identify potential directors who possess the skills, competencies and attributes that support the achievement of the credit union's strategy and its long-term success.

It is important that members of the credit union are made aware of the board's specific requirements and its need for competent members with expertise and experience. Further, it is imperative that the board accept the responsibility to advise them of this need.

The nominating committee should be appointed by the board and composed of board members not currently seeking election. While some credit unions have members serve on the nominating committee, it is essential that board members guide and inform the process. The committee should have a firm understanding of the credit union's strategy and the business challenges it will face. The committee should develop a process to attract director candidates with the attributes identified in the skills, competencies and attributes matrix that was approved by the board. The nominating committee should consider the needs of each board committee as well as the board as a whole.

The nominating committee recommends candidates it feels will best meet the credit union's requirements and recommends only that number of candidates needed to fill the number of open positions to the board. (2.5) In discharging its responsibilities, the nominating committee should assess all candidates, including incumbent candidates, against the matrix. It may be necessary to seek out individuals to join the credit union and run for a director position. In this way, the board meets its responsibility to apprise the credit union's members of the expertise needed on the board. This allows members to make an informed decision when electing directors to the board.

The names of candidates submitted for election are accompanied by sufficient biographical details, such as education, work experience, current employment, past and present board experience along with other volunteer or community positions.

Orientation, Education and Professional Development

The objective of orientation is to educate, familiarize and to help directors become effective board members in as short a period as possible. Depending on the complexity of the credit union's business, an orientation program might be delivered over several days. Each orientation program should be tailored to meet the needs of the individual director. It is important that the orientation emphasize that directors are required to act in the interests of the credit union and all its members, not just those of a specific constituency.

All new directors receive a comprehensive orientation about the credit union's business and its operations, the role of the board, committees and the expectations for individual directors. (2.6)

Current training requirements provide an introduction to credit union governance for new directors. These courses, offered though CU Source Knowledge Network, as part of the Credit Union Director Achievement program, provide a foundation on which to build.

In light of the increasingly complex regulatory and economic environment in which credit unions operate, continuing education requirements are necessary to ensure directors remain current on issues and changing governance requirements.

Continuing education will promote a culture of professionalism and contribute to good governance.

The board develops a director education policy along with an appropriate budget, both of which are disclosed to the credit union's members. (2.7)

All directors are required to undertake continuing education that is relevant to governance and the credit union's business and strategies. (2.8)

Directors should also possess the ability to read and understand a set of financial statements that present the breadth and level of complexity of accounting issues that can reasonably be expected to be raised through a review of the credit union's financial statements. Such financial literacy is needed to effectively understand the credit unions business.

Basic financial literacy and continuing education will also enable directors to remain current on topics such as financial reporting, enterprise risk management, executive compensation and new developments affecting credit unions.

All board members have a basic financial literacy, including the ability to interpret the credit union's financial statements, or commit to acquiring these skills through education or training within the first year of service. (2.9)

Time Requirements and Remuneration of Directors

In order to carry out their duties, directors must make a serious time commitment. It is not unusual for a credit union director to spend as much as 250 hours a year in the role. More time may be required depending on the particular credit union or if the credit union is experiencing operational challenges or significant change, such as a merger or a CEO transition.

Under the *Financial Institutions Act*, the responsibility to set director remuneration falls to the members. Without having the members pass a special resolution, directors cannot decide their own remuneration. The board should develop a sound compensation philosophy with specific policies setting out the basis on which remuneration, including retainers, per diems, and perquisites are calculated, and present it to members. Directors should not share in the credit union's employee benefit programs.

Remuneration is adequate to attract and retain the directors the credit union requires and reflect the professionalism they are expected to bring to their position. (2.10)

Attracting directors with the right skills, competencies and experiences can be a challenge, particularly in smaller credit unions and communities. In these instances, the nominating committee may need to seek external assistance or to seek directors outside traditional sources.

Board Renewal

Renewal brings new ideas and ways of thinking to the board. Changing conditions must be met with skills and capacities which may not be present within the board.

It is necessary to balance the need for fresh thinking with the need to maintain corporate memory; doing so ensures changing conditions are assessed in the context of the credit union while fostering appropriate solutions to current needs. A thoughtful approach to board renewal is therefore essential. The credit union's strategy, business operations and the competitive landscape must all be considered in planning for board renewal.

Board renewal is an ongoing process and it is essential that the board be vigilant and proactive in identifying where changes in its membership are needed. Each time the board reflects on its effectiveness provides an opportunity to consider where new skill sets are needed. Some credit unions have chosen to impose term limits on directors to encourage board renewal. Term limits of nine to 12 years are common. Others feel that incumbent directors bring expertise and should not be restricted from seeking re-election. In either case, members should be made aware of the credit union's board renewal policy and the relationship between this policy and the work of the nominating committee. It is through the ongoing assessment of effectiveness that boards identify those areas where changes in its matrix will need to be considered.

However a board pursues renewal, directors should only remain on the board if their annual assessment confirms that they continue to make a valuable contribution.

The credit union has a board renewal policy which outlines the board's approach to renewing and strengthening itself to meet the credit union's strategy and oversight needs. (2.11)

Chapter 3 – Committees

Committees are essential to good governance. Committees assist the board by:

- assuming the responsibility to ensure in-depth analysis of important information is completed
- ensuring compliance
- overseeing the development of plans that will impact the development of the credit union's strategy
- ensuring controls are in place and operating effectively

Under the *Financial Institutions Act,* credit unions are required to have an audit committee, investment and loan or risk management committee and a conduct review committee. In most British Columbia credit unions, additional committees have been appointed to meet specific needs identified by the board.

The board establishes the appropriate committees to assist the board with its work, including legislated mandatory committees (conduct review, audit, investment and loan) and other committees as required to address the risk oversight, governance and human resource responsibilities of the board. (3.1)

The committees should ensure their actions are reported to the entire board at regular intervals and that issues requiring full board attention are elevated when necessary. Through regular committee reports to the board, each member of the board is apprised of the full condition of the credit union and the co-ordinated effort of the committees is assured.

The increasing importance of risk oversight has changed the roles of the investment and loan, audit and other committees. Whether risk oversight is to fall under one or more committees is an important consideration in ensuring risk is given sufficient attention. At least one committee should have specific responsibilities for risk and if this role is to be shared, the terms of reference of the committees should be developed in a way that ensures all required areas are covered and that each committee is clear on its responsibilities. In order to ensure risk oversight is effectively co-ordinated, it is becoming more common to appoint a risk committee.

In ensuring the board has the skills it requires, **careful consideration is given to the skills required to ensure an effective committee structure. These are made apparent during the annual review of the skills, competencies and attributes matrix. The nomination committee considers these when recruiting members to serve on the board. (3.2)**

Audit Committee

Audit committees are responsible for the integrity of the financial statements. The audit committee fulfills additional responsibilities by ensuring the credit union is in control, that the disclosure of information is properly vetted and that emerging developments are assessed effectively. The audit committee should be aware of its responsibilities under the *Financial Institutions Act* and the *Audit and Audit Committee Regulation.* Some credit unions now require the audit committee to have at least one member with a formal accounting or financial designation.

The chair of the audit committee and a majority of its members are financially literate and at least one member has accounting or related financial management expertise. (3.3)

At a minimum, the audit committee:

- monitors the integrity of the financial statements of the credit union and its subsidiaries
- reviews and recommends for board approval financial disclosures and published financial statements
- reviews and challenges, where necessary, the accounting principles employed
- reviews the audit findings and scope of the external audit
- reviews the external auditor's qualifications and independence, the terms of engagement and recommends appointment
- reviews and approves the appointment of the internal auditor, their mandate and the audit plan
- reviews all returns to be filed with the Superintendent and recommends for board approval
- reviews all reports of the internal and external auditor and ensures the internal control practices of the credit union are effective
- meets with the internal and external auditor at least once per year, and more often if required
- approves the appointment of the external auditor for any non-audit services
- makes regular reports to the board and additional reports as required
- provides confidential access for "whistle blower" complaints.

The audit committee's findings are usually reported to the board after each meeting of the committee. Audit committees are required to review financial reporting and other disclosures prior to the board considering them for final approval.

In response to concerns about financial reporting and monitoring in the past decade, the responsibilities of audit committees in publicly traded companies have been expanded. For example, under securities law, public companies are required to establish procedures for receiving and investigating anonymous employee concerns about questionable accounting or auditing matters.

Investment and Loan Committee/Risk or Risk Management Committee

This committee establishes the board's investment and lending policy, evaluates principal business risks, recommends the credit union's appetite for risk and helps define its risk profile. Specific responsibilities include:

- setting policies and monitoring compliance as they relate to the credit union's loan and investment portfolio
- working with the CEO and other designated parties to complete risk assessments and establish the credit union's appetite and tolerance for risk taking
- establishing certain loan approval limits
- receiving reports from the Chief Risk Officer or the executive designated to fill this role
- approval of certain loans.

The committee's responsibilities may also include the ongoing assessment of the credit union's principal business risks.

Conduct Review Committee

The conduct review committee protects the credit union's reputation by monitoring related party transactions and preventing the exercise of undue influence by related parties. Specifically, the committee:

- reviews transactions of related parties
- develops and monitors policies affecting related parties
- defines conflict of interest
- reviews the conduct of directors and staff as it relates to other parties and other matters that may affect the credit union's reputation
- maintains a list of related parties
- reviews and updates the Code of Conduct, and monitors compliance
- reports to the board of directors on its findings.

The committee is responsible for undertaking a thorough review before approving transactions with related parties. The committee must only approve these transactions when they are in the best interest of the credit union and specify the factors they assessed when reaching their decision.

Other Committees

Credit unions may establish other committees and provide them with the mandate to undertake specific tasks.

Credit unions have in some cases established separate governance committees whose terms of reference include such matters as:

- recommending the structure of the board and committees
- reviewing the board composition, the matrix and the degree of diversity
- overseeing the board assessment process
- managing the board's annual planning process
- reviewing and updating all policies
- overseeing the new director orientation program
- recommending the education and development program for directors.

Increasing attention to executive and incentive compensation has heightened the need for compensation and human resource committees to oversee the development of compensation programs, monitor the impact of incentive programs, recommend disclosure practices for executive compensation, evaluate the credit union's staff compensation plan, remain abreast of new developments and oversee pension and benefit programs.

Governance, human resource and compensation, risk management and nominating committees are not required by statute but are becoming more common and necessary. Instead of establishing separate committees, some credit unions have added these responsibilities to existing statutory committees. Adding risk management to the investment and lending committee and governance to the conduct review committee are some examples. Regardless of how the credit union decides to structure its committees, clearly assigning these responsibilities will ensure that these areas receive appropriate attention and oversight.

Chapter 4 – Board Effectiveness

Board effectiveness relies on processes that use the collective skills, knowledge, experience and personal attributes of board members to contribute to the credit union's success. Boards are required to take a number of steps and reach a variety of decisions to fulfill their mandate.

An effective board has:
- clear roles and responsibilities
- good board organization – e.g., division of work between committees and the board
- constructive relationship between the board and management
- effective decision/making processes
- high standards for meetings that include quality pre-reading packages, management presentations, debates and topic focus, etc.

Board and Committee Terms of Reference and Policies

The mandates of the board and committees are set out in their terms of reference.

The board has a comprehensive set of governance policies that outline the credit union's governance framework and articulates how the board carries out its responsibilities. This includes:
- **terms of reference for the board, committees, directors, the board chair and the CEO**
- **a code of conduct that sets out the standards of business ethics and conduct which govern the actions and activities of directors and employees of the credit union, including conflict of interest**
- **guidelines that address how the board will bring forward, discuss and resolve issues at its meetings**
- **policies that outline how the board carries out its responsibilities with respect to important areas such as CEO evaluation, succession planning, strategy, risk, performance monitoring, accountability and assessment. (4.1)**

Selecting the Board and Committee Chairs

Boards and committees that function effectively could not do so without an effective chair. The skills, capacities and attributes needed for an effective chair will vary according to the task and to the changing needs of the board or committee.

In all cases, the chair must have a sound understanding of the organization, its mission, vision, values, strategy and the role the board and its committees. The board chair must develop a strong working relationship with the credit union's CEO. The committee chairs will need the same type relationship with their executive. Above all, each must be committed to the credit union's success.

Board members must have the ability to listen effectively, facilitate discussion and ensure that good decisions are reached on a timely basis allow the organization to move forward. Although full agreement may not be possible in all cases, the chair must be able to gain consensus that the majority position will carry and that the directors will support the outcome. The ability to deal with detractors in a forthright manner and to handle and resolve contentious issues while retaining the trust and respect of fellow board members is essential.

Although board and committee chairs are not usually asked to act as spokespersons of the credit union, there may be certain instances where they must. Committee chairs are required to make presentations to the board. Board and committee chairs must therefore have the ability to deliver their message effectively.

Role of the Director

Directors act in the best interests of the entire credit union. Although they may bring a variety of viewpoints forward, directors do not solely represent the interests of specific constituencies.

To ensure the board is effective in its decision making, directors must use analytical thinking and independent judgment, listen to all view points and then decide in the best interests of the credit union. Further, directors require a full understanding of the terms of reference for the board and each committee.

Board members must remain independent of management and be independently minded. They must be able to use their skills effectively to evaluate the information provided to them, ensure areas of highest priority receive adequate focus and to ensure balanced decisions are reached.

Planning and Prioritizing

Boards must be forward looking. Building effective work plans requires the board and committees to set aside time to consider its next year's requirements. This should occur on an ongoing basis ensuring emphasis is placed on the most important issues the credit union will face. Annual requirements such as new director orientation, the review of reports, undertaking assessments and establishing the following year's work plan should also be taken into consideration when planning for the year's work.

Through effective planning, the board can meet high priority requirements, such as the ongoing assessment of the execution of the credit union's strategy, risk management and monitoring emerging issues.

The board and each committee establishes an annual calendar or work plan based on its terms of reference and the credit union's strategic goals to guide their deliberations and ensure they meet their responsibilities over the course of a year. (4.2)

Meeting Frequency and Agendas

An annual calendar or work plan is used to manage meetings and workloads effectively, set out each such issue and establish the timeframe in which they are to be completed. For example, the board may find it appropriate to replace monthly meetings with longer, bi-monthly or quarterly meetings with a full day for committee work, and a full day for the board meeting.

Irrespective of how often the board meets, time on the board agenda must be allocated effectively to ensure that vital issues such as strategy and risk are considered with enough time for a comprehensive discussion. In developing agendas, consideration should be given to timesaving measures such as the role of the board's committees, streamlining ongoing reporting and making better use of consent agendas.

In all cases, board members must receive meeting materials enough in advance of the meeting to allow sufficient time to review and understand the material. Materials should be formatted in a way to encourage board members to ask relevant questions and conduct sufficient analysis to ensure an effective contribution can be made at the meeting. All board members should be fully prepared for meetings.

Reports and Reporting

The frequency and content of reports to the board and its committees must be carefully assessed to ensure focus is kept on areas of highest priority.

As boards devote more of the agenda to strategy, enterprise risk and emerging issues means that there may be less time for the in-depth review of financial and statistical reports, operational reporting and routine regulatory reports. These can be managed by devoting certain board meetings to intense discussion of current operations. On an ongoing basis, recurring reports can be handled through consent agendas and by delegating more comprehensively to the committees.

In-Camera Sessions

In-camera meetings afford an opportunity for boards and committees to have frank discussion and to broach issues which may not, or should not be raised in an open session. Holding in-camera sessions also provides an opportunity for the board and its committees to assess their effectiveness.

In-camera meetings are useful opportunities for the board to reflect on such matters as the quality of information it is receiving, board and committee organization, testing the degree to which the board remains independent of management and improving overall effectiveness.

Other matters may also be discussed in-camera. The decision to hire or terminate the CEO and discussing the CEO assessment, are examples. In certain instances directors may wish to make personal disclosures in-camera.

In camera meetings strengthen inter-board relationships and allow the board or committee to function without management's influence.

The board and each committee hold in-camera sessions at each meeting. (4.3)

Chapter 5 – Hiring, Compensating and Evaluating the CEO

Responsibility for leading and managing the credit union resides with the CEO. The CEO is responsible for the day to day operations of the credit union and reports directly to the board.

The CEO leads the organization in achieving the board-approved direction. The CEO plays an essential role in leading the development of the strategic plan, meeting the objectives it establishes and making pivotal decisions to build and protect the credit union.

The board's role is to oversee the CEO, approve the credit union's strategic direction and to monitor its affairs. In addition, the board is a resource for a wide range of advice and insight for the CEO and adds value by constructively engaging with the CEO around the credit union's strategy and operational planning. The relationship between the board and the CEO is crucial to the ongoing success of the credit union. Ideally, this relationship is informed by trust and respect for each other's skills, knowledge and authority. As such, one of the board's most important jobs is hiring, compensating, evaluating and, if necessary, replacing the CEO.

The board is responsible for overseeing and holding the CEO to account for the credit union's performance as well as providing strategic advice and guidance. There is a natural and important tension in this relationship. To ensure that this relationship remains objective, the process for setting the CEO's performance expectations and his or her subsequent assessment should be agreed upon in advance.

Hiring the CEO

The board is responsible for recruiting a CEO who has the experience and competence required to lead the credit union. The task of recruitment may be facilitated through the appointment of a search committee which may draw on outside resources to help locate and assess suitable candidates. It is, however, the board that must approve the appointment of the CEO and in that respect, each director must be fully engaged in making the final decision.

Evaluating the CEO

The criteria for evaluating CEO performance vary across the credit union system. For example, some credit unions may rank employee engagement, member satisfaction, market share and share of wallet as highly as financial metrics, such as net income or profit, when determining performance. Other credit unions may focus more on financial metrics when evaluating CEO performance. More important than the specific targets the board uses to measure performance, the board should be satisfied that the CEO is leading the credit union in the direction it has set.

The board has a formal process in place for measuring the CEO's performance at least annually against specific goals and objectives, and for reviewing and approving changes in compensation. (5.1)

Compensating the CEO

Executive compensation is one of the board's most important decisions. The CEO's compensation should be based on objective criteria such as comparability with similar credit unions and other financial institutions, the unique needs of the organization, and geographical considerations. Compensation programs must be specifically linked to the achievement of objectives the board considers essential to the success and stability of the credit union. Consideration must be given to the composition of executive compensation, including the role of base salary, incentive payments and other perquisites.

Incentives are an important tool available to boards to encourage CEO performance. Most credit unions use bonuses or other incentives to motivate the CEO to achieve specific targets. To encourage long-term sustainability of the credit union, the board should develop incentive plans that are prudent, tied to long range goals, align with the credit union's strategic plan and reflect the values of the credit union.

Compensation programs are specifically linked to the achievement of the objectives the board considers essential to the success and stability of the credit union. (5.2)

Incentive plans are prudent, tied to long range goals, align with the credit union's strategic plan and reflect the values of the credit union. (5.3)

Succession Planning

It is a key responsibility of the board to ensure that there are no gaps in the credit union's executive leadership. Having the right CEO in place is essential to achieve the credit union's strategy. Succession planning ensures that the credit union's future leadership needs are identified in advance and that a plan is in place to ensure they are met.

The board ensures that the CEO has a succession plan in place for the development and replacement of top executive and other key positions. (5.4)

Wherever possible, the board must work with the CEO to understand the credit union's leadership requirements and the complexities of the CEO and executive roles to plan for succession. Using this information, the credit union's strategic plan and other sector information, a determination can be made respecting the skills and capabilities required and whether current position descriptions should continue to apply. The credit union's future needs must also be taken into account. Credit unions seeking mergers, planning aggressive expansion campaigns or responding to new competitive pressures will seek CEOs with appropriate strengths to meet their specific needs. If a new CEO brings a specialized skill set, the board will need to determine whether the skills and capabilities of board members are appropriate to support the CEO. Profiling or benchmarking CEO skill sets best suited to meet the credit union's emerging needs will help refine succession planning requirements.

The board should be aware of internal candidates with the potential and interest to move into executive and CEO positions. This provides the opportunity for the board to become more familiar with these individuals and to understand their strengths and shortcomings as well as the training and development they may require. Should the board feel it is necessary, it may contract with a qualified outside firm to assist in designing the credit union's succession plan.

Conditions may change and circumstances may arise where the CEO is not right for the times. The decision to replace a CEO is a significant one and one the board, as stewards of the credit union, must be prepared to make if necessary.

The board has developed, and reviews annually, a succession plan to respond to a planned or unplanned departure of the CEO. (5.5)

Chapter 6 – Strategy and Planning

Strategy defines the direction a credit union will take to achieve success and meet the expectations of members and other stakeholders.

Strategic planning is the process of deciding how the credit union will differentiate itself from its competitors, and use its strengths to better meet the needs of its members and ensure a sustainable future. It aligns the credit union's requirements with the resources it has available.

The CEO leads the strategic planning process and is responsible for developing a strategic plan that describes how the credit union will fulfill its mission in accordance with its vision and values. The plan should identify the strengths and weaknesses of the credit union, recognize risks, uncover opportunities, identify specific goals and then describe the steps that it will take to accomplish them. The plan should also align with the credit union's values and the interests of its members.

The board engages in the strategic planning process at least once a year by helping to determine those actions that allow the credit union to meet its most important objectives. This includes giving full consideration to the risks that must be managed and the opportunities provided.

Strategic planning is best thought of as an ongoing process as opposed to an annual event. The importance of having the right strategy to guide the credit union must not be underestimated. Changing conditions may require the board and executive to reconsider or reaffirm the strategy. Without an adequate understanding of the strategic requirements of the credit union and the plan established to meet them, the board may not be able to make a fully reasoned assessment of the best course of action.

By requiring boards to focus on long-term objectives, the process of strategic planning can invigorate and strengthen a credit union and renew the sense of purpose and commitment among directors, management and staff. The strategic plan provides the foundation for operating plans and capital budgets. Effective and well-developed strategic plans are the basis of success.

The board takes an active and ongoing role in developing the credit union's strategy and fully debates and approves the strategic plan brought forward by the CEO. (6.1)

Mission, Vision and Values

The credit union's vision, mission and values are the foundation of the strategic plan**.** They set the standard against which a credit union's business and community activities should be measured and guide the development of the credit union's strategy and everyday business decisions.

Boards are ultimately responsible for establishing the credit union's mission, vision and values. Decisions that establish the over-riding values of the credit union help set the "tone" of the organization and ensure that it strives to maintain the highest ethical standards. Through demonstrating high standards of personal and professional conduct, directors build confidence in their decisions and the credit union's activities.

As financial cooperatives, credit unions around the world have adopted the following cooperative principles:

1. Voluntary and open membership
2. Democratic member control
3. Member economic participation
4. Autonomy and independence
5. Education, training and information
6. Co-operation among cooperatives
7. Concern for community

These cooperative principles are value statements that should be considered and respected when setting the mission and vision of the credit union, defining how it will be run as an ethical business, and deciding which business activities it will pursue.

Board Involvement in Developing the Strategic Plan

By ensuring that the CEO has considered alternative approaches and has made a reasoned decision as to the best way to proceed, the board meets its requirement to exercise due care and attention. By being fully engaged in the strategy setting process and bringing to bear the background and experience of each board member, a balanced approach is assured.

Each credit union will use its own processes to formulate strategy and develop a strategic plan. Moreover, the manner in which the board is engaged and its contribution to strategic thinking and planning will differ from institution to institution.

In developing a strategic plan, the roles of the board and the executive team differ but complement one another. The executive team brings in-depth knowledge of the credit union's lines of business, its day-to-day operations and the operating environment. With this knowledge, the executive team is in the informed position to lead the process for developing the strategic plan. The board brings a broad perspective, local knowledge and alternative viewpoints to the discussion, which enables it to critically assess and provide feedback on the plan. When harnessed effectively, the dynamic created by these different perspectives helps the credit union create a robust strategic plan.

While their broad experience and knowledge provides value, directors should develop as full an understanding as possible of the credit union's current operating environment, its business model and the challenges it will face.

Throughout the development of the strategic plan, the CEO should regularly update the board on the status of the planning process and provide early and frequent opportunities for board feedback.

Through its upfront involvement in setting the strategy, the board has the opportunity to give early consideration to the factors that will need to be taken into account in establishing incentive programs. Progress against the long-term strategy and the achievement of short-term objectives as outlined in the annual operating plan are usually combined to provide the performance targets for the incentive plan.

Once approved, the board has a responsibility to monitor the credit union's progress against the plan. Strategy should be reviewed as a standing agenda item at each meeting of the board and sufficient time should be allowed to ensure adequate discussion.

Capital and Liquidity Planning

Capital planning is a key part of the strategic planning process and is crucial in ensuring a credit union can achieve its strategic objectives. A credit union should perform an analysis of its current and future capital requirements in relation to its strategic objectives and its risks. The strategic plan should clearly describe the institution's existing capital needs in relation to the risk appetite approved by the board and the capital required to support planned asset growth.

In reviewing the capital plan, the board will need to be mindful of all risks that would affect capital. Anticipated capital needs should be based on the direction of the strategic plan. The capital plan should also identify how it will be reviewed and monitored.

The board reviews and approves policies that ensure the credit union maintains adequate capital to support operations, enterprise risk, growth and remain in compliance with applicable regulations. (6.2)

The *Liquidity Requirements Regulation* sets liquidity requirements for B.C. credit unions. The board should be aware of how the credit union meets its liquidity requirements and issues that would impact the credit union's ability to generate sufficient liquidity from its local markets. The board should ask the CEO to identify what steps the credit union would take to deal with any liquidity shortfalls.

The board ensures liquidity planning is addressed as part of capital planning. (6.3)

Annual Operating Planning and Budgets

Boards are also responsible for approving operating plans and budgets. The budget and operating plan are driven by the credit union's strategic plan and should demonstrate how the credit union will allocate resources to achieve the goals identified in the strategic plan.

Developing an operating plan is the responsibility of the credit union's executive team. Board members must be satisfied that the operating plan and the budget align with the organizational goals outlined in the strategic plan.

When strategic plans are reassessed, the operational plan should be reviewed to ensure continued alignment.

The board is responsible for approving the operating plan and confirming it advances the credit union's strategy. The board approves any changes made to the plan and to the supporting operating and capital expenditures budgets that are outside of policy.(6.4)

Member Input to the Strategic Plan

As member owned financial institutions, credit unions must be aware of member needs. A number of approaches can be taken to get member input on the credit union's business activities and priorities.

Soliciting member feedback may be helpful in strengthening the strategic plan and encouraging member input on the priorities and direction of the credit union. How this is done will depend on the individual credit union and the mechanisms and practices in place for surveying the views of members.

Performance Measurement

The board and management agree annually on a comprehensive set of performance measures for the credit union that reflect progress against the strategic and operating plans. (6.5)

Management regularly reports to the board on the credit union's performance, together with any actions planned for areas that are not meeting expectations. (6.6)

Chapter 7 - Risk Oversight

Risk arises when outcomes are not known with certainty. Risk is inherent in making decisions or taking actions and, as noted, is an essential element of the strategic planning process. Credit unions use their capacity to assume and manage risk to generate higher returns. However, assuming excessive risk may have adverse consequences.

The board must ensure steps are taken to identify, analyze and assess business risks and opportunities. Strategies and processes must be in place to manage them effectively. Additional steps must be taken to ensure that risks are monitored and evaluated, that the effects of risk are understood and that the credit union's cultural underpinnings include "risk awareness".

Credit unions are exposed to a variety of risks. The board and executive team should understand the nature and level of risk assumed by the institution and how this risk is reflected in the development of the strategic, capital, liquidity and operating plans.

Risk Appetite and Tolerance

While the CEO will take the lead in managing risk, the board is responsible for approving the credit union's risk appetite and its risk tolerance.

The board must have a firm understanding of the relationship between risk and profit. Specifically, boards must understand how risk is being taken and the impact of that risk on capital and other parts of the credit union's operations. In effect, boards are authorizing the CEO to invest member assets and therefore must have the knowledge to be confident that there is disciplined and responsible oversight of these investments.

Taking on too much risk can have adverse consequences. Without some risk taking however, the credit union may not generate competitive earnings. **The board reviews and approves a level of risk tolerance that ensures the credit union only takes on risks within its capacity to manage. (7.1)**

The board-approved level of risk tolerance and key risks of the credit union are factored into the credit union's strategic, capital and liquidity plans. (7.2)

Enterprise Risk Management

Through implementing an enterprise-wide risk management framework, a credit union creates an inventory of all of the risks it faces. The board should ensure that there is ongoing monitoring of how much risk will be accepted in order to generate profit and what steps will be taken in the event that the level of risk exposure approaches or exceeds the established level of risk tolerance.

The credit union has an enterprise risk management system that ensures the totality of its risks is evaluated, and the interrelationship of the risks is understood. (7.3)

Boards should understand the enterprise risk management system and understand its effectiveness in identifying, evaluating and managing the most significant risks under a range of projected conditions.

The board ensures that a complete assessment of risks is made and that these are considered in the development of the strategic plan. (7.4)

Below are examples of the principal business risks facing credit unions:

- *financial risk:* margin volatility, convergence risks and timing factors can affect profitability if not hedged – because credit union capital is financed principally by earnings retention, the management of financial risk is integrally important
- *credit and counterparty risk:* the potential that the value of financial assets may not be recognized or that counterparties may extract value that had not been agreed, in which case the credit union could experience unanticipated loss
- *liquidity risk:* sufficient cash resources will not be available at a reasonable cost to meet operational requirements with consequent effects on the credit union's financial margin
- *strategic and business risk:* the selection of an inappropriate strategy may affect the credit union's capacity to compete and to meet its mandate to serve members in both the immediate and longer term
- *operational risk:* unexpected internal and external events arising in the day to day running of the credit union could affect the credit union's ability to be effective and may have consequential effects on its ability to achieve its strategy
- *regulatory risk*: regulatory changes may require the credit union to change direction or alter its business practices with potential consequences to its profitability
- *technology risk:* the credit union's information technologies, or information technology architecture may prove insufficient or too costly to allow it to compete effectively
- *human resource risk:* the potential the key persons may leave the organization or become incapacitated, and cannot be replaced
- *reputational risk:* the residual risk arising from ineffective management of the foregoing risks and developments that cast doubt on the ethical practices of the

credit union or the credit union system, its financial strength and sustainability or its judgement may impact its ability to achieve its strategic objectives.

The board, at least annually, reviews the key risks to the credit union, and satisfies itself that the credit union's processes to identify and manage risk are appropriate and effective. (7.5)

Committee Responsibility for Risks

The board may appoint a specific committee to enhance its oversight of the risk management process. This does not relieve the board or other committees from having to assess, understand and oversee risk. As examples, the conduct review committee will evaluate the risk associated with the actions of individual board members. The committee responsible for human resources and compensation must be aware of the risks associated with decisions relating to the approval of compensation plans.

The board and each committee undertakes a review of the risks inherent to their areas of oversight and the steps being taken to manage them, the systems in place to monitor risk taking within the credit union's defined appetite for risk and the degree to which risk management is considered in decision making. (7.6)

Stress Testing

Economic considerations beyond the control of the board or CEO may increase risk. To the degree that the credit union could be harmed more severely than it can comfortably manage, or could impair its capital base, the board should understand the steps the CEO will take to manage overall risk and ensure that additional reporting is provided when warranted.

Credit unions with complex information technology architectures, using sophisticated financial instruments, securitizations or foreign borrowings in their treasury management function and those undertaking significant expansion will need to expand their risk monitoring commensurately.

The credit union regularly utilizes scenario analysis models to determine how robust or vulnerable the financial structure is to a variation of key factors and assumptions (i.e., stress testing). (7.7)

Stress testing requires a determination of the value of the assets that could be affected by a change in circumstances and the degree to which their value may be impacted under various conditions.

It is important to consider the degree to which the organization will be affected in the event that the outcomes of the stress test were to materialize. The effects extend beyond variability of financial results in that they may limit the credit union's ability to meet its strategic objectives, limit the capacity to deliver service or trigger the need for unanticipated expenditure.

Disaster and Recovery Planning

The board ensures that the credit union has a disaster management and recovery plan for unforeseen disaster or the loss of key persons and that it is updated regularly. (7.8)

Chapter 8 – Monitoring

The board of directors is responsible for monitoring to ensure legal and regulatory responsibilities are met, that behavior and decision making meets the ethical standards the board has set and that the credit union's performance is in accordance with its strategic plan.

To be both effective and efficient, monitoring should be a systematic determination of whether the credit union is meeting the expressed expectations of the board. Determining "how will we know?" is a difficult challenge for any organization. Decisions relating to the type and content of reports, the role of the board and committees should be considered in the development of any actionable plan. The board should be satisfied the credit union is moving in the direction established by the strategic plan and the credit union's financial position is sustainable without exposure to excessive risk.

The board may conduct monitoring or delegate responsibility for detailed reviews to committees that report to the board. In most cases, board-level monitoring will concentrate on:

- strategy and performance against the strategic plan
- key performance indicators
- the competitive environment
- the identification of risks and the systems to manage them
- exceptions to policy.

Committees may be more appropriate for monitoring:

- the accuracy of the financial statements and the adequacy of internal controls
- risks, investments and lending
- regulatory and policy compliance
- conduct review
- governance
- human resources and compensation.

The board has a policy that sets out its responsibilities to monitor the credit union's affairs, the issues it will monitor and the manner and frequency with which it will do so. (8.1)

Strategy and Competitive Environment

The board monitors the execution of the strategic, operating and capital plans, as well as budgets. (8.2)

The board reviews the credit union's internal and external environment on an ongoing basis and makes adjustments to its strategic, operating and capital plans and budgets as required to respond to any changes. (8.3)
Ongoing monitoring provides the board with an opportunity to assess whether underlying assumptions should be reassessed, whether implementation requires rethinking, and that the implementation of strategies respects the credit union's mission, vision and values.

Financial and Operating Performance

In their stewardship role, the board is ultimately responsible for the sustainability of the credit union.

Earnings are essential to sustainability. Earnings are particularly important because they are the principal source of the credit union's capital base and the key to its short-term solvency. The CEO should update the board regularly on the financial performance of the credit union.

Some credit unions have adopted a "dashboard" reporting system that presents the credit union's key performance indicators concisely and graphically. The CEO and the board should agree on the key performance indicators that will be monitored. Consideration should be given to financial and non-financial indicators and how the credit union is performing relative other financial institutions. Such comparisons provide a means for assessing performance and determining whether to consider course corrections.

The reporting on financial and operational performance is comprehensive and includes sufficient information and discussion of the credit union's financial performance relative to its competitors. (8.4)

Compliance

Credit unions operate in a complex statutory environment. Credit unions must comply with a range of provincial and federal legislation, along with other legal requirements. For example:

- provincial legislation including the *Financial Institutions Act*, the *Credit Union Incorporation Act*, the *Company Act*, the *Personal Information Protection Act*, the *Securities Act*, the *Employment Standards Act* and the *Human Rights Code* as well as regulations applicable to each of them

- federal legislation - the *Proceeds of Crime, Money Laundering and Terrorist Financing Act of Canada*
- regulatory requirements including those of the Financial Institutions Commission, the Insurance Council of BC, the Office of the Information & Privacy Commissioner of British Columbia, the BC Securities Commission, the Mutual Fund Dealers Association and FINTRAC
- the terms and conditions as set forth by Central1 Credit Union
- the terms and conditions of major contracts.

Compliance with statutory requirements, major contracts and agreements is a responsibility shared by directors, management and staff at the credit union. Monitoring compliance is a role shared by the board and management. The board is not involved in the day-to-day operations of the credit union and meets its responsibilities to monitor by ensuring adequate policies are in place, there is evidence control systems are operating effectively, that the credit union is in compliance with its statutory requirements, that ethical standards are met and that performance is in accordance with their plan.

Compliance management responsibilities should be clearly delineated between the board and management. The board's compliance responsibilities require detailed attention and are best handled by committees. Including detailed provisions for compliance in their terms of reference will ensure the committee focuses on its compliance responsibilities.

The board ensures that the credit union has sufficient policies, systems and procedures in place to ensure it remains in compliance with its statutory and contractual requirements along with appropriate systems to identify and report to the board on areas of non-compliance. These policies are reviewed and updated annually. (8.5)

At least annually, the board ensures the organization is compliant with relevant laws, the requirements of any regulatory bodies and its own governing documents (including its Rules). (8.6)

Chapter 9 – Accountability and Disclosure

The board is accountable to members and regulatory bodies for the stewardship of the credit union.

Accountability to Members

In recent years, organizations around the world have faced increasing pressure to become more transparent in their activities and more responsive to those they serve. The pressures have resulted in demands for greater accountability and disclosure. Accountability is the obligation the board assumes to accept responsibility and to disclose the results of its activities in a transparent manner.

In their leadership role, boards are accountable to the owners of the organization – the members. Members should receive a fair accounting of the credit union's activities and be in a position to judge the effectiveness of the credit union's leadership. Disclosure is key to informing members. Wherever possible, the board should report through websites or other electronic media**.**

The minimum requirements for disclosure are contained in the *Financial Institutions Act* and the *Credit Union Incorporation Act*. These minimum standards require an annual report, with consolidated financial information, be mailed to every member and made available to the public. Most credit unions now have policies in place that exceed these requirements. Some credit unions have adopted practices which mirror many of the rigorous disclosure requirements placed on publicly traded companies.

In addition, credit unions should provide information regarding their operating affairs. The format for providing this information is in the nature of a management discussion report. The management discussion report provides a review of the business through the eyes of management. These results should be provided as part of the annual report, along with the audited financial statements, or as a stand-alone document.

Management discussion reports should include a description and profile of the credit union, commentary on major financial results, developments and trends, an overview of principal business risks and how they have been managed, information on management and board compensation and forward-looking views with necessary qualifying statements.

The board publishes (e.g., on the website), at a minimum:

- **the credit union's Rules**
- **an overview of the director election process**
- **an overview of the credit union's governance framework, including the board's mandate and committee structure**

- **its policies governing dividends and other allocations to the communities it serves. (9.1)**

At the annual general meeting, there is an opportunity for credit union members to ask questions of the directors and/or senior management. (9.2)

Governance Disclosure

The information when reporting on governance should include:
- director profiles, including the committees on which they serve and the length of time remaining in their term
- director attendance records for board and each committee
- educational programs taken/attended by each board member
- compensation and benefits paid to directors and senior executives
- the work of the nominating committee.

In today's environment, executive compensation is receiving significant attention. Disclosure of remuneration should be accompanied by a description of how compensation was determined and the basis on which any incentives were awarded. Such disclosure is already required in publicly held corporations and is starting to gain acceptance in other credit union systems. Compensation disclosure will give members insight into the links between executive pay and performance. Ontario has passed statutory amendments which require credit unions to report executive compensation. In British Columbia, disclosure of personal information such as executive compensation is prohibited under the *Personal Information and Privacy Act* unless the individual consents to the disclosure.

Reporting the details of the board's activity and their compensation helps members better understand the responsibilities the board must meet. Those seeking a seat on the board will be better informed as to the expectations they must meet as a director.

The governance report should also include expanded comments on the actions taken by the nominating committee. It is important for members to understand how the board seeks and recommends candidates.

As part of its annual report, the credit union discloses:
- **director attendance records and the amount of compensation paid to each director**
- **a management discussion report covering financial and operating matters, principal risks, how these have been managed, and commentary on the credit union's expected future**
- **its executive compensation policy and the remuneration paid to the credit union's three highest paid officers**
- **its profit allocations. (9.3)**

Disclosure of Dividends and Investment in the Community

The payment of dividends, provision of donations and support for specific causes are important decisions taken by the board. Since these are all allocations of the credit union's assets, members should be aware of the decisions and the reasons behind them.

Disclosure of the credit union's dividend and community investment policies informs members how the board has chosen to distribute the assets of the credit union and allows members the opportunity to question or comment as they feel necessary.

Accountability to Other Stakeholders

In chapter 6, the board's role and responsibilities with respect to compliance with regulatory reporting requirements were set out. The credit union may be required to report to other bodies including lenders, and in some cases, bond rating agencies.

The status of credit unions as regulated entities in British Columbia and the existence of the unlimited deposit insurance guarantee heightens the interest of the regulator and, indirectly, taxpayers in the soundness and sustainability of the credit union system.

Chapter 10 - Governance Assessment

Boards and directors require feedback on how they are performing individually and collectively, how their committees are functioning and how individual directors are meeting their responsibilities. The objective of the assessment process is to improve performance of boards and directors.

The board takes the necessary steps to remain abreast of emerging governance standards and ensures that the credit union's governance meets best practices. (10.1)

On an annual basis the board should undertake a full assessment of itself and each committee. There is no single approach for conducting these assessments. Consideration is usually given when determining if terms of reference have been fulfilled, specific milestones were achieved, the effectiveness of the board's processes and the degree to which its decisions have helped or hindered the credit union's progress.

In-camera sessions held at each board meeting provide the board and each committee the opportunity to consider how effective they have been. The CEO, if requested, can often provide insight. Assessments provide important feedback to directors seeking to improve their individual performance and that of the board and committees.

The board should decide how the internal assessment process should occur and can decide whether to seek the assistance of an external facilitator to add further objectivity. Where warranted, a qualified external party may be engaged to complete an assessment of board and director effectiveness. In these instances the board is seeking to determine the degree to which its processes can be objectively determined to have been effective.

The board annually assesses the performance of the board, committees, the board chair, each committee chair and individual directors against their respective mandates or position descriptions. (10.2)

Board Assessments

The board periodically reviews the effectiveness of its governance practices and procedures to determine where improvements may be needed, and implements necessary actions to make those improvements. (10.3)

It may consider questions such as the following:

- did the board meet its responsibilities under the terms of reference?
- how well did the boards make decisions?

- did the board do an effective job in understanding risk, and in helping to shape the strategy?
- was the board successful in setting the tone at the top – did the actions of the credit union reflect the tone that had been established?
- did the incentive program provided the CEO achieve the desired results?
- did the board assist the CEO by bringing new perspectives and stimulating new thinking that resulted in better decisions?
- has the credit union achieved the level of capital adequacy sought by the board and has its decision making contributed to its achievement?
- was performance linked to strategy and did the selected key performance indicators reflect the desired outcomes adequately?
- how effective was the board selection and assessment process itself – were areas of needed improvement identified and is the credit union going to be better positioned to succeed as a result?
- is the board confident it can perform effectively in a crisis?

In order to fully examine its effectiveness, the board may wish to consult with the external auditor, the internal auditor, the risk officer and the CEO. The board may engage a qualified, independent party to periodically assess its effectiveness.

Committee Assessments

An assessment of committee performance usually considers such matters as the committee's success in meeting its responsibilities under its terms of reference, the effectiveness of its decision making and opportunities for enhancing the committee's contribution to the work of the board. The assessment may include requesting comments from other board members, staff and outside parties with whom the committee works.

Individual Director Assessments

Individual director assessments usually consider such matters as understanding of core issues, attendance, preparedness for meetings, knowledge, insight, contribution and understanding. How directors relate with each other and the degree to which they facilitate achieving effective and binding decisions is usually explored.

Assessments should also reflect on the role the director fulfills in helping the board and the committees they serve on meet the responsibilities outlined in the respective terms of reference. Candour in the assessment process is necessary to properly evaluate performance. In this respect, the board should maintain the integrity of the assessment process by setting the parameters for how the nominating committee takes director assessments into account when determining who they may recommend to stand for the board.

It is important that the assessment process be robust and that there is appropriate follow-up. Once the assessment is completed, the board should consider steps to improve the effectiveness of individual directors, committee and board chairs, the committees and the board as a whole.

Appendix 1 - Task Force on Credit Union Governance Terms of Reference

The Task Force on Credit Union Governance was provided the following terms of reference by the Superintendent of Financial Institutions:

“Through a series of up to seven meetings, held at times to be agreed, the Task Force is asked to consider the following matters:

- the role of governance in building a strong, secure and stable credit union system,

- the core responsibilities of boards of directors and the means through which their performance can be measured,

- effective ways to reinforce the accountability of boards to depositors, members and other stakeholders of the credit union,

- the degree to which financial performance, subject to the rigour of effective risk management, can serve as indicators of good governance,

- how best to ensure board decision making and the performance of the credit union can be linked,

- requirements for building high performing boards now and into the future,

- transitional issues in governance affecting credit unions as a system, and

- other matters which the Task Force deems critically important.”

Appendix 2 - Members of the Credit Union Task Force on Governance

Bev Briscoe - FCA, F.ICD, has been a director for a number Corporate and not-for profit organizations including Westminster Savings Credit Union

Tom Chambers – FCA, ICD.D, Former Managing Partner, Pricewaterhouse Coopers LLP, director Catalyst Paper Corporation, MacDonald Dettwiler and Associates Ltd., Viterra Inc. and Coopers Park Corporation

Brian Childs – Current Chair Ladysmith and District Credit Union, 40 years involvement in cooperative and credit union movement and small business owner

Theresa Dergousoff - BComm, CA, ACCUD, Director Grand Forks District Saving Credit Union

Doug Enns – FCA, C.Dir, founder of Upturn Consulting Ltd., Chair of the Advisory Board, RalMax Industries

William Hopkins - LLB, lawyer, mediator and arbitrator, former Chair of the Financial Institutions Commission

Catherine McCreary - LLB, C. Dir, lawyer and arbitrator, governance coach for member based organizations, former board member VanCity and Central 1 credit unions

Launi Skinner - Chief Executive Officer, First West Credit Union

Michael Wagner - ACUIC, Chief Executive Officer, Salmon Arm Savings and Credit Union

Elizabeth Watson –LLB, ICD.D, Founder of WATSON Advisors Inc.; governance advisor across sectors, including credit unions; has served as a director on a number of boards; former Governance Committee Chair of the Institute for Corporate Directors.

Bill Wellburn FCA, C. Dir, chair of Coast Capital Savings and the Provincial Capital Commission, director and audit committee chair, Greater Victoria Harbour Authority

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