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# *A manual of credit union governance*

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## Contents

The authors.....	2
Acknowledgements.....	8
The participants.....	9
1 Introduction .....	11
2 Understanding governance .....	12
2.1 The key players responsible for governance .....	13
2.2 The principles and practice of governance.....	13
2.3 Governance and its relation to management .....	14
2.4 Typical outcomes from misunderstanding the governance function .....	16
2.5 The interconnectedness of governance principles.....	17
2.6 The principles to the framework of strategic governance .....	17
3 The function of the board of directors .....	19
3.1 Board accountability .....	19
3.2 Board authority and responsibility .....	21
3.3 Purpose, mission and values.....	21
3.4 Appointment of a CEO and senior management team.....	22
3.5 Delegation of authority over operational management to the CEO .....	22
3.6 Setting board policy .....	23
3.7 Oversight and control .....	23
3.8 Oversight, support and challenge of executive management.....	24
3.9 Governance structure and process.....	25
3.10 The statement of board roles and responsibilities .....	25
4 The function of the CEO and management .....	26
4.1 The function and authority of the CEO.....	26
4.2 The strategic leadership of the CEO .....	27
4.3 Skills, characteristics and knowledge of a CEO .....	27
5 The board - management relationship .....	28

5.1	Clear division of responsibility .....	28
5.2	A relationship built on partnership.....	29
5.3	The chair and the CEO .....	30
5.4	Clarity of expectations .....	30
5.5	The delegation of executive authority .....	31
5.5.1	The approach to delegation .....	31
5.5.2	A schedule of delegated authority.....	32
5.6	The CEO, senior management and other staff members.....	34
5.7	Management of the CEO.....	34
5.8	CEO performance appraisal .....	35
5.9	The CEO as an executive director of the board .....	35
6	Co-operative values, principles and organisational culture.....	36
6.1	Co-operative values.....	37
6.2	Co-operative principles .....	38
6.3	The board role in leading a values-driven organisational culture .....	40
6.4	Monitoring and evaluation .....	40
6.5	Values, principles and business success.....	41
7	Strategy and the setting of goals and objectives.....	42
7.1	Introduction .....	42
7.2	Strategic and operational plans .....	42
	The strategic planning process .....	43
7.3	A continuous and essential activity .....	43
7.4	A formal planning cycle.....	44
7.5	Setting strategic direction.....	47
7.6	Setting strategic objectives.....	48
7.7	Assessing risk and compliance.....	50
7.8	Communicating the strategic plan.....	52
7.9	The monitoring of strategic objectives.....	53
7.10	In summary – the business planning cycle.....	54

7.11	Key points to remember on strategy and strategic planning .....	56
8	Oversight of risk and compliance .....	57
	Credit unions and risk .....	57
8.1	Credit unions and risk .....	57
8.2	Risk governance and risk management .....	58
8.3	Compliance.....	61
8.4	The Risk Management Process (RMP) .....	62
8.5	An audit and risk committee .....	70
9	The role of board policy .....	72
9.1	Policies on the limitations of executive authority .....	74
9.2	The writing and review of board policy .....	74
10	The role of the board in monitoring performance.....	75
10.1	Monitoring performance against the strategic plan.....	76
10.2	The board objectives report.....	77
10.3	The balanced scorecard .....	78
10.4	Financial reports.....	80
10.5	Risk register/Risk report.....	81
10.6	Compliance Report.....	81
10.7	The CEO Report.....	82
10.8	Additional papers for Board approval.....	82
10.9	Access to further MI outside of board meetings .....	82
11	Board organisation .....	83
11.1	The size and composition of the board.....	83
11.2	The president or chair of the board .....	83
11.3	Executive and non-executive directors .....	84
11.4	Board meetings and agendas .....	85
11.5	The strategic planning cycle.....	85
11.6	The role of the chair in board meetings.....	86
11.7	Other officers of the board .....	87

11.8	Election and terms of office of board roles .....	88
11.9	The use of board sub-committees.....	88
11.10	Recommended sub-committees.....	89
11.11	Chairs of sub-committees.....	90
11.12	The remuneration of non-executive directors .....	90
<b>12</b>	<b>Strengthening credit union boards .....</b>	<b>91</b>
12.1	Knowledge, competence and experience of directors.....	91
12.2	Specific competencies required to fulfil particular roles .....	92
12.3	Board and director evaluation .....	92
12.4	Principles for evaluation.....	93
12.5	What is to be evaluated?.....	94
12.6	Evaluation mechanisms.....	95
12.7	Evaluation delivery .....	96
12.8	Toolkit materials .....	97
12.9	Board and director training and development.....	97
<b>13</b>	<b>Director recruitment, nomination and election.....</b>	<b>98</b>
13.1	A strategic approach to director recruitment and succession planning.....	98
13.2	The nominations or search committee .....	99
13.3	Election by the members at a general meeting.....	99
13.4	Nomination by petition.....	100
13.5	The issue of term limits.....	100
13.6	Co-options and observer participation in board meetings.....	102
13.7	Recruitment and succession action planning .....	102
13.8	Transparent and clear nomination and election procedures .....	102
13.9	Induction of co-optees, elected board members, observers and independent advisors.....	103
<b>14</b>	<b>CEO recruitment and professional development .....</b>	<b>103</b>
14.1	The process of recruitment and selection.....	103
14.2	Expectations and job description.....	104
14.3	Thinking about succession planning .....	105

14.4	CEO retention.....	108
14.5	CEO performance management .....	108
14.6	The CEO contract of employment .....	110
14.7	Considering remuneration .....	112
14.8	CEO training and professional development .....	112
14.9	Handling conflict between the board and CEO.....	112
15	Accountability to the membership .....	113
15.1	Accountability to members as customers.....	113
15.2	Accountability to members as owners .....	114
15.3	Information, transparency and disclosure .....	116
15.4	Meaningful democracy.....	117
15.5	Communication and participation as owners .....	119
	Bibliography .....	121

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### **A note on terminology**

In this text, the term "credit union" is used for both UK and Romanian CARs. The main reason for this is that the World Council of Credit Unions in Madison, USA, recognizes the CAR as credit unions according to their own established criteria.

The term CEO is used for executive directors. Employees of UK credit unions are headed by the CEO. The same is applicable for Cooperative Banks, Rural Banks and Ethical Banks in Italy. In Romania, the employees of CARs are coordinated in an operative manner by the

Economic Director / Executive Director / Chief Accountant. In Romania, he/she is a member of the Board of Directors.

### **The tool-kit**

This manual is complemented by a governance tool-kit as an accompanying publication. Most of the examples and templates quoted in the manual are to be found in the tool-kit.

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## 1 Introduction

This manual of credit union governance emerges out a series of discussions, interviews and seminars engaging board members and executive staff in credit unions in the North West of England and in case de ajutor reciproc (CAR) in towns throughout Romania.

Credit unions and C.A.R. form part of the same family of co-operative financial institutions that have been established to serve their members and their local communities. They are member-based organisations and it is to the members that boards of directors and executive staff are ultimately accountable. In Great Britain and Romania, these financial co-operatives serve the general population but endeavour to serve people poorly served by the mainstream financial system. In both countries they focus predominantly on savings and loans. They are locally based organisations established with a strong sense of social purpose to improve the financial health and stability of their members.

Credit unions in the North West of England and C.A.R. in Romania have developed a strong working relationship since 2013, facilitated through Uniunea Națională a Caselor de Ajutor Reciproc (U.N.C.A.R.S.R.), the leading trade association for C.A.R. in Romania. Over this period, despite significant operational differences, it has become clear that the two sets of co-operative organisations share many of the same challenges in developing the business and in ensuring quality in service delivery. A key issue that has constantly arisen in discussions between credit union and C.A.R. board members and executive staff has been the importance of the good governance. Without effective governance, neither type of institution can thrive and prosper in the interests of its members.

It was for this reason, that U.N.C.A.R.S.R. prioritised a focus on governance education in the financial literacy programme funded under the Erasmus + initiative “Cooperation for Innovation and the Exchange of Good Practices” and specifically under the measure, “Strategic Partnerships for adult education”. Co-operators in both countries realised that if their organisations were to successfully develop services and financial education interventions for financially excluded and low-income individuals, they needed first to be safe and sound financial institutions. The key to stability is good governance.

This manual is based on a programme of action and reflection undertaken by credit union and C.A.R. board members and executive staff in Britain and Romania. This was

undertaken in collaboration with Italian partners in the programme who are engaged in the education and development of co-operatives.

The manual sets out the principles and practice of effective governance as applicable to the credit union and C.A.R. sectors. It presents a logical, consistent and integrated system of governance that reflects the culture and style of co-operatives, but which is robust and fit for the purpose of assisting boards of directors and CEOs to deliver a sound and well-run business.

## **2 Understanding governance**

Corporate governance describes the system by which a nominated group of people direct, lead and control an organisation and ensure that its vision and mission is articulated and sustained.

Whenever people come together in a collective endeavour to achieve a common purpose there is a need for effective corporate governance. In every case there is a need for a group of people to take responsibility for steering, guiding and overseeing the organisation and enabling it to achieve its purpose and, where relevant, reflect the will of its owners or key stakeholders.

It is impossible to speak of credit union governance without at the same time attending to strategic goals and objectives. It is about the way in which a group of elected directors, in collaboration with a CEO and management team, work collaboratively and co-operatively to achieve their goals and strategic objectives.

Good governance is critical to success in any organisation and particularly to delivering a sound and well-run business. In the past credit union research has identified the lack of effective governance as one of the two fundamental causes of credit union insolvency and default, the other being poor and ineffectual management.

Understanding governance means grasping the principles and practice of the organisational system that will enable a credit union to achieve its purpose on behalf of its members.

## 2.1 The key players responsible for governance

In organisations of any size, there are always multiple players involved in steering an organisation to achieve its purpose. There are different levels of responsibility and accountability and there are those with delegated authority and those to whom those with delegated authority are accountable.

In credit unions, it is the members (the shareholders) who elect the board and have the authority to agree the constitution, the rules and the external auditor. The CEO<sup>1</sup> and senior management contribute expertise and skill in framing the strategy of the credit union.

The regulator has a key role in interpreting, codifying and enforcing the legal parameters within which a credit union must operate within the bounds of its enabling legislation. However, the major player in the governance of a credit union is the board of directors. It is this team of people that is elected to be responsible and accountable for directing, leading and controlling the credit union and ensuring it achieves its purpose. It is to this group of people that the members give the overall and ultimate authority to control, direct and oversee the management and operations of the credit union.

It is within the context of this authority that the board appoints the senior executive and thereby strongly influences the manner of delivery of the organisation's objectives. The executive is accountable to the board for implementing its strategic objectives. It is for this reason that governance is primarily seen as the remit and function of the board of directors.

## 2.2 The principles and practice of governance

The distinction between the principles and the practice of governance is critically important. The practice of governance is particular and can vary, but the principles on which practice is based are general and more enduring.

The practice of governance, as articulated in specific structures, processes and procedures, is always contextual. Whether in Romania or Britain, there is no one single model of good governance that is suitable for all credit unions irrespective of the status, size

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<sup>1</sup> The term CEO is used for the lead, senior person within the credit union staff team. The term will be used even though in practice, in Britain, the lead staff member in particular credit unions may be entitled manager, co-ordinator or administrator. In Romania, the lead person within the staff team is always the Executive Director. In this manual, the term CEO is used for both CEO and Executive Directors.

and complexity of the business. There are many different models of governance all of which can work and enable them to succeed depending on particular circumstances and conditions.

The practice of governance will differ in relation to the size and complexity of the credit union. Further, the practice of governance must continually adjust and adapt to the changing circumstances of the business and the needs of the members. However, the practice of good governance is founded upon a framework of concepts and principles that are enduring and are widely applicable across organisational, industrial and international boundaries. They apply equally to credit unions in Britain and Romania.

These principles are the fundamental truths, elements or propositions that underpin good governance in general and that set the benchmarks for particular models of practice. They form the explicit bases for the development of systematic approaches to governance and are often enshrined in codes of governance such as the UK Corporate Governance Code and in basic credit union texts as the British Credit Unions' sourcebook, CREDS, or the Romanian, Strategia Privind Funcționarea și Dezvoltarea Sistemului C.A.R. 2016 – 2020, Principiile de Guvernanță la Casele de Ajutor Reciproc.

Understanding the principles of governance is essential to understanding the nature of governance itself. It is possible to be familiar with elements of the practice of governance in an organisation, but without a good understanding of the principles upon which practice is based, it is impossible to grasp how the different elements of governance link and interconnect. It is also difficult to understand how and why particular governance practices can and should change and evolve in response to changing contexts and circumstances.

### **2.3 Governance and its relation to management**

Historically most credit unions were established as collectives run by and for their members. Whether in communities or in workplaces, people came together to organise and to staff the credit union in the interests of the membership as a whole.

As credit unions grew, the complexities and the time involved in running a co-operative financial institution increasingly required boards to hire more professional staff and to delegate to them greater authority for managing the credit union.

The employment of professional executive management is often challenging for boards of directors, as they struggle to understand how their function is distinct from that of

management. Conceptual understandings of governance can be so engrained and enmeshed with understandings of management that it can be difficult for directors to separate the two. Even lists of the roles and responsibilities of boards of directors can look like management responsibilities. It is not surprising then that governance is often not really seen as a distinct function, but rather as an upper-level tier of management.

The first principle of the system of governance is that governance is not management one step removed but is a distinct theoretical and practical function and reality in its own right. Management principles may be of relevance to governance, but governance in itself is not management.

A good starting point for discussing a system of credit union governance is the classic definition of governance set out in the first version of the UK Corporate Governance Code published in 1992 by the Cadbury Committee. Paragraph 2.5 I states:

*“Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board’s actions are subject to laws, regulations and the shareholders in general meeting” (quoted in FRC 2012)”*

This definition states clearly that governance is a system of inter-related elements and processes through which a company is directed and controlled in the interests of its shareholders. Within this system, there are the distinct but connected roles and responsibilities of the shareholders as owners; of the board of directors as stewards of the company and accountable to the owners, to the law and to the regulator; and of management as accountable to the directors for the effective running of the business.

It is clearly stated that the board of directors is responsible for governance and that its role is seen in terms of setting strategic aims, providing the leadership to achieve objectives and to supervise or oversee the management and the performance of the business. It must report to shareholders (in credit unions, the members) on their stewardship of the organisation. There is no sense in this definition that the board is involved in management.

*A central principle of the system of governance is, therefore, the distinction between the function of governance and the function of management within all credit unions.*

Clearly, on the basis of this principle, the system of governance is implemented most straightforwardly in credit unions where different people undertake the two distinct functions. However, it is important to stress that this principle is universally applicable to all credit unions. Even in credit unions in Britain where directors also volunteer as operational staff members, the two functions of governance and management exist as distinct entities and have to be recognised as such.

## **2.4 Typical outcomes from misunderstanding the governance function**

Three generalised scenarios that often result from the mistaken view that governance is an upper-level tier of management.

- A strong chair (or sometimes the treasurer) effectively usurps the role of chief executive and acts as the de facto CEO. Even though the chair and other directors insist that the CEO manages the credit union, in fact the CEO must get the chair's pre-approval for even minor operational decisions.
- Alternatively, even though the CEO makes operational decisions without need for formal approval, as a practical matter even trivial management decisions involve protracted discussions at board meetings, with board members unable to resist the temptation of telling the CEO how to do his or her job.
- By contrast to the first two scenarios, once they have hired a CEO, some boards act as if there is little left for them to do except to rubber stamp management decisions after asking only perfunctory questions. Whilst in the first two scenarios the chair or board routinely meddle in management, in the third scenario the board abdicates its responsibilities of monitoring and overseeing management.

Of course, none of these generalised scenarios present themselves in such an unambiguous manner. But elements of each scenario are often apparent, from time to time and in varying degrees, in both large credit unions and small. Indeed, sometimes all three scenarios can manifest themselves in the same credit union.

## 2.5 The interconnectedness of governance principles

Governance principles form an inter-connected system with each principle relating to or being dependent on others. Effective governance depends on the implementation of all the principles simultaneously within one inter-dependent framework of practice.

For example, a central principle is that directors maintain an effective focus on strategy. But this principle cannot be implemented unless the board observes an equally important principle of assuring that all directors have the skills and competencies to think critically and strategically. Further the board cannot address strategic issues on a fully informed basis unless it adheres to the principle that the CEO is responsible for providing the board with a cogent and coherent analysis of its strategic choices. Adoption of a strategy by the board is not enough unless the board also adheres to the principles of continuously monitoring and measuring the CEO's execution of the plan as against set targets.

In this system of governance, the strategic focus of the board is part of what is meant by good governance. To talk about governance without speaking of the strategic plan would be like talking about steering a ship without any reference to its intended destination and the navigation charts that show how to get there.

But the system of credit union governance is more than a framework of interconnected principles; when implemented in practice it is a system of relationship and behavioural processes and reporting and information flows. The principles inform, for example, the relationships and required behaviours between board and members, the board and the CEO (and senior management) and between the chair and the board and CEO. They also inform the information flows required to support board meetings with the appropriate management, risk and compliance data, financial and performance information.

## 2.6 The principles to the framework of strategic governance

In outline, the following are the central principles to the governance framework:

- Effective governance depends on the recruitment and retention of skilled and competent directors.
- The board is accountable to the membership for the structure and framework of governance.

- The board is accountable to the membership for the performance of the credit union.
- The board has ultimate stewardship, leadership and authority over all aspects of credit union organisation. The board is tasked by the members to ensure that the credit union achieves its purpose, within the framework of legislation and regulation.
- Only the voice of the board, as determined by the majority in properly constituted meetings has authority in the credit union.
- The board is responsible for setting the strategic direction and policies of the credit union.
- The board is tasked with overseeing and maintaining the co-operative culture and values of the credit union, over the attainment of strategic objectives and over the management of risk and compliance.
- A key accountability of the board is to monitor and evaluate financial and organisational performance and the overall management of the credit union.
- The board must delegate full executive authority to the CEO to manage the business, within the constraints of budgets and policies set by the board.
- The CEO is responsible for the analysis of strategy and for preparing the strategic business plan.
- The CEO's accountability is to the board as a collective body, not to the chair or to individual directors.
- The board should objectively monitor and evaluate the CEO's performance by reference to the strategic plan and to board-defined performance indicators.
- The board should be committed to continuous improvement of its governance processes and its system for director succession.

The above principles comprise the elements of a system of governance which, in one way or another, can be implemented in all credit unions, albeit it may take more time in some credit unions than in others. The principles, and the links and connections between them, will be expanded and analysed in greater depth throughout this manual.

### 3 The function of the board of directors

The approach to governance in this manual stresses the distinct nature of the function of governance as opposed to that of management. This entails a definition of the roles and responsibilities of the board of directors and those of the CEO and senior management and clarity about how these responsibilities are implemented in practice.

It is not uncommon for directors, even those with long service, to lack a clear understanding of their roles and responsibilities as board members. There can often be confusion about how precisely the function of the board of directors differs from that of the CEO and management. It is essential therefore to articulate the precise purpose and function of the board within governance. Good practice is to detail this function in a clear statement of director roles and responsibilities which then can form part of a written director job description (see the accompanying tool kit for copies of statements of responsibilities).

#### 3.1 Board accountability

The central function of the board of directors is to ensure that the credit union achieves its purpose in the interests of the members. It is elected by them as the overall governing authority of the organisation, and it is to the members that it remains accountable.

The function of the board, therefore, is to lead the credit union and to have stewardship and authority over its organisation and operations. It is ultimately accountable for its leadership and stewardship and must demonstrate to the members that its performance and its decisions are in their interests as the owners of the credit union.

This can be characterised as: “not management one step removed, but ownership one step removed”. The function of the board is to lead, to direct and to control the credit union on behalf of the owner-members but not to manage its business operations.

Board accountability to the members in a co-operative credit union is, however, quite distinct from that of a board in a publicly held corporation.

A typical corporate board is concerned about the customers and image of the company, but it is predominantly concerned to ensure its stock holders receive a good economic return on their investment. Hence, in a for-profit corporation there is a built-in

conflict between the shareholder-owners of the company and its customers, as it is the income generated from the latter that pays the dividend and impacts the share price for the former.

In a co-operative credit union, this conflict does not exist since members are both shareholder-owners and customers at the same time. Unlike stock in a regular corporation, credit union shares are not traded and cannot increase or decrease in value. Credit union members have no opportunity to profit by selling their shares.

Members do receive a dividend on shares, but this is more like interest on savings, which, de facto they are, as they cannot be traded and are not at risk of depreciation. A dividend on savings in a credit union is more like a customer benefit than a benefit of ownership.

In a credit union, the board is accountable to the members both as owners and as customers. As owners, the members hold the board accountable for the safety, soundness and long term sustainability of the credit union as a co-operative financial institution. As customers, they hold the board accountable for the quality of service they receive, including the dividend or interest paid on savings and the rates charged for loans and other services.

In practice, a board in a credit union is more accountable to the members as customers than as owners, i.e. for ensuring that the credit union gives members a better deal on financial services than they would otherwise find in the for-profit sector. The board is accountable for the credit union offering real benefits and added value to members and contributing to their financial resilience and stability.

Adding value for members though involves board members facing issues of conflict of interest. For example, even though all members receive the same dividend rate on savings, higher dividends advantage savers at the expense of higher interest rates on loans for the borrowers. Lower dividends can mean lower interest rates on loans. Similarly, if credit unions do not charge fees on services, this may mean increased economic benefit to the members who over-use those free services at the expense of others who do not use them at all.

The real challenge for board members is to weigh up the competing wants and needs of the members and to achieve a balance that is equitable to all. The board is accountable to

the members for the policy guidance it gives to the CEO and management on the design of an equitable suite of products and services for the membership as a whole.

### **3.2 Board authority and responsibility**

The board of directors has the ultimate power and authority to ensure that the credit union delivers an effective financial service for its members. This power and authority can only be understood within the context of accountability to the members, for it is the members who delegate to the board the authority to make decisions on their behalf and in their interests.

With power and authority come responsibilities. These are responsibilities specific to the governance of the credit union and are distinct from the strategic and operational management responsibilities of the CEO and staff team.

There is a critical distinction between “ends” and “means” to clarify the distinct functions of board and of management.

- In general, “ends” concern the vision, the values, the purpose, the direction, and the goals of the credit union. They designate fundamentally what the credit union wants to achieve, for whom and at what cost. The designation of ‘ends’ is the clear responsibility of the board.
- The “means” concern all the strategic and operational management activities that have to be put in place to achieve the purpose of credit union and specifically its goals and objectives. The ‘means’ are the clear responsibility of the CEO and staff team.

Based on this distinction, the responsibilities of the board of directors can be divided into the following seven key areas.

### **3.3 Purpose, mission and values**

The board is responsible for defining the purpose of the credit union and ensuring it retains its character as a co-operative financial institution accountable to its members. This includes approving the mission and values and principles statements of the credit union.

Setting the purpose and the values of the credit union must be in the control of the board. The staff may propose the wording of mission and values statements but it is the board that must agree and approve them.

### **3.4 Appointment of a CEO and senior management team**

It is a board responsibility to appoint the lead person responsible for the strategic and operational management of the credit union. Normally, this person is the CEO, but in some British credit unions could be called the manager or co-ordinator.

Choosing the right CEO to lead the management of the business is perhaps the single most important task a board has to perform. The board can never delegate the hiring of the CEO to the staff or any outside agency. The CEO is a key individual within the strategic governance system who must be appointed directly by and remain directly accountable to the board.

Normally the CEO would have delegated authority to hire the rest of the staff team, but direct oversight of and involvement in the hiring of other senior managerial staff is often a responsibility retained by the board. However, it is the CEO who has the delegated authority to finally approve the appointment of other senior staff members.

### **3.5 Delegation of authority over operational management to the CEO**

While the board concerns itself with the vision, values, purpose, direction, and goals of the credit union, the CEO is responsible for the means of attaining everything the board, on behalf of the member-owners, wants to achieve.

In the system of credit union governance, the board is responsible for delegating authority to the CEO to achieve the purpose of the credit union, within the limitations set by board policy, agreed strategy, available resources, legislation and regulation, and any other constraints placed on the CEO by the board.

Boards properly limit the CEO's delegated authority because not all the means to achieve strategic goals and objectives are lawful, moral or otherwise acceptable to the board. Means could be unethical or out of fit with the values of a co-operative organisation; others

could be too risky or costly, and some the board might properly forbid because, in its own collective good judgment, they just do not seem right or appropriate.

Apart from these defined limitations, however, the board of directors should delegate to the CEO full authority to determine the means by which the credit union will achieve the ends set by the board. This is important, for if the board also determines the means to realise its goals and objectives, it is unable to hold the CEO accountable and responsible for success or failure if the CEO simply executes the actions the board directed. Central to the system of strategic governance is the monitoring of CEO performance, and it is important that the CEO has direct authority and management control over the actions and operations of the organisation.

### **3.6 Setting board policy**

The setting of policies which define the broad framework within which the credit union operates is a central function of the board of directors.

It is important here to be clear about the distinction between board and management policies and procedures. Board policy concerns the principles, rules and the guidelines which set the context for the direction, strategy and operations of the credit union. They do not concern the means by which policies are implemented.

Management may also have policies in relation to operating the business. These concerns the way in which activities and interventions that enable the objectives of the credit union are to be achieved are structured. Procedures and processes set out in detail how those activities are to be accomplished in practice by operational staff. Management policies, processes and procedures are the responsibility of the CEO and staff team.

### **3.7 Oversight and control**

Board oversight and control is a fundamental principle of governance and is critical to the success of any credit union of whatever size or complexity.

There are three main areas of focus to ensure the safe and sound development of the credit union as a co-operative financial institution, operating in the interests of its members:

- 1) **Co-operative values, principles and organisational culture:** It is a specific board responsibility to oversee the development and maintenance of a co-operative culture throughout the organisation.
- 2) **Strategic and financial planning:** It is the board's responsibility to approve a strategic business plan which details clear organisational and financial objectives. It is then the responsibility of the board to regularly monitor progress towards the attainment of the strategic objectives. Collective oversight of the financial situation of the credit union is fundamental to good practice.
- 3) **Risk and compliance:** It is the responsibility of the board to establish an effective risk governance framework in order to oversee a comprehensive, systematic and documented management approach to risk identification, analysis and mitigation. It is the responsibility of the board to assure itself that the credit union complies with legislation, regulatory requirements and its own board policies.

### 3.8 Oversight, support and challenge of executive management

The board must take a proactive role in establishing a supportive but critical relationship with the CEO. This relationship must be one based on a clear understanding of the different roles and responsibilities of the board (and the chair) and of the CEO. The board is expected, for example, to take the lead and not to be dependent on the CEO and staff for establishing systems of board oversight and control. On the other hand, the board must not overstep the mark and meddle in operational management.

Particular responsibilities in this area include:

- The assessment of the performance of the CEO primarily through his or her attainment of the strategic objectives agreed by the board.
- The development of the aptitude, skill and willingness of directors to remain independent from management and to exercise critical oversight through the reviewing, challenging and monitoring of credit union performance and questioning key management assumptions and important decisions.

### 3.9 Governance structure and process

The board is responsible for the establishment and maintenance of the governance framework which determines the way in which it conducts its own affairs. The board is accountable to the members for conducting its affairs in a proactive and positive manner. Notable governance responsibilities include attending to:

- The board's composition, structure, activities and reporting
- The skills, knowledge, capability and experience of board members
- The expertise of board members in financial understanding and analysis and in understanding the credit union business
- The culture and leadership of the board to support its risk appetite, strategy and oversight and control of the credit union and its performance
- Setting out the roles, responsibilities and expectations of directors in writing
- The policies and procedures that apply to the board directly (e.g. succession policies, declaration of interest policies etc.)
- Transparency and reporting to member-owners and other stakeholders
- Board education, training and performance assessment
- Recruitment and selection of board members
- Regular assessment by the board of its own performance in all these.

The board cannot delegate to the CEO responsibility for the management of the functioning of the board itself.

### 3.10 The statement of board roles and responsibilities

It is recommended practice that each board adopts a statement of board roles and responsibilities which is agreed through a process of discussion and debate at board level. It should highlight that directors need to be aware that they will, at least, be expected to:

- Establish, accept and maintain the culture, ethics and values of the credit union.
- Approve the strategic direction of the credit union and its long and short-term goals.
- Oversee and challenge executive management in the interests of the members.
- Monitor and evaluate progress against the goals and objectives set by the board.

- Oversee compliance and the control and mitigation of risk.
- Ensure accountability of the board to the membership for the performance of the credit union and its adherence to credit union values.

Normally, directors would be asked to sign the finally agreed statement in order to individually and collectively own the document. This statement of board roles and responsibilities provides the benchmark for board and director evaluation and clearly details the role of directors as distinct from that of the CEO and management team (see the accompanying governance toolkit for sample statements of roles and responsibilities).

## **4 The function of the CEO and management**

### **4.1 The function and authority of the CEO**

The term Chief Executive Officer, or CEO<sup>2</sup>, is used to define the lead senior staff member who is accountable to the board of directors for the strategic and operational leadership of the credit union and for implementation of its strategic plan. The CEO is the staff member who has the delegated authority of the board for running the credit union's business. The CEO forms a core constituent element of the system of governance and as such, must be appointed directly by the board to which he or she is accountable.

The CEO is fully authorised by the board to manage and direct the business of the credit union as necessary and appropriate to execute the strategies and achieve the results approved by the board in the strategic plan (or other board action). Without delegated executive authority, boards constantly become enmeshed in the minutiae of management decision making.

Delegated authority is contingent on the CEO acting in accordance with the policies, budgets, and other actions adopted by the board, and performing the responsibilities set out in the CEO job description – as well, of course, as law and regulation. These responsibilities should be documented in a board statement of the role and responsibilities of the CEO and a

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<sup>2</sup> Executive director in Romania

job description. It is for the CEO then to delegate authority and responsibility systematically throughout the credit union.

If the board insists on monitoring and agreeing every decision of the CEO, in fact it is then the board that is making the real decisions over the activities of the credit union. If the board makes the decisions, it cannot hold the CEO accountable for success or failure in the achievement of the objectives set by the board for the credit union.

## **4.2 The strategic leadership of the CEO**

The responsibility of the board for determining the credit union's strategic direction is a central feature of the governance model.

The CEO, however, has an equally important role in providing leadership in support of the Board's strategic direction-setting and in providing analysis and market awareness. As a key part of that role, the CEO should take the lead in preparing the strategic or business plan, within the parameters set by the board. The board, of course, is ultimately the body to finally agree and sign off on the business plan.

The board needs the professional expertise of a CEO in strategy, in management and in organisational development if it is going to expand and grow. Those competences should be featured in job descriptions and recruitment processes. The board hires a CEO to bring dynamism, passion and drive, to develop vision and strategy and to create and to build upon opportunities that are outside the experience and skills of the board.

## **4.3 Skills, characteristics and knowledge of a CEO**

Where credit unions are seeking to grow and expand, it is critical for boards to ensure they have a clear view of the skills, characteristics and knowledge requirements of their CEO. A greater understanding leads to smarter hiring of CEOs with resultant improvements in credit union performance.

### **Skills and competencies**

A successful CEO needs skills and competencies in strategic leadership, in management and enterprise, in financial and organisational analysis, and in communications and relationship building. These skills and competencies need to be described accurately in the job

description, and tested through the recruitment process. The emphasis, the balance between essential and desirable, and the overall demand will vary depending on a credit union's aspirations and capacity (to pay and to deliver).

*Strategic thinking* is an essential component of effective CEO leadership, and it is particularly important to assess as part of the recruitment process. It can be difficult for board members to define what is involved; however there are assessment tools available that boards can consider incorporating in the selection of CEOs and senior managers (see the accompanying toolkit).

*Personality is as important as skills and competencies.* Successful CEOs will tend to exhibit agreeableness, conscientiousness and emotional stability. Personality characteristics associated with a transformational leadership style are vision, inspiration, personally commitment to specific ideals and goals, and the ability to engage followers emotionally in the attainment of organisational objectives. These leaders are likely to have charisma, high competence, and dynamism, and importantly can establish, communicate and share a vision, while at the same time, empowering followers to focus on realising that vision in practice. Not to underplay the importance of skills, competences and knowledge; but without the personality to inspire, motivate and enthuse, CEOs can fail to take the credit union forward with even the best of strategic plans.

## **5 The board - management relationship**

### **5.1 Clear division of responsibility**

Good governance is based on a clear division of responsibilities between the board and the CEO and staff team; so that they can take undertake their respective functions effectively in the interests of the credit union and its members. The board should not try to perform the work of management and, similarly, the CEO should not attempt to assume or control the work of the board. A clear understanding and acceptance of these distinct roles and responsibilities is critical. Credit unions are strongly recommended to agree written statements of responsibility for the board, chair and CEO (see accompanying toolkit).

Boards delegate executive authority to the CEO to manage the strategic development and the day-to-day operations of the credit union. The CEO then delegates authority and responsibility for various operational functions to senior managers and staff members. However, it is the CEO who remains solely, directly and ultimately accountable to the board for the management of the credit union, in accordance with the strategies and policies agreed and adopted by the board.

These two functions of board and management do not work in isolation; they are mutually inter-dependent and must work one with another for the success of the business.

## **5.2 A relationship built on partnership**

Leadership in credit unions is a shared function, and success depends on boards appreciating that their relationship with the CEO and management has to be one of partnership, even though the CEO remains ultimately accountable to the board.

CEOs are hired for their expertise in leadership, strategy and management and are accountable to the board for the achievement of objectives. But they also inform the strategic thinking of the board and the setting of objectives, and in consequence the CEO is a collaborative partner with the board in driving the credit union forward. To this extent, if a CEO and board cannot come to genuine agreement over strategy and direction, the relationship is fundamentally compromised and therefore they may need to part company.

If a CEO is to be held accountable for the performance of a credit union, he or she needs to be clear about his or specific responsibilities and to know the exact nature, extent and level of executive delegated authority under his or her control. He or she needs to know that, even after collaborative conversations on the way forward, the authority and the power to make management decisions are ultimately his or hers.

Looking for absolute and categorical lines between the role and responsibilities of directors and that of the CEO is not always easy. Documentation can never completely eliminate confusion or debate, but it makes a much bigger stride in this direction than its absence.

### 5.3 The chair and the CEO

The CEO is accountable solely to the board, and not to any individual board member, including the chair. However, central to board-management relations is the relationship between the chair of the board and the CEO. The chair acts as the primary liaison between the board and the CEO; whilst the CEO is the single link between the board and the staff.

The chair and the CEO are the poles of the distinct functions of governance and management: the relationship should be based on a sense of equality, rather than hierarchy. To make a CEO accountable to the chair as if he or she were the CEO's supervisor or line-manager is to establish the chair as the true CEO and undermine the role of the actual CEO.

Having a single point of contact between the board and management through the chair and CEO avoids the CEO being pulled in multiple directions by requests from individual directors. Equally it avoids the board side-stepping the CEO and dealing directly with other staff members. To say that the chair is the single point of contact for the CEO does not mean that the CEO does not have direct contact with all board members, as he or she would necessarily attend board meetings, but primary contact would be through the chair.

### 5.4 Clarity of expectations

The board leads, directs and controls the credit union whilst delegating executive authority to the CEO to manage the strategy and operations to achieve its objectives. The CEO is then accountable to the board for the performance of the credit union against defined objectives.

A central principle of the governance system is therefore clarity of expectations. A CEO cannot be held accountable for directions or instructions that are unclear, unsaid or contradictory, or which come from multiple directions on the board. Board expectations are set out in board policy and in the agreed objectives set out in the strategic or business plan.

Central to the governance system therefore, is the development of board policy and the strategic objectives. It is against strategic objectives, as achieved within the context of board policy, that the performance of the credit union and of the CEO can be measured. Without clarity of board policy and clarity of objectives it is hard to properly measure performance.

## **5.5 The delegation of executive authority**

### **5.5.1 *The approach to delegation***

Delegation of authority is of fundamental importance to governance. If board members and CEOs are uncertain as to the nature, level and extent of delegated authority, their roles and responsibilities remain confused and the sound development of the business can be compromised. They can become enmeshed in management decision-making and distracted from their core role of setting strategic direction and monitoring overall performance.

For CEOs, a lack of clarity on delegated authority has major implications. If CEOs feel that they need to check out or seek approval for even minor decisions, they are hampered in developing the business and are undermined in demonstrating the strategic entrepreneurial leadership for which they are employed. Without clear delegated authority, they are in fact denied control of the organisation.

To make executive delegated authority real and effective, the CEO should be the board's single point of delegation. It is only by having a single point of delegation that the CEO can be held accountable for all aspects of the management and performance of the business.

The reason for extensive delegation of authority is to give the CEO as much scope as possible in decision making and to encourage creativity and innovation in growing and developing the credit union. Constantly having to seek approval for decisions from the chair or the board not only undermines CEO morale but is stifling to decision making.

Board concerns about delegating executive authority can arise, however, not just because of long-standing confusions around the nature of governance and management, but also because boards are concerned about losing control and compromising their accountability. For this reason, it is important that boards recognise that they always remain in control and are the ultimate authority. The CEO's delegated authority is always within the parameters set by the board through by board policies, board strategic objectives, budgets and resources, and the external constraints of by legislation and regulation.

Optionally, executive limitations policies can be developed to define what a CEO cannot do. These policies restrict the decision making authority of the CEO over specific

items. The limitations of delegated executive authority will vary from one credit union to the next. The board has to decide what decision making authority is reserved to the board.

The task of the board is not to rein in the CEO but to do everything in its power to maximise his or her creativity and innovation in achieving credit union success, but also through effective scrutiny and monitoring systems to hold the CEO accountable for the outcome and consequences of decisions taken. The governance system depends on boards realising that it is important to delegate as much as possible whilst maintaining board control.

### ***5.5.2 A schedule of delegated authority***

The extent and limitations of delegated authority are often more assumed through custom and practice than detailed in written delegation of authority schedules. Much may depend on the relationship of the CEO with the chair and the board. Apart from clarifying expectations, there are other reasons to document delegated authorities:

- In Britain, the Senior Managers Regime requires the identification of allocation of prescribed responsibilities, mostly to the chair and CEO, and these responsibilities entail the clear delegation of authority.
- In Romania, the “principiile de guvernare la casele de ajutor reciproc” make it clear that the functions of the board and the executive must be made clear.
- There is increased regulation of the use of third party technology to deliver critical services, so the day-to-day management of the outsourcing of these services will depend on a high level of authority delegated to the CEO.
- There is a strong risk for credit unions that custom and practice, however effective, will not survive the changing of one or both of the key personnel of chair and CEO.

In general the CEO has delegated authority to:

- Develop the credit union’s strategic, business and financial plans for consideration by the board, and implement.
- Manage day-to-day operations including employment and remuneration of staff.
- Identify and document operational and other risks, and formulate and implement strategies for managing and mitigating these risks as considered by the board.

- Manage the financial budget.
- Manage the control, monitoring and reporting systems to ensure that they capture all relevant information for the effective functioning of the business.
- Determine the terms and conditions for the share, deposit, loan and other products and services provided by the credit union, including interest and dividend rates.
- Ensure that the board and its committees are provided with relevant information.
- Enter into contractual arrangements and incur financial obligations on behalf of the credit union as necessary to execute the board-approved strategies.
- Implement the policies, processes and codes of conduct approved by the board.

This delegated authority is constrained and limited by:

- Board policies – not management policies, i.e. not mixed with operational practices.
- Strategic and business plans – as agreed by the board.
- Financial plans and budgets - as agreed by the board. CEOs have control of the budget, usually with predetermined tolerances to go outside the budget.
- Regulation and legislation – it is the CEO's responsibility to ensure compliance with regulatory requirements and advise the board of any changes or developments.
- Any specific executive limitation policies set by the board - not all the means to achieve strategic objectives are necessarily acceptable to the board. Means could be unethical, out of fit with the values of a co-operative organisation, some may be too risky or too costly and some the board could just be against for its own reasons. These must be clearly set out in policy documents or strategic, financial and business plans, but also may be set out in a schedule of delegated responsibility.

The CEO knows his or her delegated authority from the above documentation but also from:

- The CEO job description
- The CEO defined roles and responsibilities statement.
- A schedule of delegated authority - this brings together clearly in one place the definition of the delegated authority to the CEO from the board.

Where CEO authority is limited, the CEO must escalate decision making to the board. There will always be grey areas where authority for decision making is unclear. In such cases, the CEO should check with the chair of the board or with the board as a whole.

## **5.6 The CEO, senior management and other staff members**

As a consequence of the principle of the delegation of executive authority to the CEO alone, the CEO is accountable and responsible for the management of other staff, including senior management. It is for the CEO then to delegate authority and responsibility systematically throughout the organisation.

The board would normally approve key human resource policies for the credit union, such as standard terms of employment, contract, pay, and other benefits. However, the CEO is accountable and responsible for the recruitment, management, and discipline of staff. Boards should not be involved directly in the recruitment of staff other than the CEO. The only exception would be the hiring of those in the relatively few key executive positions who report regularly to and deal directly with the board, for example a Chief Financial Officer or Internal Audit Officer. Even though these individuals might “report” to the CEO as an employment matter, they regularly “report”, in the other sense, critical information on which the board depends, and may regularly attend board meetings. It is no diminution of the CEO’s authority for the board (or a sub-committee) to participate in the final interviews of short-listed candidates for such roles, and to provide their input to the CEO before s/he makes the final hiring decision.

## **5.7 Management of the CEO**

The CEO reports to the whole board, and is held to account by the directors collectively. But effective performance management of the CEO, including personal and professional development, cannot practically be discharged by the board as a full group. That function should be performed primarily by the chair on the board’s behalf or by a nominated sub-group of directors.

It does not follow, however, that the chair is the de facto “manager” or “supervisor” of the CEO. Instead, the chair serves as the day-to-day liaison and informational conduit

between the board and the CEO. It is sensible, as a practical matter, for the board to delegate to the chair responsibility for administering the day-to-day details of the CEO's employment. The chair should also serve as the CEO's primary internal 'coach', provide encouragement and counsel, and a supportive and confidential environment in which to discuss issues outside formal performance processes.

## **5.8 CEO performance appraisal**

The chair or a sub-group of directors should also undertake the annual personal development and performance review of the CEO. The board might reserve to itself responsibility for approving the final written review and any compensation changes that result. In any event, the CEO's compensation and other terms of employment are subject to board-approved budgets and personnel policies and to the CEO's employment contract.

The CEO's performance is measured ultimately by the performance of the credit union against its strategic plan. All other interests and contributions are secondary to the achievement of credit union objectives. In monitoring these objectives, 'hard' measures such as membership and financial indicators can predominate. To ensure that important 'soft' considerations, such as organisational culture, maintain weight and profile, these should be included in the strategic plan, with metrics, where at all possible.

Any objectives in relation to the CEO's personal or professional development should be in direct relation to achievement of the strategic objectives, and should be documented and agreed in line with the credit union's performance monitoring approach.

## **5.9 The CEO as an executive director of the board**

In practice, the CEO participates in discussion and decision making in the same way as directors. It is rare, and inappropriate, for CEOs not to participate in the policy and strategic decision making of the board. Indeed, the board often comes to conclusions and makes decisions from the CEO's information and analysis.

In Romania, all CEOs are executive directors of the board and thus de facto share in the board deliberations and decision making. In Britain, as in the USA and Ireland, CEOs are not directors of the board and thus do not share the same accountabilities or fiduciary

responsibilities as directors. However in Britain, it is a matter of choice and a small number of larger credit unions do have CEOs as executive directors.

In Britain, where the CEO has been co-opted or elected as a full voting member of the board of directors, the reason has been to stress the partnership relationship between board and CEO. In line with practice in British companies more generally and in credit unions in Romania, the CEO is an executive director; the rest of the board members being non-executive directors. The motivation to make the CEO an executive director of the board has been to ensure that he or she is fully engaged as a partner in the strategic development of the credit union and shares the same legal and regulatory responsibilities as other board members. This is the case in Romania. However, if the CEO is an executive director, it does not change the accountability of CEO to the board for meeting the board's expectations for performance. The CEO as executive director retains the same executive delegated authority to deliver on board policy and strategic objectives and retains the same relationship with the chair as a CEO who is not a member of the board.

In some British credit unions there are more than one executive director, such as the CEO plus the finance director. This cements the partnership between non-executive and executive directors on the board.

Executive directors in co-operatives should be presented to the membership for election at the AGM in the same way as non-executive directors, but this is dependent on the credit union's rules. In British credit unions, it is common to ring-fence the position of executive director to those appointed by the board but the person is still presented to the membership for ratification. The membership could still say no to the appointment of an executive director.

## **6 Co-operative values, principles and organisational culture**

The board is accountable to the members for ensuring that the credit union achieves its purpose as a democratically-controlled, co-operative, financial institution. It has the responsibility of making sure that the credit union offers quality, fair and affordable financial services to its members and that it operates to high standards of ethical practice.

The board is tasked with leading and directing a financial institution committed to co-operative values and principles and with the recruitment of a CEO having the ability to bring those values and principles to life throughout the organisation.

Values are beliefs or judgements about what is important, useful or worthy of pursuit. They engage interest, motivate action and inspire the commitment of time and energy to the achievement of organisational or personal goals. Principles align values to practical application as fundamentally agreed and acceptable standards of behaviour.

As part of the co-operative movement, credit unions have had a long tradition of commitment to cooperative and ethical values and principles. These form the belief system and framework within which the business operates.

The latest internationally recognised agreement on values and principles is the Statement on Co-operative Identity proclaimed at the 1995 ICA General Assembly in Manchester, UK.

For many members of co-operatives, these values are a decisive reason for selecting a co-operative to meet their particular need: an abandonment of these values can be economically detrimental for a co-operative or credit union.

For credit unions, like any co-operative, there is a risk that in their search for economic success they just adopt the same values and practices as standard private-sector, profit-maximising businesses. In so doing, they lose their particularity and distinctiveness and indeed their fundamental reason for being. This is something that boards should not let happen.

## 6.1 Co-operative values

The ICA Statement on Co-operative Identity puts forward ten values which it regards as fundamental to the co-operative business model. Six of these values relate to co-operative organisation and four to the ethical standards on which all co-operatives should be founded. The six co-operative values are: **self-help**, **self-responsibility**, **democracy**, **equality**, **equity** (or fairness) and **solidarity**.

The four traditional ethical values are **honesty**, **openness**, **social responsibility**, and **caring for others**.

## 6.2 Co-operative principles

The Statement on Co-operative Identity also sets out seven co-operative principles. These formulate the application of values to the practice of co-operatives, including credit unions. As a principle of good governance, each board of directors should consider how the co-operative principles, as adopted internationally by credit unions, apply to the context of its own credit union and how they can be effectively implemented through all aspects of the business.

The principles are as follows:

1. **Voluntary and open membership.** Boards need to ensure that the credit union is accessible to everyone who is eligible to join. There should be no intended or unintended barriers to active membership. Credit unions should not be run for only one section of the common bond.
2. **Democratic member control.** The members exercise control through participation in general meetings, through authority over the constitution, rules and purpose of the organisation and through the election of a board of directors. It is the responsibility of the board to ensure that the members are informed of the strategic and economic progress of the business and are encouraged to participate in the democracy.

The challenge for credit unions is to ensure their boards have the required skills to oversee a financial institution and, at the same time, are able to represent the membership and to act in their interests. But they must always remain accountable to the members who retain ultimate control of the institution.

3. **Member Economic Participation.** Technically the members collectively own the accrued capital of the credit union but they receive no personal economic benefit from their ownership. In practice, members of a credit union participate economically in a credit union primarily as customers and in proportion to the type and the amount of transactions undertaken. They recognise the value of this participation through receiving better rates, fees and service than they would receive from for-profit financial institutions. Ensuring the effective and equitable economic

participation of the membership is a challenge for credit union boards, for example allocating benefits to savers relative to borrowers.

#### **4. Autonomy and Independence.**

It is the role of the board of directors to ensure that the credit union remains an autonomous and independent organisation accountable primarily to its members.

Credit unions regularly enter into agreements with other organisations. Boards must ensure that they do so on terms that ensure the independent, autonomous control of the members. Members who are put forward by stakeholder groups and are elected to the board must remember that their accountability is to the membership as a whole, and not to any external organisational interest.

**5. Education, Training and Information.** Directors should ensure that all participants in a credit union understand its distinct, co-operative and credit union identity and ethos. As co-operative financial institutions, credit unions have a key role in the financial education of their members in order to support their long-term financial stability. Financial education cannot be an add-on in a credit union; it is a fundamental aspect of their rationale and purpose as a self-help financial institution.

**6. Co-operation among Co-operatives.** Evidence worldwide demonstrates that credit unions serve their members most effectively when they co-operate amongst themselves and stay firmly together. They find it much harder to succeed as independent entities; a fact that explains why everywhere throughout the world credit unions come together for their mutual benefit in regional, national and international associations. There are also clear benefits from working with other co-operative sectors.

**7. Concern for Community.** This concern is particularly important for credit unions, whose mission is to maximise financial security and stability within the membership and to widen access to co-operative financial services within the population at large. Therefore they must be open and responsive to the concerns of the societies and communities within which they operate.

### 6.3 The board role in leading a values-driven organisational culture

Boards of directors are tasked with ensuring that the values and principles permeate and characterise the strategies, operations and service delivery of the credit union. They remain the standard or the benchmark for all aspects of co-operative credit union organisation.

However, they are not set in stone and boards may modify and indeed add further values as appropriate to their particular context and situation. Examples seen include “providing the best possible customer service” and “employee participation”.

The board delegates authority to the CEO to implement co-operative values and principles throughout the credit union. It is paramount therefore that the board appoints a CEO who believes in and is committed to the co-operative ethos. The board retains oversight and accountability to the members for that implementation: the board must lead from the top if a co-operative culture is to be instilled throughout the organisation. Education and training in co-operative values and principles, for directors, staff and members, must form part of a credit union’s development plan.

To ensure clarity about the values and principles, it is good practice for the board to enshrine these in a distinct written statement. This is the **values and principles statement**, as distinct from the mission statement which sets out the credit union’s overall purpose and aim. This statement should not just be a ‘cut and paste’ of the international values and principles statement; rather it needs to be composed and agreed to reflect the particular situation and ethos of the credit union.

### 6.4 Monitoring and evaluation

Although an important first step, a statement of values and principles will not itself create a shared co-operative culture. Co-operative values and principles must be promoted, taught, owned and embedded in all aspects of the credit union if they are to make a difference to the way in which it conducts its business.

Boards of directors need to ensure that credit union policies, strategies, education and training reflect co-operative values and principles. They need to ensure also that there are

mechanisms in place to monitor and evaluate how the credit union is performing against its own stated values and principles.

One such mechanism is to review of values and principles within a social audit. This can offer the opportunity to board members and staff to reflect on the actual values and principles of the organisation, as revealed through strategies, statements, achievements, operations and behaviour, and how these relate to the adopted statement of co-operative values and principles.

Without regular attention to and review of values and principles, credit unions, like other co-operatives, face a threat of degeneration, through their adoption of a culture and a way of working that is indistinguishable from that of the for-profit sector.

## **6.5 Values, principles and business success**

The distinctive characteristic of credit unions in the market place is not so much the types and range of products and services on offer. Rather what distinguishes credit unions is the way that they are designed to do business as co-operative member-focused organisations. By bringing savers and borrowers together in a mutual, co-operative enterprise, credit unions can offer quality products and services at competitive rates in a way that supports the social and economic wellbeing of their members.

The distinctive characteristic of credit unions is the values and principles on which they are based and the social as well as economic goals to which they are committed. Research worldwide often reveals that credit unions are trusted more than for-profit, investor-owned banks. This trust only arises because credit unions are seen to be value-driven enterprises which put their members' interests at the heart of their business model.

## 7 Strategy and the setting of goals and objectives

### 7.1 Introduction

Central to an effective system of governance is the process of strategic planning and the setting of organisational and financial objectives<sup>3</sup>. Along with board policy, it is through the setting of these objectives that the board makes its values and vision known to the member-owners and its expectations clear to the CEO and staff. The board's role in providing leadership and direction and maintaining oversight of the strategic planning process is at the heart of the system of governance being explored in this project.

It is by monitoring the achievement of the strategic objectives, as set out in the strategic or business plan, that the board measures and evaluates the performance and success of the credit union and of the CEO.

For the regulator, the establishment, maintenance and implementation of an up-to-date strategic plan is essential to effectively running a financial institution<sup>4</sup>.

### 7.2 Strategic and operational plans

The strategic plan is concerned with the ends or objectives that the board aims to achieve for the credit union, along with their costs, resource requirements and priorities. Defining and agreeing these objectives is the main concern of the board. However the CEO and other senior managers must be actively engaged in the strategic planning process. In fact, the board engages a CEO to bring strategic leadership to the credit union and to provide information, data and analysis to ensure that the strategic objectives are specific, measurable, attainable, relevant and time-bound. Board oversight involves challenging, critiquing and advising to ensure that the strategic objectives conform to the vision, mission, purpose and values of the credit union and meet the expectations of the board and the member-owners.

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<sup>3</sup> Note the difference between objectives and goals as used in this paper. Goals refer to the longer-term purpose of the credit union and may not always be strictly measurable. Objectives are the actions or targets required to attain the goals of the credit union and must be specific, measurable, attainable, relevant and time-bound.

<sup>4</sup> For British Credit Unions See CREDS 2.2.4

The timeframe for a strategic plan is typically three or five years, with a formal review and update by the Board annually. The strategic plan is distinct from a credit union's operational plan. Operational plans record the means, specifically the actions, tactics and interventions, necessary to achieve the strategic objectives of the board. The operational plans are the direct remit of the CEO and management team. Operational actions should not be embedded in strategic plans, where they risk becoming the focus of board decision-making or monitoring.

The timeframe for management's operational plan would normally be over a year, but this would typically consist of individual and detailed departmental or project plans targeted for completion over a few weeks or months.

## **The strategic planning process**

### **7.3 A continuous and essential activity**

Strategic planning is often viewed and practised as a once-off annual event, an 'away day' in which the board is expected, over a few hours, to come up with all the strategies and business tactics (including the new products, marketing and internal operating initiatives) needed for the coming year. All too often this approach results in a plan document that no one consults until the planning session the following year.

Underlying the system of governance being developed in this project is the understanding that this 'once-a-year' method of strategic planning is unlikely to be effective in building strong, successful credit unions that are able to meet the financial services needs of their communities. Strategic planning is regarded not as a one-off event, but rather as a continuous and essential component of good governance throughout the year. Effective boards focus continually on strategy and on assessing management's performance in achieving strategic objectives.

Indeed, it is understood, following international best practice, that at every meeting the board should, in one way or another, focus on the following 'strategic' matters:

- Staying informed about the credit union's operational, financial and competitive position and the environmental factors impacting on it.

- Evaluating the on-going appropriateness of board policies to govern management's operation of the credit union.
- Reviewing management's progress toward achieving plan goals and objectives, based on measurable criteria that have been agreed by the board in advance.
- Challenging management to determine and mitigate any significant risks that may impact on the delivery of the credit union's strategic plan.

The board's role in leading and maintaining oversight of strategic planning is an ongoing process of monitoring, assessment and modification of the strategic plan as it is being implemented and delivered on an ongoing basis.

## 7.4 A formal planning cycle

Strategic planning is a characteristic of the continuous functioning of an effective board, but it is also dependent on a robust approach to a formal annual process or planning cycle undertaken sequentially throughout the year. In fact, a formal process for bringing together the board's continuous strategic planning into an annually-updated strategic plan document is an essential element of good governance.

Regulators expect boards to set the strategic vision, goals and objectives for their credit unions, along with the values, principles and policies that must be followed by management in achieving those goals and objectives. Each board is expected to document their decisions on those matters in a written strategic business plan, which also serves as a key statement of intent from the directors to the membership.<sup>5</sup>

The Board is accountable for the production and final approval of the strategic plan. However, it is the CEO's and staff's responsibility to provide information, data and analysis to ensure that strategic goals are attainable and relevant. The CEO and management draft the plan document, based on the values and written policies and the short-term objectives and long-term goals that are defined, explored, critiqued and adopted by the board. The board must ensure that the final document conforms to the values and purpose of the credit union.

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<sup>5</sup> This is not to suggest that the whole strategic plan document itself should be published to the members, something which would not be considered appropriate in credit union movements internationally.

A formal annual planning process or cycle would normally include the following steps, broadly in sequence:

- Definition and/or review of the mission, vision, values and purpose of the credit union
- Determination and/or review of the strategic direction of the credit union
- Review of the previous year's plan and analysis of progress to date
- CEO and senior management analysis of and rationale for their proposed strategic priorities, goals and objectives for the next three to five years, supported by relevant research data and information
- Board oversight and critical questioning of a draft or outline strategic plan in collaboration with the CEO and senior management
- Production by the CEO and senior management of a financial projection that reflects the assumptions and investments set out in the draft strategic plan.
- An analysis of risk and compliance associated with the proposed plan, where the board has properly challenged the CEO and team to determine that all significant risks have been properly considered in development of the plan
- Agreement by the board of the measures to be used to monitor progress against defined strategic objectives as well as of the system for monitoring performance throughout the year.
- Completion of the strategic plan document by the CEO and senior management, followed by agreement and adoption by the board.
- Ongoing monitoring and evaluation of progress towards the achievement of the goals and objectives of the strategic plan at board meetings throughout the year. In some cases, credit unions supplement this process of board monitoring and evaluation by arranging more in depth mid-term review meetings, potentially including at least 6 monthly updates to the financial forecasts (which is a regulatory requirement for those CUs issuing interest-bearing shares<sup>6</sup>).

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<sup>6</sup> <http://www.bankofengland.co.uk/prd/Documents/regulatorydata/interestbearingshares.pdf>

The board's role in leading and maintaining oversight of the strategic planning process is fundamental to good governance and is at the heart of the governance model. This should involve scheduling the above steps in a systematic approach to plan production and plan review throughout the year.

An annual planning cycle would therefore integrate:

- Regular performance monitoring against the strategic objectives as delineated in the existing plan. This should form part of regular monthly board meetings with the feeding of results into the next annual planning cycle.
- The discussion of strategic topics in monthly board meetings. It is good practice to plan particular discussions in advance to feed into the conversations out of which the strategic plan arises. Board discussion of strategic issues in regular meetings should inform interventions on the plan and/or its renewal through the production period.
- A period of plan review and production, including, if appropriate, workshops on elements of the plan and an annual strategy planning day. Some credit unions also have review meetings mid-way through the year to test the plan and ensure it remains fit for purpose in light of performance and external events. There is no point in maintaining the plan as the benchmark if reality has moved too far away.<sup>7</sup>
- A date for submission of the final plan to the board and its agreement and endorsement by the board for the following year.

Given the time commitment involved, boards should schedule the strategic planning cycle into their annual calendar.

The remainder of this paper focuses on the recommended steps for completing (or updating) a strategic plan that meets regulatory requirements and documents the decisions the board has made on key matters. These steps relate to the overall vision, direction and objectives of the credit union, its specific short-term objectives for the coming year, risk and

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<sup>7</sup> All the same, in the absence of real changes in the operating environment, it is not good practice to “move the goal posts” during the planning year just because monthly performance targets are being consistently missed.

compliance analysis and the definition of the standards of measurement by which progress towards strategic goals can be evaluated.

## 7.5 Setting strategic direction

The board has the overall responsibility for setting the strategic direction of the credit union, which covers the principles, priority themes and goals for the credit union over a three to five year planning timeframe.

Strategic direction might, for example, emphasise expanding internal capacity and capability, or focus on membership, savings and loans growth, or seek to strengthen the reserves position over expenditure.

The process for developing an agreed strategic direction should be through informed, focused discussion at board meetings. It should be based on the vision, mission and values of the credit union, which as key foundational elements need to be established if they are not already in place.

The vision and mission of the credit union are unlikely to need to be reviewed on an annual basis. However, significant risks, material issues or substantial opportunities may drive a review or change. It is the responsibility of the board to determine when the vision and mission should be reconsidered or reaffirmed.

The direction-setting process requires a thorough discussion of the advantages and disadvantages of possible alternatives and includes challenging assumptions and identifying risks. It must include an analysis of the external environment, informed by the CEO and management. This assessment should take account of a range of factors including the evolving needs of members, the actions of competitors as well as economic, political, and regulatory influences. It can be helpful to construct simple scenarios that summarise the options available, incorporate basic assumptions and describe potential implications.

Boards should take a pragmatic view on the review of strategic direction. Significant changes every year will make it hard or even impossible for actions over time to be mutually supportive and build upon one another to achieve broader objectives. Over a number of years, the direction may need adjustment to reflect changes in the external environment and achievement to date, but not wholesale revision. Conversely, boards should not fail to make

significant changes if this is the best response to circumstances and the credit union's operating environment.

## 7.6 Setting strategic objectives

It is useful and often important to start off the formal annual planning process with a professionally facilitated off-site planning session in which the board, CEO and senior staff review the current strategic plan<sup>8</sup> and explore the principal themes and issues that need to be addressed in a revised plan going forward.

However, if the board is engaged in the process of continuous strategic planning that this system of governance advocates, the decisions made by the board in completing the final plan document will come as no surprise to anyone. Instead, in well-governed credit unions, the strategic plan flows 'organically' from the board's process of continuous understanding, monitoring and planning that goes on all year long.

In preparation for that first meeting, it is the responsibility of the CEO and the management team, who have the requisite professional knowledge and experience, to provide the financial and technical inputs directors need to inform their planning. These inputs include:

- Research into the current and forecast state of the financial services market and, if possible, into the needs of members and potential members
- The competitive, regulatory, technological and other threats and opportunities that will confront the credit union
- An analysis of current and future credit union performance and potential outcomes
- An analysis of the financial implications of the strategic choices facing the board.
- Preliminary proposals for new products and other initiatives that will have significant financial and/or member perception impacts on the credit union

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<sup>8</sup> Here it is assumed that the credit union already has a strategic plan which needs to be reviewed. It might be in certain cases where a strategic plan does not exist that the development of a new plan would be discussed at this initial meeting.

- Suggested short-term objectives and long-term goals, and the strategies the CEO would employ for achieving them.

The directors' role is to discuss and challenge these inputs in accordance with their agreed direction, and decide upon the specific strategic objectives and priorities for the coming year and the following three to five years. It is critical that all directors are fully engaged with the process of setting objectives and understand what they are committing too. If this is not the case, it will be hard for them subsequently to contribute effectively to the board.

It is then management's job to draft a proposed strategic plan document (or update an existing one) that accurately reflects the preliminary decisions made by the board at this initial meeting. The draft document should clearly identify the agreed short-term objectives and long-term goals of the board and is likely to relate to such areas as:

- Financial objectives as determined by specific financial ratios (e.g. target capital adequacy ratio, bad debt ratio and loan to asset ratio)
- Target growth in membership, loans, and savings (as well as in any other financial services offered by the credit union)
- The development of products and services (including potentially exit from services/closure of products as well as the creation of new, and the enhancement of existing, products/services)
- Operational and infrastructure enhancements, such as the introduction or extension of information technology to processes and delivery channels
- People considerations, such as skills development, recruitment and retention
- Developments in governance and democracy (including member engagement)
- Strategic policy changes, such as modifications in credit risk appetite
- The development of partnerships working with other agencies.

The objectives of the strategic plan will need to be evaluated for time and cost, and precedents and dependencies. It is vital that the financial and non-financial resources required to deliver the plan are in place, or that the securing of these resources has been identified as a

dependency for the relevant projects. In effect, this process sets the pace at which the credit union will achieve its vision and objectives.

In particular, the financial picture of the credit union over the same timeframe as the strategic plan must be analysed and set out in a financial plan which forms part of the overall strategy document. This must incorporate the financial implications of the activities set out in the strategic plan, including any capital investments.

The financial plan should be prepared by the CEO and management team, who have professional expertise, access to relevant data on current and historic performance and who can develop the thinking as required. The director with lead responsibility for finance may wish to become familiar with the detail of the financial projections, to assure the board of the integrity of the financial planning. All directors should have an understanding of the key assumptions<sup>9</sup> underlying the financial plan; without this, they will not be able to ascertain the realism of the plan, or be able to exercise effective oversight and performance management.

## **7.7 Assessing risk and compliance**

A vital component of the strategic planning process is the identification, evaluation and mitigation of the risks associated with chosen strategic priorities and defined objectives. These might include general risks, such as changes in the local economy adversely affecting employment, and specific risks, such as the renewal of a lease for premises leading to increased costs.

The relation between strategic planning and the oversight of risk is stressed by the Financial Reporting Council (FRC) in a recent paper:-

*“The board has responsibility for an organisation’s overall approach to risk management and internal control. The board’s responsibilities are:*

- determining the nature and extent of the principal risks faced and those risks which the organisation is willing to take in achieving its strategic objectives (determining its “risk appetite”);*

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<sup>9</sup> Key assumptions are those assumptions that have material significance to financial projects – these may include assumptions on membership, savings and loan growth, rate of inflation, and loan losses.

- *agreeing how the principal risks should be managed or mitigated to reduce the likelihood of their incidence or their impact”<sup>10</sup>*

The board must ensure that a risk governance framework is in place that identifies, measures and manages the risks to the credit union’s organisation, operations and, importantly, to its strategic objectives.

As part of the planning process, the board must determine the risk appetite of the credit union in relation to the proposed strategic goals and objectives, ensure that the likelihood and impact of risks are assessed, oversee the identification of mitigating actions (including an assessment of the likelihood and impact of risk post-mitigation) and confirm that all risks are allocated a risk owner with control responsibility.

It is the board’s role to oversee the risk governance framework but it is the responsibility of the CEO and management to identify, analyse and manage risks in the credit union.

As part of this responsibility, the CEO and management draw up a risk register which sets out the nature of risk in the credit union, its likelihood and possible impact, and the means by which it will be mitigated and controlled. This risk register must be compiled or revised in reference to the strategic plan in a way that informs board strategic decision making. It is included in the strategic plan as an appendix, and subsequently reviewed regularly by the board in its monthly meeting.

It was stressed above that strategic planning is a continuous and essential component of the good governance throughout the year. So too is the oversight of risk, which cannot be confined to the production of an annual risk register. The board must be constantly aware of the risks facing the credit union and the extent to which they are changing and be ready to take action when appropriate.

To this end, it is important that the credit union’s risk governance framework document gives an indication of how and in what way incidence of risks to the credit union will be escalated to the board. For the most part, these will be picked up through the strategic

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<sup>10</sup> Financial Reporting Council. Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (September 2014), FRC, London

plan monitoring procedures, but the board must be informed immediately of any incidence of risk to the strategic plan that may fall outside the monitoring framework.

## 7.8 Communicating the strategic plan

Since the plan is the single document that defines the credit union's immediate and medium term ambitions, it is important that it is shared with committee members and senior staff. In Britain, a copy must be supplied on request to the regulator<sup>11</sup>.

A summary version could be produced for members and for paid and volunteer staff. This would need to be written in plain English (Romanian) and would need to protect the commercial confidentiality of the credit union.

However a summary document is important as staff need to understand the credit union's objectives, the main activities that are scheduled over the coming years and how their role plays a part in delivering them. Local operational plans can then be set in this wider context. For members, a plan summary demonstrates how the board intends the credit union to develop under their stewardship, and enables them to hold directors to account at AGMs or other meetings.

The strategic plan is sometimes requested by grant funders, community bodies or other external partners. It is useful to have the option of providing the full or shortened version.

The strategic plan is a means of communicating the professionalism of the credit union, so it should be well-presented and reflect its importance within the governance and management of the credit union. The plan provides a point of continuity in the organisation beyond the connected personnel. The Board and CEO should consider having the summary version of the plan (if produced) and their Annual Report to Members and Accounts professionally designed and printed.

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<sup>11</sup> CREDS 2.2.4 "A *credit union* must establish, maintain and implement an up-to-date business plan approved by the committee of management and supply a copy on request to the *appropriate regulator*"

## 7.9 The monitoring of strategic objectives

The strategic plan is a critical aspect of the governance model and it must be used as a working document by the board throughout the year. Credit unions that only review the strategic plan once a year and then confine it to a draw are failing in their duty of good oversight of the organisation, and indeed may thereby be non-compliant with regulatory requirements.

Boards need to keep a constant watching brief on the implementation of the plan through the regular monitoring of performance against the agreed strategic objectives at board meetings, which is central to good practice.

Strategic objectives, both financial and non-financial, as detailed in the plan document must be specific, measurable, attainable, relevant and time-bound.

To assist in the measurement of progress towards objectives, strategic objectives are converted to a series of indicators (cf. key performance indicators) or metrics (standards of measurement), by which credit union performance can then be readily and easily measured in board meetings. In fact, the business of the regular monthly board meeting should mainly focus on the achievement of objectives as defined in the agreed indicators or standard (metrics). (see Scorecard and board objectives report).

On the basis of such clear indicators of progress, directors are able to pose questions and CEOs provide a robust, reasonable and worked out explanations, if and when objectives are not met according to the plan and its time-scale. Such critical analysis can then lead to corrective action or the revision of objectives if required.

The objectives of the strategic plan are also the most evident expression of the board's expectations of the CEO. The performance of a CEO is assessed and measured directly by progress towards the achievement of the organisational and financial targets as expressed in the strategic plan.

As well as monitoring performance, directors must continue to challenge whether or not the credit union has sufficient human, financial and other resources to deliver the strategic plan and whether the management team has the capacity and the wherewithal to deliver on time.

## 7.10 In summary – the business planning cycle

An annual planning process or cycle would normally include the following steps, broadly in sequence:

- Definition and/or review of the mission, vision, values and purpose of the credit union
- Determination and/or review of the strategic direction of the credit union
- Review of the previous year's plan and analysis of progress to date
- CEO and senior management analysis of and rationale for proposed strategic priorities, goals and objectives for the next three to five years, supported by relevant research data and information
- Board oversight and critical questioning of a draft or outline strategic plan in collaboration with the CEO and senior management
- Production by the CEO and senior management of a financial projection that reflects the assumptions and investments set out in the draft strategic plan.
- An analysis of risk and compliance associated with the proposed plan, where the board has properly challenged the CEO and team to determine that all significant risks have been properly considered in development of the plan
- Agreement by the board of the measures to be used to monitor progress against defined strategic objectives as well as of the system for monitoring performance throughout the year
- Completion of the strategic plan document by the CEO and senior management, followed by agreement and adoption by the board
- Ongoing monitoring and evaluation of progress towards the achievement of the goals and objectives of the strategic plan at board meetings throughout the year.

Some credit unions supplement board monitoring and evaluation by arranging mid-term review meetings. For example, it is a regulatory requirement in Britain for credit unions issuing interest bearing shares to review the assumptions and forecasts in the business plan every six months, and to re-approve the plan as appropriate.

An annual planning cycle would therefore integrate:

- Regular performance monitoring against the strategic objectives in the plan. This should form part of regular monthly board meetings with the feeding of results into the next annual planning cycle
- The discussion of strategic topics in monthly board meetings. It is good practice to plan particular discussions in advance to feed into the conversations out of which the strategic plan arises. Board discussion of strategic issues in regular meetings should inform interventions on the plan and/or its renewal through the production period
- A period of plan review and production, including, if appropriate, workshops on elements of the plan and an annual strategy planning day. Review meetings mid-way through the year assist the board to test the plan and ensure it remains fit for purpose in light of performance and external events. There is no point in maintaining the plan as the benchmark if reality has moved too far away
- A date for submission of the final plan to the board and its agreement and endorsement by the board for the following year.

## 7.11 Key points to remember on strategy and strategic planning

- Strategic planning is central to effective governance.
- Regulators require a strategic plan, meaningfully deployed.
- The board's role is to provide leadership, direction and oversight.
- The plan sets out the 'ends' - the goals (long term aspirations) and the objectives (measurable achievements) for the credit union.
- The strategic plan should not detail the operational tasks required in order to deliver the plan – the 'means'.
- Strategic planning is a continuous, year-round activity, encompassing oversight, assessment and modification of the strategic plan.
- A formal annual planning cycle should be in place to update the written plan.
- In the development or review of the plan, the CEO will provide assessments of the credit union's operating environment, proposals for new initiatives and financial analyses, and produce drafts of the plan document.
- The board's role is to test, challenge and critique these materials, and ensure the final plan conforms to the values and purpose of the credit union.
- An away-day can play a valuable role in plan production, but should not be the sole occasion on which the plan is discussed and considered.
- The board is responsible for setting the strategic direction, and agreeing with the CEO the strategic objectives, which should be specific, measurable, achievable, relevant and time-bound.
- The objectives within the plan are the basis of the board's expectations of the CEO and should be the basis for measuring and periodically assessing the CEO's performance.
- Monitoring of progress against the plan should take place in an agreed form at every board meeting.
- The plan, and its oversight, needs to include risks and mitigants. A risk register should be a sub-set of the plan that can be monitored alongside other strategic objectives.

- A financial plan is required within the overall plan that fully reflects the agreed budget and forecasts (including income and expenditure, balance sheet, cash flows and any capital investments).

## 8 Oversight of risk and compliance

### Credit unions and risk

Board oversight, control and the mitigation of risk is a fundamental element of good governance and is critical to the success of any British credit union or Romanian Case de Ajutor Reciproc (C.A.R.)<sup>12</sup> of whatever size or complexity. This includes board scrutiny of risk within policies, strategic plans and budgets of the credit union.

#### 8.1 Credit unions and risk

Board of directors have the responsibility of ensuring that a credit union maximises value for its members. In an uncertain world, this is always accompanied by risk. Actions and decisions taken by boards of directors, CEOs or executive directors<sup>13</sup>, staff members, stakeholders, and third parties (including acts of omission) can result in either positive or negative outcomes for credit unions. Events and circumstances can also arise that either enhance strategic and operational opportunities or, alternatively, erode the credit union and its benefit for members.

Boards need to examine and assess the risks, opportunities and uncertainties in running a credit union. They need to weigh up the nature of risk and their level of appetite, willingness or desire to take on that risk. They cannot be so apprehensive and worried about risk that actions to develop the credit union are compromised or undermined. Opportunity

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<sup>12</sup> As throughout this manual, the word credit union is used both for credit unions and Casale de Ajutor Reciproc (CAR)

<sup>13</sup> The lead executive employee in a credit union can be either a Chief Executive Officer (CEO) or Executive Director depending whether or not the employee is a member of the board or not. Most credit unions in Britain have CEOs who are not board members, but some do have Executive Directors who are board members. In Romania, the lead executive employees is always an Executive Director. In this paper, we use the title CEO to refer to both a Chief Executive Officer (CEO) and an Executive Director.

and risk are often the two sides of the same coin; value cannot be created for members without the taking of risk. Sensible risk taking is critical to growth and expansion of the business.

In fact, risk is inherent in any business. Effective governance depends not on an aversion to risk but rather on a systematic approach to the oversight of a business risk management process. Boards must consider and oversee risk in a way that ensures that it is managed, controlled and mitigated to safeguard the assets of the credit union and to develop the credit union as a safe and sound financial institution able to serve its members effectively.

The aim of risk management is not to eliminate risk, but rather to ensure processes and systems are in place to maximise opportunity and to control and mitigate risk effectively i.e. in a considered way. The question for directors is how to build a business risk management process that allows for entrepreneurial and strategic risk taking and which does not result in some bureaucratic tick box system that prevents the taking of action.

Credit unions which are so risk averse that, for example, they hardly lend their members' money are just not fulfilling their purpose. Directors have to ensure and oversee a business risk management process that allows strategic and operational risk taking without endangering the credit union as an institution or the assets of its members.

## 8.2 Risk governance and risk management

The UK Code of Governance stresses the responsibility for determining and mitigating risk as a principle of good practice for boards of listed companies. It is clearly also good practice for the boards of co-operatives. The UK Code states as main principle C2:

*“The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems (FRC, 2014b, p17)”*

This is reinforced specifically for credit unions in CREDS:

*“SYSC 4.1.1 R requires every firm, including a credit union, to have robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective*

*control and safeguard arrangements for information processing systems”. (2.2.2 CREDS, Release 12, Dec 2016)”*

This is also stressed in the Romanian, “Strategia Privind Funcționarea și Dezvoltarea Sistemului C.A.R. 2016 – 2020. Principiile de Guvernanță la casele de ajutor reciproc”

*« Cerințele sistemului de guvernanță aplicat sunt: - administrarea corespunzătoare a riscurilor/managementului riscurilor;- adecvarea politicilor și a mecanismelor de control intern Consiliul Director monitorizează situația riscurilor și a conformității pe baza informațiilor primite de la comisia de cenzori, de la directorul economic/executiv/contabilul șef și a rapoartelor de inspecție sau de control prezentate de uniunea teritorială județeană, stabilește măsurile de corecție care se impun și raportează situația riscurilor și a conformității adunării generale sau conferinței membrilor C.A.R.*

*Consiliul Director al C.A.R. are un rol important în crearea unei culturi și a unui limbaj comun privind guvernanța și gestiunea riscurilor. Aprobă planul și politicile de control a riscurilor elaborate de managementul și personalul executiv, respectiv obiectivele de referință, condițiile și limitele de prudențialitate între care se va desfășura activitatea C.A.R., precum și termenele de raportare a situației riscurilor și a conformității »*

The board is accountable to the members and to the regulator for ensuring that the credit union is a safe and sound organisation and for overseeing, guiding and approving the approach to the management of risk. The overall accountability for ensuring a culture of risk awareness, a common understanding and language of risk, and a systematic business risk management process resides with the board. This overarching assessment, monitoring and control of risk at board level are defined as risk governance.

Effective risk governance presupposes that a credit union has a structure with defined board and management roles and responsibilities and effective administrative, accounting and reporting procedures. It involves the board’s active oversight of organisational structure, strategy, policy and procedures, communication, interaction, and reporting. It is dependent on boards setting a ‘tone at the top’ and giving guidance and offering critical insight on the

The authority for risk management is delegated to the CEO who then has the responsibility for the implementation and operation of a risk management process within the parameters and policies set by the board. It is a process that applies to all aspects of the business; in structures, systems and processes, strategic and financial planning, operations, controls and service delivery, and in policy and regulatory compliance.

Thus distinction between risk governance and risk management is set out in Table 1 below, which delineates who does what in the risk management framework and process.

It is to be noted though that effective risk management entails boards ensuring that there is a strong risk management culture and a common language running throughout the organisation.

This includes the board itself, where risk equally appertains to the recruitment and renewal of directors and CEO.

### **Table 1. Roles and Responsibilities for the Risk Management Framework**

This table was produced by the Credit Union Development Association (CUDA) in Ireland in order to outline the distinct roles and responsibilities of the board and management within the board's risk management policy.

<b>Board of Directors</b>	<b>The executive</b>
Oversight of framework – gains assurance on it effectiveness.	Develops process to implement risk management in the credit union
Approves and annually updates the risk Management Policy.	Assigns responsibilities for Risk ownership, monitoring of risk and risk reporting
Articulates risk appetite/ risk tolerance statements	Identifies the process to develop risk profile of the credit union.
Gains understanding of overall risk profile of the Credit Union at inherent and residual levels.	Implements process to determine risk profile and to assess the severity of each risk.
Gains understanding of significant risks at inherent and residual levels.	Implements process to determine risk responses are in place and identify if further action is required.
Approves acceptance of residual risk or risk response where residual risk is outside risk tolerance level.	Reports to the Board on the risk profile of the credit union including significant risks at the inherent and residual levels
Gains assurance that management has undertaken the risk responses as outlined.	Takes action and monitors to ensure risk responses operate effectively.
Monitors risk indicators for known significant risks on quarterly basis and more frequently where specific risks emerge.	Presents monthly reports to the Board which present level of risk by PRISM category <sup>14</sup> .

<sup>14</sup> PRISM is the risk based supervision framework as published by the Central Bank of Ireland – see PRISM Explained (2011), Central Bank of Ireland. The PRISM categories of risk are credit risk, market risk, operational risk, insurance risk, capital risk, liquidity risk, governance risk, strategy/business model risk. Environmental risk and conduct risk.

Monitors emerging risks and discuss implications with management	Presents information to Board on emerging risks
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### 8.3 Compliance

The risk management process has to be understood within the context of legislation and regulation. It is the law and the regulator that sets the main overriding parameters and constraints within which credit unions and financial institutions are required to operate.

For this reason, a risk management process has to have a significant bias towards a framework of compliance to regulatory requirements. As shall be discussed later, boards of directors can adopt certain tolerances to the management and control of risk; in relation to what may be called their risk appetite. But in relation to regulatory compliance, tolerance of non-compliance is problematic since it may result in a revocation of the licence to operate.

It is the responsibility of boards of directors to ensure that their credit unions are compliant with the law and regulation, not just in relation to credit union legislation and regulation but also in relation to such legal requirements as appertain to money laundering, data protection, consumer credit and mortgage lending (GB only) and other relevant areas, including its own policies.

To ensure compliance, it is recommended credit unions produce:

- A compliance checklist – this would include all regulatory ratios as well as all aspects of legal and regulatory compliance
- A compliance calendar – this would mainly note when certain areas of compliance were up for review
- A breach register - noting areas where the credit union is out of compliance and the reasons for this
- An approval log (where approval has been given for actions that have a compliance requirement)

In GB, credit unions must appoint a money laundering reporting officer. In some credit unions this position is held by the CEO as it is clearly a role within the management of risk. Other credit unions may decide to appoint a director to the role.

It is not obligatory but clearly good practice to appoint a compliance officer to oversee the compliance checklist, calendar, breach register and approval log. This position if allocated is likely to be held by a member of staff. The development of a compliance framework of the above elements will have to include a system of reporting on compliance to the board.

## **8.4 The Risk Management Process (RMP)**

The RMP refers to the comprehensive set of policies, processes and procedures which specifically identify, manage, and control the level of risk that a credit union encounters in its operations and in the pursuit of its strategic objectives.

There is no one-size RMP or framework that will fit all cases – it must necessarily reflect the business model and strategic approach of individual credit unions and consequently policies and procedures within the framework will vary among credit unions.

However, many credit unions develop a process that is based on the following eight steps. These steps highlight that risk management is a continuous process in a credit union.

### **Step One - Setting expectations: risk culture, language and appetite**

Step one concerns the setting of expectations by the board as supported and advised by the CEO. The board needs to set its expectations in regard to the creation of a risk management culture in the credit union, in regard to the way risk is understood and explained and in regard to the approach taken to the management and control of risk.

This begins with the creation of a common risk language. Board members, the staff and everyone throughout the credit union need to understand what is meant by risk and how this applies to the different aspects of the business. This language will speak of capital risk, credit risk, environmental risk, governance risk, liquidity risk, insurance risk, market risk, operational risk, strategic/business model risk, conduct risk as many other forms of risk as appertains to a particular credit union. It is this terminology that details the risk universe.

Setting expectations also involves boards establishing a risk appetite policy which creates the boundaries within which the CEO and other executives can operate. It delineates the amount of risk that a board of directors is willing to accept, manage or avoid in the pursuit of a credit union's strategic and operational objectives. It sets the tolerances in the

achievement of those objectives. If board expectations are to be made clear to the CEO and management, risk appetite has to be clearly articulated, defined and, importantly, written down in a risk appetite statement. It is the board of directors that is accountable for setting the risk appetite of the credit union. But it does this in collaboration with the CEO whose expertise and advice they seek in understanding and formulating its definition.

Risk appetite and consequent tolerances are often reflected as financial ratios in strategic plans or in performance monitoring schedules<sup>15</sup> (e.g. the tolerance of a certain bad debt ratio or loan to asset ratio) or in defined targets for loan delivery, member service and the handling of complaints. They also appear in board policy documents particularly in statements that limit the delegated authority of the CEO. Just as credit unions set different objectives, they necessarily develop different risk appetites and tolerances.

In the literature on risk, there are multiple approaches to the development and formulation of risk appetite statements. Most begin with the creation of a high-level, broad statement that can apply widely across the credit union and generally inform its risk management policy and culture. The challenge is to make this high-level statement practically relevant. This is done by the development of more detailed risk appetite policy statements with risk tolerance levels for strategic and operational objectives and specific categories of risk in the credit union.

It is important to note that risk tolerances in relation to specific objectives can only be set once the risk appetite has been defined and agreed by the board. But the setting of risk tolerances is essential if boards are to delegate authority to the CEO and management team. Risk tolerances support management control and give space for entrepreneurial activity, but they also set threshold levels which if breached, have to trigger a response.

## **Two – Identifying risks**

The next step in the risk management cycle is to identify current and emerging risks. There will be a multitude of risks facing any credit union and any method or process should realistically focus attention on the principal risks that is those that will affect the business

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<sup>15</sup> A tolerance for risk for example is built into the balanced scorecard approach as noted in the chapter on the monitoring of performance.

strategy in a significant way. The risk identification method needs to be considered in the context of the business risk universe so the risks cover all aspects of the credit union's operations and not just the financial areas.

The identification of risk focuses the mind of directors and CEOs on the possible negative consequences of the actions (or inaction) they take and it enables them to make decisions and provisions that offer the possibility of the prevention of harm to a credit union in advance. But risk does not apply just to the actions and/or inaction of the credit union, but also to the actions or inaction of external agencies and indeed to events occurring naturally or within the environment that may result in detriment to the credit union as a stable financial institution. Renn (2008, p1) points to this association of risk with negative consequences of actions and external events when he writes:

*“Risk denotes the possibility that an undesirable state of reality (adverse effects) may occur as a result of natural events or human activities” (Renn, 2008)*

Risk is regarded here as the possibility of an event occurring that would adversely impact on the achievement of an organisation's mission or business objectives.

But risk can have positive effects too and just be a deviation from the expected. Risk is defined as an exposure to loss against uncertainty, either as a result of particular actions, external events or as embedded in the activities of an organisation, but, importantly, it can also be the driver of strategic decisions and result in positive outcomes. Risk is not always to be avoided but rather it is to be managed, controlled, mitigated and even sometimes embraced. Understood positively, a well-managed risk may just be an opportunity.

A properly conducted process step should involve the board, CEO and key management in defining each risk carefully and specifically before any assessment of the level of risk, in relation to possible likelihood or severity, takes place. This process can take time in order to ensure that the risks are properly defined and written down.

The board tasks the CEO and the executive team to identify, analyse, assess and report on the range of risks facing the credit union. However, the board cannot just leave the control of risk to management; it must be sufficiently cognisant of the nature of risk to critically question and assess the findings and reports of management and thus to be in a position to provide effective governance of the risk management framework.

### Step Three - Assessing and measuring risk

Risk identification done properly is a relatively straightforward exercise and can generate a large number of risks, some of which are much more pressing than others. The next step in the process is to develop a method to assess and measure the level of the identified risks.

This is a critical step as the board must have in place a method to be able to make a robust assessment of the principal and materially significant risks to which the credit union's business model, strategy and operations are exposed.

The traditional approach is to measure the level of risk in terms of the probability of an event happening multiplied by the impact this event would have on the organisation. Risk equals probability multiplied by impact, so high probability multiplied by high negative impact would equal high risk.

A scoring system is often applied to such an equation as is illustrate Figure 3 below, scores are given for both impact (consequence) and occurrence (likelihood) and these are multiplied together to give an overall risk rating. This allows for the relative ranking of what may be quite diverse areas of risk.

The higher the overall score, the higher is the potential severity of the risk. A high probability or a recognised frequency of the event occurring combined with an estimated severe impact on strategy or operations will result in a high risk rating. A lower probability of the event occurring against a lower estimation of severity of impact will result in a lower risk rating. In Figure 4, the highest value is 25.

The scores from one to five are given against written criteria set by the credit union. Examples of such criteria are in the tool-kit that accompanies this manual but each credit union has to determine its own criteria of scoring given its own operating context.

This scoring assessment process allows for the principal (or key) risks to be identified and a shared set agreed by the board. Not all perceived risks are of equal magnitude or of immediate concern. Some are clearly of much greater significance than others.

It is imperative to understand that the scores are just a mechanism for ranking of the diverse set of risks to enable the board to get to one shared list. Risk management is about judgement and the scoring process is just a tool to aid the ranking of risks. Giving the scores

any more importance can lead to misunderstanding of their purpose and turn the RMP into a mathematical exercise.

It is also important to note that low scores do not mean that the risk is insignificant. A score of 5 could be created by a risk that is potentially of very high impact but of very low probability (5x1). Even though unlikely to happen, this is a serious risk which needs to be properly managed and mitigated. It is worth stressing that some risks, even though of low probability, have such severity of outcome that they merit special attention. It is for this reason that all credit unions must have a business continuity and disaster recovery plan as part of their risk management framework.

The identification and assessment of risk should be recorded in a risk register or similar recording system (see the accompanying tool-kit). Once likelihood and consequences (impacts) are analysed and risks values determined, risks can then be prioritised for action through a traffic light system.

**Figure 4 – Assessing the severity of risk**

This Figure shows how a risk rating score is gained by measuring likelihood against consequence or impact. How likelihood and consequence are to be understood is determined by each credit union (see accompanying toolkit).

		Consequence				
		5	4	3	2	1
Likelihood	5	25	20	15	10	5
	4	20	16	12	8	4
	3	15	12	9	6	3
	2	10	8	6	4	2
	1	5	4	3	2	1

#### Step Four - Assessing control

The next step is to assess the control effectiveness over the identified risks, particularly those scoring high on the risk rating system. Risks that have a high impact should have a high degree of effective control. Low impact risks should have less control applied

given that credit unions have limited resources and the high impact risks should have more effort to keep controls effective.

Controls that are in place need to be listed in the risk register (see accompanying toolkit) or in a control assessment table. Some credit unions give the risks a new score once they are sure of the effectiveness of the control measures. So in these registers, there is a score prior to an assessment of control and another after the controls have been put in place.

An assessment of control of identified risks has to be undertaken within the context of the board's risk appetite and defined tolerances. In this stage those risks that present ongoing major concerns to the credit unions will be flagged up in red on the risk register.

### **Steps Five - Determining risk strategies**

Once risks have been identified and assessed, boards need to ensure that they will be managed and mitigated in line with the risk appetite, but not in a way that undermines the enterprise and drive of the organisation. Boards of directors need to ask themselves some basic questions including:

- Do we have a process in place that ensures that all risks that matter are managed effectively and within a defined timeframe for risk reduction?
- Are we sufficiently tolerant of risk not to undermine the entrepreneurship and drive of the board and staff team?

It is the CEO and management that develop strategies and processes to mitigate and control risk and then present these for approval to the Board. These strategies can be summarised as the four T's:

#### **Take; Treat; Transfer; and Terminate.**

- **Take:** frequently referred to as accepting the risks. The board takes no action to reduce the risk but monitors the level of risk through control processes and systems. These risks reflect the core mission of the credit union and are worth taking.
- **Treat:** there are a number of ways that risk and opportunity can be treated. The risks can be *priced* with varying levels of interest premiums for instance the loans carry higher rates for higher risk individuals. The risks can be *reduced* by limiting the amount that can be borrowed or the repayment time is shortened. The risk can be *mitigated*; here the board is willing to accept the risk but endeavours to *reduce* the

level of risk involved through control systems and processes. The aim is to manage the risk within established and agreed tolerances, for example, a credit union accepts a certain level of delinquency (bad debt) so long as it is within defined limits and covered by loan loss reserves. It can be treated by preparing *contingency plans* knowing that the risk acceptance may go wrong so an alternative back-up is planned for any disruption or disaster recovery. Risk can even be *exploited*, when a credit union, for example, persuades a sponsor to make capital available to cover the risk of lending to more members judged to be of higher risk.

- **Transfer:** here the credit union is not ready to accept the risk but will transfer it to a third party. This is typically the case when credit unions purchase fidelity bond and other insurances such as directors' liability insurance.
- **Terminate:** this is *avoiding* the risk to *prevent* or *eradicate* the likelihood that the credit union will embark on a course of action that falls outside the tolerances set in the risk appetite statement. Here the board's risk appetite for the risk in question is so low that it considers the risk to be *unacceptable* or *unwarranted*.

### **Step Six - Mitigating and controlling risk**

For each principal risk identified and assessed as significant, the board would normally need to be reassured that an appropriate response is planned or currently in operation to bring the risk within an acceptable level of risk tolerance.

As has been noted already, there is no suggestion that all risk is to be avoided.

Principal or key risks should be recorded in the risk register or in a similar system in order to ensure effective review and monitoring of progress. In fact, the identification and assessment of risk is incomplete without there being a recorded response which explains how a particular risk is being managed, mitigated and aligned to the risk tolerances of the board.

There is no one standard set response to risk; each credit union has to decide on its own response for itself which should be cognisant of its common bond.

### **Step Seven - Monitoring risk and internal control**

It is often not the large strategic risks that undermine the stability of the organisation, but rather the more day-to-day risks linked to operations and service delivery. These are the risks that demand robust internal controls that deter or detect errors, omissions or

misstatement of financial or other information. If credit unions want to reduce risk, they need to start with ensuring the robustness of their internal controls. These controls need to be defined and documented and linked to a credit union's risk appetite and tolerances. CREDS refers to this point in detail (PRA, 2016a).

*“A credit union must establish, implement and maintain: [...] adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the credit union, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems. (PRA, 2016, 11.1 (3))”*

### **Step Eight – Assessing performance**

Effective risk management is dependent on the regular review by the board of risk levels and targets in relation to strategic objectives and credit union management and operations. As a matter of course all management information reports considered at the monthly board meeting should be accompanied by a consideration of risk. The inclusion of risk tolerances and targets within the balanced scorecard, for example, should be standard practice.

From time to time, and at least annually, the board should carry out a review of risk management policies, including setting risk appetite, risk tolerances and the effectiveness of strategies to manage and control risk exposures. This should cover all areas of actual and potential risk, and include a review of all financial, operational and compliance controls.

The board should also, from time to time, initiate plans to test controls and impacts of the principal or key risks facing the credit union. This would often include the stress testing of key risks, or simple scenario analyses of what would happen in certain circumstances and if the controls in place were insufficient or failed. Stress and scenario testing is an important element in RMPs.

Overall, the board, through processes of monitoring and review, needs to assure itself that risk is being managed appropriately, within set tolerances, in order to ensure that the credit union remains a safe and sound financial institution. Boards of directors must:

1. Ensure that the CEO and management understand and carry out correctly their roles and responsibilities in risk management.

2. Ensure that the credit union has an effective independent audit function which monitors policies and procedures in regard to risk and compliance and tests the design and effectiveness of internal controls to mitigate risk.
3. Regularly review business operations and the resourcing and independence of review functions to confirm they are performing at appropriate levels for risk tolerance and regulatory compliance.

A comprehensive risk framework would inform credit union members, as owners of the credit union, and other stakeholders of the risks facing the credit union in the pursuit of its strategic objectives. The board as well as management should report on the management and control of risk in the annual report. In general, good governance involves disclosing to the membership, to whom the board is accountable, the principal risks and uncertainties facing the credit union and how those risks are being responded to and managed.

It is an essential competence of all credit union directors is the ability to identify the nature of risk and to understand how it is mitigated and controlled. Each director is responsible for understanding the nature and dynamics of the RMP and how it links to the credit union's business model and strategic plan. All directors need to sufficiently understand the articulation of risk appetite and risk tolerances, the methodology of risk identification and assessment and the nature of risk management and internal control systems. Individual board members and the board as a whole need to be able to confidently oversee and be assured by the RMP in place in the credit union.

## **8.5 An audit and risk committee**

As part of its RMP, the board is directly accountable for establishing an independent internal audit process. This will typically involve establishing an audit and risk committee of the board or the supervisory committee as traditionally elected by the membership in the UK and in Romania. However, in either case, the issue is the effective implementation and the quality of the internal audit process.

The specification of an internal audit function will vary depending on specific credit union factors including scale, diversity and complexity of the activities and the number of

branches and employees, as well as cost versus benefits considerations. Nevertheless it is essential that the board and CEO obtain objective assurance and advice on risk and control.

An adequately resourced internal audit function (or its equivalent where a third party is contracted to perform some or all of the work) can provide such assurance and advice.

In relation to British credit unions, CREDS 2.2.46 details the key elements of a satisfactory system of internal audit, which stresses risk analysis and the way in which this analysis has to inform the internal audit plan.

*“The key elements of a satisfactory system of internal audit include the following:*

*(2) Risk analysis. Key risks in each area of the credit union's business should be identified. The adequacy of the specific controls put in place to address those risks should be assessed.*

*(3) Internal audit plan. This should be developed on the basis of the risk analysis” CREDS 2.2.46”*

In relation to the RMP, therefore, the role of internal audit is to verify the process and to provide risk based assurance to the board including reporting to the board on the accuracy of information being provided in risk management reports. It is then essential that the board oversees the way in which the internal audit function tests the risk register and risk management plan, and then reviews and provides independent assurances on each key risk.

The board is accountable for overseeing both the external and internal audit process. But control of internal audit is normally delegated to the audit and risk committee which plays a key role in confirming that management is monitoring and managing risk. The committee reports directly to the board on any risks that remain outside tolerance levels.

Depending on the size and complexity of the credit union, some boards of directors may also appoint a distinct risk committee to oversee the RMP, although in Britain and Romania the size of most credit unions would suggest that the roles of the risk and the internal audit committee can reasonably be combined in an audit and risk committee.

In addition to overseeing the internal audit, an audit and risk committee is responsible for reviewing management's identification of principal risks and ensuring that the RMP is in place to measure, monitor, manage and mitigate risk exposures. It oversees the application of risk management practices and the on-going identification of emerging risks and report to the board on risk exposure levels. It would also be tasked to ensure that

appropriate levels of resources are allocated for assessing and managing risk throughout the credit union.

The audit and risk committee would report directly to the board on RMPs and findings. It would normally be made up of at least three representatives from the board (or an independent advisor) with representation from appropriate officers in the credit union. Some credit unions will appoint a risk management officer, although in practice this role could be combined with other validation roles such as money laundering risk officer (MLRO) or a data protection officer (DPO).

Boards are also free to obtain independent professional advice on its role in risk management to ensure that it is meeting the standards expected within the sector. What it should not do is leave the consideration of risk and compliance to the CEO and management alone.

## 9 The role of board policy

The board sets policies about the values of the credit union, its vision, the target groups it wants to serve, with what kind of products and services and at what cost (the ‘ends’). It then delegates authority to achieve what it wants to achieve to management which concerns itself with the means to attain the ends set by the board.

It is here that the distinction between board policy (about ends), management policies (about means) and procedures (more practice detailed prescription for staff on areas of operational means) arises.

The first task then, in the governance system, is to divide out what is properly board policy from what is management policy and procedures. Where that division is made is ultimately a board decision, and will be decided by different boards differently. In some larger credit unions, for example, a number of human resources policies would need management approval but others would be management policies and not come to the board.

It is important for a board not to decide on policy that is a management responsibility, for if the board decides such policy, which will include quite detailed specifications; it cannot

hold the CEO accountable for credit union performance as it has taken some of that upon itself through this intervention.

Good governance asks boards to take a more robust and disciplined approach to the setting of board - not management – policy. Rather than approve policies about management and procedural issues, boards need to develop board policy, which does not deal with management activities, but sets out the values and perspectives of the credit union and determines the context within which the CEO is obliged to act. Given that it is the expectation of the board that the CEO and staff operate within policy, it is important that boards are fully in control of board policy development. This, of course, does not prevent boards seeking the advice and input of the CEO into board policy, providing the board retains full control of the policy development process.

Policies can exist at different levels of detail, from broad statements of aims and values to quite precise defined policy elements. It is up to the board to define the detail of policies up to the point it considers that the CEO and management is able to interpret the policy correctly and without difficulty. How that policy is then achieved is down to management. The important point for boards is not to stray inadvertently into the area of means and management responsibility.

This more robust focus on board policy rather than on policy in general, which inevitably includes both management policy and procedures, should result in a series of relatively brief board policy statements which can then be used to monitor the progress of the credit union.

For example for lending there could be board policy, management policy and detailed procedures and processes. The board would set out in its policy the broad principles and objectives of lending, including the target market to be served. The board would then delegate authority for loan product development, interest rates, credit administration, loan underwriting and credit control to the CEO, who would then set out a management policy framework for the handling of operations and developments in these areas. Procedures and processes would set out the rules and guidelines for the practical administration of lending by loan underwriting, credit control and administrative staff.

## 9.1 Policies on the limitations of executive authority

Executive limitations policies can be set which restrict the decision-making authority of the CEO. They define what a CEO is not to do rather than what he or she can do. In general, though, boards need to delegate maximum management policy making authority to the CEO so that he or she can achieve the overall objectives of the credit union.

In the lending example above, the board could limit the authority of the CEO by determining that the credit union is not, for example, to compete in the payday lending market, not to offer loans with a repayment period of over two years and not to charge interest rates over a specified limit that is below the legal maximum.

## 9.2 The writing and review of board policy

Board policies are those policies that must be developed, agreed and owned by the board itself. They include any required by the Regulators and those which impact significantly on the way the credit union treats members and staff. It is the board's responsibility to ensure that all such policies are consistent with co-operative values and principles. The board must also be assured through the CEO that management policies are also consistent with co-operative values and principles.

However, the framing and writing of board policy will undoubtedly involve the CEO and other staff members. They may be developed, for example, through a sub-committee structure of the board in which the CEO or other senior staff members participate. The professional knowledge and insight of the CEO is in fact required in the formulation of board policy.

The important point, however, and one that the board cannot fail to undertake, is that the board needs to agree and own board policy after significant debate and discussion. Directors can only own their own policy once they have time to analyse and critique its content in open discussion. Otherwise they descend into a board dependent on the decisions of the CEO.

The board should set itself a regular mechanism to review board policies at least annually. This needs to be built into the board schedule for the year.

## 10 The role of the board in monitoring performance

To monitor performance effectively, board members need a range of management information (MI) on which to base their understanding of the business. Without access to accurate and up-to-date data about organisational and financial realities, directors are left to draw conclusions and make decisions in a vacuum. However, determining the amount, level and scope of the MI that boards require to ensure effective oversight of the business can be problematic.

As credit unions expand and develop, they generate an increasing amount of complex information and data in relation to strategy, operations and finance. Even with the constraints of much credit union software, information systems enable managers to amass and interpret detailed data and produce multiple reports on a wide range of issues, all of which assist in better management.

Some CEOs seek to give as much information and data as possible to the board. Perhaps this is because they consider that directors have a right to know everything about the business or even out of a misplaced concern that directors need to be involved in all decisions taken in the organisation. This wholesale transmission of MI can be supported by directors who are attracted to commenting on all aspects of the business and believe that they need sight of all information and data; an expectation conveyed back to management.

Of course, board members do have a right to have sight of all MI and data if they so wish. The problem arises not from directors having access to information, but rather from their being passed this data and information without some form of filter. Directors presented with information that takes hours to assimilate, which is complicated to analyse or which is only understood by a few undermines collective responsibility and board effectiveness. Too much information results not in greater control but less; if overwhelmed by the amount of information available effective board oversight of the business can be compromised or lost.

Directors need to understand the business, how it is performing and to be in a position to take action if required. To do this in meetings, they require MI that focuses on the key issues and which is presented in a form that is accessible and can be easily understood by all.

Additional and detailed MI can be made available to directors for consultation and consideration outside of board meetings, for example through secure document sharing systems such as Microsoft SharePoint.

Typically, director members of sub-committees, such as the finance, risk or internal audit committees would examine and discuss additional more detailed reports as pertinent to their committee. However, such detailed MI would not be reviewed or approved in board meetings, although questions arising from such information could be allowed.

For board meetings, MI has to be simplified and presented in a way that enables all directors to see clearly what is happening in the business. Boards need to ensure that MI systems are designed and implemented so that all directors are in a position to monitor performance and make effective decisions.

Some credit unions have already introduced dashboard or simplified presentational methods to direct directors' attention to the key issues that concern the board. Building on such experience, governance recommends a system of board reporting that aims to maximise the accessibility and relevance of MI.

## **10.1 Monitoring performance against the strategic plan**

It is essential in board meetings that the directors focus on the achievement of strategic plan objectives, as it is against progress towards them that the performance of the credit union as well of the CEO is measured. There are two reports used by boards for this purpose: the *board objectives report* and the *balanced scorecard*.

These reports aim to give directors an immediate and clear view of business progress. They concentrate board attention on the most important issues and away from the temptation of discussing operational detail. They aim to promote critical thinking, analysis and learning and to assist boards to take action or modify plans as appropriate. It is recommended that these two reports are considered high up on the agenda at every board meeting.

## 10.2 The board objectives report

This report relates directly to the specific strategic objectives as set out by the board in the business plan. It monitors progress against objectives and ensures that the business plan is a working document used by the board and CEO throughout the entire year. Ideally the report would include but distinguish between board and management objectives in line with the division of roles and responsibilities.

The composition of the board objectives report is agreed by the entire board and finalised following board approval of the business plan. It typically focuses on those objectives to be achieved within the coming year.

An example report is attached is to be found in the accompanying tool-kit. The table columns relate to the definition of the objective, the timeframe within which it is to be achieved, the persons responsible for its attainment and the status that month in regard to its achievement.

The report is normally colour-coded to assist the board to see easily which objectives are on track to be completed and which are behind schedule. This report would normally be completed by the CEO or another senior manager through consultation with the chair to ensure no difference of opinion.

The number of objectives to be included will depend on the strategic plan. However, the report should refer to headline strategic objectives only and not exceed two pages in length. Management will also have an action plan to achieve its objectives, outlining more detailed actions and targets, but this is not required at the board meeting.

The report will also need to record any modifications or adjustments to the objectives in detailed in the strategic plan throughout the year. However, any major revisions would involve a review of the strategic plan and a rewriting of the objectives report.

The overall aim of the objectives report is to ensure that the board and the CEO keep a focus on the attainment of the objectives as set out in the business plan and do not get diverted into other areas and considerations.

### 10.3 The balanced scorecard

This is a planning and management tool often used by business managers to measure overall organisational performance against objectives.

Unlike the board objectives report, a scorecard is primarily quantitative and statistical. It is balanced as it includes non-financial as well as financial performance indicators or metrics. The aim is to focus on the wider aspects of the business than can be measured by financial ratios alone, even though these form an essential component of the scorecard.

Like the board objectives report, a scorecard is used to oversee performance in a manner that is accessible to directors. It offers a clear set of easily understood measures or metrics to monitor progress in reference to the strategic plan. It replaces the need for boards to spend large amounts of time reading long management reports and financial statements. For it gives all directors equal and immediate access to the most important information and data they require to take control of the credit union and to drive it forward.

There is no one single format of a balanced scorecard that can just be adopted by each and every board. With CEO input, each board agrees to the items to be included on the scorecard as they relate to its own strategic plan and objectives, and to the particular needs of the board. An example is attached in the appendices.

The idea of the scorecard is to take the financial and non-financial objectives, as defined in the strategic plan, and to convert these where possible into statistical indicators or metrics. For each objective, tolerance levels need to be noted in order to give boards an immediate indication of over or under-achievement in relation to each particular objective. Minimum tolerance levels indicate when action must be taken as a priority by the board. The scorecard often notes too what would be counted as exceeding target levels. This would denote high level performance in a particular area.

As in the objectives report, the scorecard is normally rated according to a colour coding system; with red indicating that performance is below the minimum acceptable tolerance level, yellow (or amber) indicating that it is below the minimum target level, green indicating that performance is on or better than target. A star can be used to indicate that the set target is significantly exceeded. Scorecards often also include direction of travel indicators (by arrows up, down or level) which assist boards to see clearly what is happening.

Performance indicators or metrics are typically set against five areas: governance, member service, financial performance, employee satisfaction and efficiency and effectiveness. Boards must determine which subject areas and indicators of progress to include.

### Governance

Reports statistically on progress to the achievement of board and management objectives as set out in the board objectives report. It can also include any other specific board objectives that can be measured statistically.

### Member Service

Records new members per month against target. It could also include: data on accounts closed per month, complaints, survey results, demographics.

### Financial performance (by key ratio analysis)

An essential element of this report is the measurement of financial performance by ratio analysis. Normally the scorecard would cover:

- Net income/total assets
- Capital/assets ratio
- Regulatory reserve ratio
- Loan delinquency ratio
- Loans/assets
- Income from loan portfolio
- Income to expenditure ratio

### Staff turnover and satisfaction

Addresses staff engagement and development. It can include: results of staff satisfaction surveys, number of staff joining and leaving, the number leaving for a better job (a measure the level of staff professional development).

### Efficiency and effectiveness

This section could include: the value of new loans made during the month, percentage of borrowers, percentage of self-service transactions and percentage on payroll deduction.

The objectives report and the balanced scorecard are open to interpretation and development, but it is essential that both relate to the business plan.

There are examples of both the objectives report and the balanced scorecard in the accompanying governance tool-kit.

## **10.4 Financial reports**

In addition to the financial information provided in the objectives report and balanced scorecard, directors also require headline financial MI in relation to income and expenditure as compared with the budget in the financial plan and to movements in membership, savings (deposits), loans and loan delinquency.

The aim is to ensure that information is accessible and easy to understand. Simplified dashboard approaches, including pictorial graphs and charts, are to be recommended.

### **Income and expenditure statement, compared against the budget**

For board meetings, the income and expenditure statement should be a summary that records income and expenditure only against main budget headings. It should give an indication of the anticipated year end position.

A fully itemised income and expenditure statement must be available to directors but not presented for discussion in the meeting, to avoid discussion straying into the minutiae of expenditure. For board meeting purposes, the main income headings on a simplified statement would include interest on loans, grants and other income; expenditure would include salaries, bad debt provisioning, and other overheads.

It should also indicate surplus, actual and projected, and the amount anticipated to be available for dividends on savings. It would also need to allow for the entering of “known” differences or expected changes that would impact on the budget.

This report would normally be colour coded (RAG rated) to enable board members to see immediately where expenditure is on or off target.

### **Dashboard display of MI**

In addition to the ratio analysis on the balanced scorecard, it is recommended that board members are presented with specific information on performance in relation to growth in members, savings deposits (shares), and loans made. They also require a trend analysis in

regard to interest received on loans and levels of loan delinquency. A dashboard presentation of data, both numerically and graphically, is often the most easily compiled format. Information presented in this way is usually accessible to all directors and can quickly inform their understanding of the development of the business without the need to read and digest complex reports.

The dashboard sets out in visible form development in a particular subject area monthly or quarterly (as appropriate) over the period of a year. It compares the current situation with the target objective in the business plan and with the situation in the same time period the previous year. This presentation enables directors to see trends over time, and avoid knee-jerk responses to one month or one quarter dips in performance, or alternatively complacency arising from one-off upward blips.

An example of a dashboard presentation of MI is to be found in the accompanying tool-kit.

## **10.5 Risk register/Risk report**

Board monitoring and review of the management of risk entails the recording of significant and principal risks, together with response activities, in a risk register or other form of database system. Completion of the register should not be a one-off exercise. It must inform the board's thinking about risk and the regular review of risk governance and management systems, and should be referenced regularly.

The updated risk register must be available to directors at all times. However, at each board meeting, it is expected that the CEO would give a risk report outlining the greatest risks and actions being taken to mitigate them. This can be an extract from the register focusing on those colour coded red and yellow (or amber).

An example of a risk register is to be found in the accompanying tool-kit.

## **10.6 Compliance Report**

Risk governance should also include a systematic approach to compliance, based on the development of a compliance calendar and checklist. Compilation of the calendar and checklist would normally be carried out by the CEO or a designated member of staff.

A report on compliance must form part of every board meeting, given by the CEO or the compliance officer. It does not normally need to be the full compliance calendar and checklist, but it would include any new regulatory or internal policy breaches and, the status of actions being taken on these and any prior breaches.

The report would also include an explanation of any new regulatory developments that will impact upon the organisation and how management are responding to these.

Examples of compliance reports and calendar are to be found in the accompanying tool-kit.

## **10.7 The CEO Report**

The CEO is accountable to the board and a formal written CEO report is expected at each meeting. However, it is important that this report is brief and to the point. In most cases, it would be no more than a two-page bullet point report highlighting recent major developments and those which are likely to arise in the near future.

## **10.8 Additional papers for Board approval**

Further MI may be required by the board in relation to any particular items that require specific board approval. These would be items that fall outside the CEO's range of delegated authority, such as unbudgeted expenditures, contracts, claims against the credit union and developments that fall outside the current strategic plan.

These papers should be brief (1 – 3 pages maximum in each case) and should outline the background to the item, an analysis of any costs and benefits involved, any regulatory and policy issues and the CEO recommendations.

## **10.9 Access to further MI outside of board meetings**

As already noted, all other MI including more detailed financial reports should be available to directors as background papers, usually accessed electronically. Also available and accessible should be communications from the regulator, trade associations and key suppliers that the board does need to see but which does not have to be discussed formally in meetings, although particularly important information from these should be noted in the

CEO's report. Directors should also see publications, literature and marketing materials, but not necessarily as agenda items.

## 11 Board organisation

### 11.1 The size and composition of the board

The size of the board is an important issue in credit unions in Britain and Romania.

Large boards can be unwieldy and hinder the active engagement of all the directors. They can also necessitate the formation of multiple sub-committees that can potentially undermine the central authority of the board. Boards that are too small may lack sufficient skills or be overly demanding on participants.

In Britain, the number of board members is not defined, but is held to be at least five, with no stated maximum. Legislation in Ireland states that boards should be seven, nine or eleven<sup>16</sup> persons. In Romania, boards tend to be made up of five or seven directors.

The elected board has to consider the specific roles or positions on the board.

### 11.2 The president or chair of the board

Traditionally boards have elected a president who is the chairperson; a vice-president who is the vice-chairperson; a treasurer and a secretary. However, these can be modified by a rule change. In Romania these positions are elected directly by representatives of the membership, rather than by the boards themselves (see section 13).

The role of a president requires special attention by the board. The approach to governance in this manual places a strong emphasis on the role of the chair of the board. The chair has the responsibility for ensuring that the board carries out its functions efficiently and effectively, and that management is held to account through the oversight and scrutiny of the board as a whole. The chair facilitates the credit union's governance process but remains always accountable to the board for any decisions taken. *The chair is not the commander of*

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<sup>16</sup> It can be good practice for boards to have an odd number of members as this avoids, if all board members are present, tied decisions on important matters, without the need for an additional casting vote of the chair.

*the board*, in any top down hierarchical manner, but directors owe accountability to the chair for their performance as a board member.

The system of governance has no overriding role for a president of the credit union; rather it focuses on the president as chair, leader and co-ordinator of the board who also acts as the primary liaison between the board and the CEO. The term “president of the credit union” gives a status to the chair that can ultimately undermine the central authority of the board. President has an executive ring to its meaning that is not implicit in the concept of a chair.

### **11.3 Executive and non-executive directors**

Another area for consideration is the issue of executive directors.

In Britain, in line with company practice more generally, and allowable under credit union regulation, the CEO and other senior officers, responsible for management, can be appointed (elected) as executive directors of the board; the rest of the board members then being clearly regarded as non-executive directors.

A number of British credit unions have executive and non-executive directors, a choice open to all credit unions. However, in most British credit unions, the CEO is not an executive director.

In credit unions where there are executive directors, in line with the co-operative principle of accountability to the membership, these directors should be presented for election at the AGM, every three years. However, executive director positions can be ring-fenced to those people employed and proposed by the board. Nevertheless, the membership should be asked to ratify the appointment as an executive director.

In Romania, all CEOs are executive directors of the board. However, there seems to be no examples of other senior staff members also being executive directors. At the time of the Fincare project, it was unclear if Romanian credit unions can appoint other senior members of staff as executive directors. In Romania, executive directors are appointed by the board and not presented for ratification or election by the membership.

## 11.4 Board meetings and agendas

The board of a credit union should meet at least monthly. In Britain, this is technically the guidance of the regulator rather than a rule. But it is guidance as to how the regulator sees credit unions ensuring that they have robust governance arrangements in place.

If a credit union departed from this guidance, and decided to have fewer board meetings, it would have to demonstrate how an alternative arrangement still satisfied the requirement to ensure a robust governance framework.

In Romania, all credit unions hold a monthly board meeting, which is a requirement laid down in the statutes of the credit union.

A typical board meeting agenda would include based on the reporting components set out in chapter 10 on monitoring performance:

- CEO's report
- Goals report
- Balanced scorecard
- Financial report
- Compliance Report
- Risk Register/Risk Report
- Specific papers for Board approval
- Information papers for the Board

The content and format of these items were discussed in more detail in chapter 10

If a board meeting takes more than 2 to 2.5 hours, it is probably discussing the wrong things and straying into a discussion of operational management.

## 11.5 The strategic planning cycle

As explored in Chapter 7, strategic planning is a defining characteristic of an effective board. This is dependent on a robust approach to a formal annual process or planning cycle undertaken sequentially throughout the year in board meetings. All board meetings should focus on strategic development and follow the strategic planning cycle. The steps of a formal annual planning process or cycle are explained in chapter 7.

The board's role in leading and maintaining oversight of the strategic planning process is fundamental to good governance and is at the heart of the governance system.

Given the time commitment involved, boards should schedule the strategic planning cycle into their annual calendar. The annual calendar should also include the schedule of the review of board policies as noted in Chapter 9.

## **11.6 The role of the chair in board meetings**

The chair should take control of meetings, ensuring that everyone who wishes to has a reasonable chance to speak and take part. She or he should be able to listen to and understand a wide range of views, present information clearly and concisely and get clarification of relevant points, thus enabling the board to make effective decisions.

The chair does not have individual authority to take decisions except insofar as consistent with board agreement or where explicitly directed. The chair should consider the performance of the board as a whole, and take relevant steps to make improvements where possible. It seems appropriate for each director to have an annual one-to-one discussion with the chair about their involvement on the board.

In undertaking the following responsibilities, the chair will be supported by other director colleagues and the CEO.

- The chair should lead effective meetings by:
- Ensuring that board decisions are made within the remit of the board's agreed policies
- Planning the annual cycle of board meetings, and chairing and facilitating these to ensure their smooth running
- Planning the agenda for meetings.

The chair will support the performance of the board by:

- Ensuring that succession plans are in place for all directors
- Ensuring that directors receive induction and adequate training to enable them to fulfil their roles
- Monitoring the calibre, level of commitment and attendance of all directors
- Ensuring that the board reviews its own work and how effectively it operates; making sure to take any corrective action required

- Checking that decisions taken at meetings are being implemented.

## 11.7 Other officers of the board

The system of governance places stress on collective responsibility and accountability of the board. Within this collective accountability, there are specific roles on the board that credit unions generally adopt over and above that of the chair. These are vice chair(s), treasurer, secretary as well as chairs of sub-committees.

As with role of chair, in Britain, these roles are elected appointments of the board. In Romania, where they exist, they are roles that are elected directly by the membership representatives.

### Vice chair

The role of vice-chair is usually to carry out the duties of the chair in the absence of the chair. Some credit unions have more than one vice chair to ensure absences are covered. This is not a mandatory role, but is recommended. The vice-chair can be given additional specific responsibilities e.g. member engagement.

### Treasurer

The treasurer role has a long history on credit union boards. In some British credit unions, the treasurer has been the de facto finance manager, dealing with aspects of financial management and producing the management accounts for the board and used by staff. However, in professionally managed credit unions, the treasurer's traditional role is now undertaken by the Chief Finance Officer or other finance staff.

Nevertheless, it is imperative that there is at least one director on the board with a specific and skilled finance orientation who can focus specifically on testing in detail the robustness of financial performance. This must not result, however, in other directors relaxing their level of attention to financial oversight and relying on the director with the role of finance, whether or not having the designation of treasurer. This is an avoidance of due accountability and a risk of dependency.

A means of ensuring robust oversight of finances is through a finance committee where the recommendation is that the chair of these committees has an accounting or financial qualification or background (see below)

## Secretary

The secretary has traditionally had an important role on co-operative boards. In general, the secretary is responsible for ensuring that board and general meetings held and conducted according to the rules and proper records are kept.

In Britain, it is the secretary who signs documentation and returns as required by the regulator, as well as contracts and other legal documents. It is a legal requirement that the secretary, appointed by the board, signs such documentation when required to do so.

## 11.8 Election and terms of office of board roles

The process of election to the board roles differs in Britain and Romania. In Britain, at the first meeting after the AGM, the board elects the chair, vice-chair(s) and secretary. These roles are ordinarily undertaken for a term of three years following election after appointment, although they still need formal appointment by the board after each AGM. The system of strategic governance recommends that a director only holds a particular office for a period of no more than two consecutive three year terms before standing down for at least one period of three years before re-election, or following the standard director term limits at the credit union, whichever is the shorter.

These officers may resign at any time, without necessarily resigning as a director at the same time. Of course, it is preferable if this is a managed process, whereby the officer signals well in advance their intentions. The board should have a succession plan in place for each board role. In Romania, these roles are elected directly by the membership at the AGM.

## 11.9 The use of board sub-committees

This authority to lead the credit union resides not with any particular board member or group of members, but only in the collective voice of the board, as determined in properly constituted meetings.

However, most boards find that they cannot cover all their business effectively in the monthly or regular board meeting alone. To ensure a level of rigour and depth of analysis in

the process of oversight and control, they find that they need to establish sub-committees to take responsibility for particular key areas of governance.

It is recognised that sub-committees can play a significant supporting role to the proceedings of any board. Sub-committees allow directors to explore issues in greater depth than is possible within the time constraints of the monthly or regular meeting and to reach considered conclusions that can inform the decision making of the entire board.

However, boards need to approach the establishment of sub-committees with some caution. For despite their evident advantages, they can lead to negative consequences. First, they can sometimes blur the distinct functions of governance and management, and secondly and more importantly, they can result in a reduced engagement of the entire board in issues that are properly its collective responsibility.

In order to avoid these two scenarios, boards need to clearly define the remit and purpose of sub-committees, set their terms of reference and levels of delegated authority as committees of the board, keep their number to a minimum and ensure effective processes of reporting and accountability to the board within its properly constituted meetings.

### **11.10 Recommended sub-committees**

Because sub-committees carry delegated authority from the board, there is a risk of diluting the board's engagement and sense of accountability if there are too many sub-committees, as well as draining individual director time and energy. In addition, board sub-committees should be focused on governance processes not management tasks.

For these reasons, where possible, boards should limit the number of sub-committees. The following are areas that are suitable for board sub-committees:

- Audit Committee, covering internal audit
- Finance, covering detailed financial review and policy guidance
- Risk, covering review of risks and risk management ( maybe combined with Audit into an Audit and Risk Committee)
- Nomination covering director nominations and succession (see 12.2 below)

- Remuneration (likely to be large credit unions only), covering remuneration of CEO and directors, possibly other senior management, and policy guidance for all employees

### **11.11 Chairs of sub-committees**

The chairs of these committees may be elected by the committee, but the appointment should be approved by the full board. Their role is twofold:

- To ensure the committee operates effectively and within its terms of reference
- To ensure that reporting to and consultation with the main board is appropriate and consistent with the terms of reference.

Chairs of these committees may also bring specific professional expertise. For example, some credit unions have mandated that the chair of the Audit Committee is a qualified accountant. HR or employment law expertise may be useful for Nomination and Remuneration Committees.

### **11.12 The remuneration of non-executive directors**

In Britain, only a small number of credit unions explicitly remunerate or pay non-executive directors for their services as a director, over and above the payment of expenses, loss of earnings or conference attendance. Directors are mostly volunteers, as they are in credit unions in the United States and Ireland.

In Romania, all non-executive directors are remunerated with a salary (honorarium).

In setting the remuneration of directors on credit union boards, it is important to bear in mind the following key points

- Credit unions and co-operatives generally offer very modest fees for non-executive directors, by comparison with the for-profit private sector in general. Credit unions need directors who share the values and principles of co-operation and who are not there solely for remuneration.
- There is a difference between paying a ‘going rate’ for relevant skills, knowledge and experience to professional non-executive directors drawn from the market and

irrespective of their being a member of the credit union, and the remuneration of directors to recognise and respect the commitment of taking on director responsibilities. The former would be a higher rate of remuneration than the latter.

- Remuneration is best not to be dependent on attendance at meetings but should be accompanied by a robust performance appraisal.
- Transparency to the membership in a co-operative is essential, and remuneration rates should be published openly. Members should agree remuneration rates in the AGM.

## 12 Strengthening credit union boards

### 12.1 Knowledge, competence and experience of directors

The effective development of credit unions in the modern competitive market place depends on a high level of director capability and competence in governance, much greater than may have been found on many traditional credit union boards in the past.

Director capability and competence will be increasingly emphasised by regulators in Britain, Romania and elsewhere, particularly in relation to larger credit unions. This could involve directors having to increasingly demonstrate that they have the qualifications and experience to serve on the board of a credit union.

Each credit union must decide its own list of essential and desirable skills and competencies as they apply to its own context and situation. However, a typical list of essential director competencies would be ability to:

- demonstrate a commitment to credit union ethics and values;
- understand the business of delivering financial services within a competitive market environment;
- interpret financial statements and assess credit union financial performance;
- identify the nature of risk and how it is mitigated and controlled;
- demonstrate an understanding of credit union legislation and regulation;
- think critically and independently, to ask questions and challenge assumptions;
- be a team player, to respect confidentiality and collective decision making;
- to act in the best interest of the credit union and its members.

Desirable skills and competencies may, for example, refer to particular expertise in such areas as strategic planning, internal control and audit, risk, remuneration, and board/management relations.

New directors to the board may not in every case be able to demonstrate that they possess all the essential skills and competencies. It may be sufficient that they are able to demonstrate an ability and willingness to acquire the skills that are missing.

On some boards, directors are sought with expertise or competence in legal affairs, money laundering, compliance, marketing, IT or HR, which in larger credit unions would be management responsibilities. However, in these circumstances, directors offering management advice must do so in an individual not a director capacity and conscious of the preeminent role of the CEO in managing the business

## **12.2 Specific competencies required to fulfil particular roles**

The board will also need to clarify the specific competencies required to fulfil particular roles and positions on the board, such as the chair of board and chairs of constituent committees. Certain desirable competencies may become essential when fulfilling a particular role.

A clear definition of the skills and competencies for selection as the chair of the credit union is required in all credit unions. The accompanying tool-kit includes a statement of the roles and responsibilities of the chair. This would need to be accompanied by a person specification indicating the essential leadership and organisational competencies required to undertake the role.

## **12.3 Board and director evaluation**

A systematic approach to recruitment and succession planning starts from an analysis of the needs of the board and of how and where it needs to be strengthened. This involves evaluations of individual director contributions and of collective board performance. Such evaluations not only identify which skills and competences need to be retained and enhanced into the future, but also those which are weak or lacking on the board.

It is on the basis of knowledge gained through evaluation and assessment that boards can identify which kinds of people, with which kinds of skills, competences and levels of experience, need to be recruited to the board to fill gaps or replace people leaving through the ending of their term of office. Such evaluation also identifies those people who need to be retained.

It is a principle of governance that boards should attend to the evaluation of individual director and collective board performance. Many directors and boards have served for years without any systematic or direct appraisal of their contribution. Just as with any other aspect of a credit union's performance, the board and the directors need to be assessed from time to time, to ensure that they have the requisite skills and knowledge, diversity and representation of the membership, and that they are making the necessary contribution.

The UK Corporate Governance Code 2014 requires that: “[A] board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.” This enables boards to put in place actions to improve performance, such as director development plans, recruitment of new skills (directors) or even retirement of existing, non-contributing directors.

If a CEO is an executive member of the board then he or she should be assessed alongside other directors in their specific directorial capacity. Performance management of the CEO as the senior staff member is discussed in Chapter 5.8.

## 12.4 Principles for evaluation

The following principles are recommended in approaching evaluation:

- The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted
- Evaluation may in general be internally conducted, but if possible there should be an externally facilitated review at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the credit union
- The evaluation should be made available to the regulator, following any visit or general request for information

- Ensuring arrangements are in place is a responsibility of the Nominating Committee, or failing this, the chair (although there can be risks to placing this on the chair in terms of conflict of interest), with the administrative support of the CEO / staff team
- All evaluation activity should respect confidentiality, so that participants feel able to be open and honest.

## 12.5 What is to be evaluated?

Evaluation should address the effectiveness of the board as a whole, the contribution of individual directors and the performance of specific officer roles such as chair, treasurer and secretary. It is vital that in general, but specifically in advance of any evaluation, every board member clearly understands his / her responsibilities. Directors should have a documented set of responsibilities and / or a role description. This provides a baseline for individual and collective performance evaluation.

What are being evaluated are such issues as:

- Is the board meeting all of its responsibilities?
- Are all the right components of good governance in place?
- Is the contribution and commitment of directors at the required levels?
- Does the board work effectively as a team?
- Is there clarity of purpose and direction?
- How does the board enforce its accountability to members?

Therefore the issues to be assessed by a board evaluation should include:

- Development of strategy, and the monitoring of strategy and performance
- Balance and level of skills and competencies on the board, including financial literacy
- Quality of communication within the board and with staff
- Board processes and procedures, including the effectiveness of meetings and decision-making, and the suitability of reporting and information
- Governance processes.

It is important that the assessment of board effectiveness focuses primarily on processes. The team-working aspects must be covered, but this can often be a “comfort zone”

for discussion, when the aim should be to test whether the right processes are in place to achieve the board's objectives, such as effective provision and scrutiny of management information.

## 12.6 Evaluation mechanisms

There are three potential approaches to evaluation mechanisms, which have different relevance to the assessment of boards and individuals:

- **Personal:** self-evaluation of a director's contribution to the credit union board, for example to develop professional development plans
- **Peer:** individual evaluation of the performance of peers and the group, to ensure high performance standard and potentially to establish performance criteria for re-nomination for election to the board. This may adopt a 360 degree feedback approach.
- **Collective:** group evaluation of group performance, to ensure high performance standards.

The self-evaluation approach is the most common. This invariably involves a questionnaire that asks individual directors to rate their competence and performance against a range of criteria. This is usually a numerical rating. It generates a picture of an individual's view of himself or herself that can be helpful for the individual in planning their development.

This method can be extended to evaluate board performance as a whole, i.e. the questionnaire asks an individual to score the board's performance on a range of measures. This offers board members a framework for providing feedback to their colleagues as a group on how they believe the board is performing. By looking at average, high and low scores, it is possible to see where there is relative consensus or a broad range of views. An example template tool for self- evaluation is to be found in the tool-kit.

It is important that if individual scores are collated, anonymity is preserved where possible, in order that people feel confident they can be honest and objective. Peer or 360 degree evaluation takes these questionnaire-based assessments a step further – it asks directors to score other directors This can be done broadly, i.e. everyone scores everyone else, or more focused, e.g. just scoring the key office-holders.

The advantage of a 360 degree process is that it provides an alternative perspective. For example, a highly self-critical chair lacking in confidence might score his or her performance quite low, but find it valuable to discover that the other board members are more positive.

Commenting on the performance of others is much more challenging than self-appraisal. Boards should be seeking an environment where there is sufficient honesty, openness and trust that constructive feedback is an accepted and constant feature of board interactions.

Group evaluation involves direct, face-to-face discussion, whether through dedicated time at a board meeting or a separate workshop. It will tend to demand external facilitation to be effective. It is recommended that this form of evaluation takes place as a follow-up to the questionnaire-based evaluations, so that discussion can focus on data, rather than get caught in observations from individuals that are contested.

## 12.7 Evaluation delivery

These tools can be used by boards themselves. There are advantages, however, in using an external facilitator, in particular for peer or 360 degree feedback and group discussion, as noted above. These advantages include:

- Professionals can be experts in discerning messages that might not clear from the base data and they may observe more effectively body language and other non-verbal or questionnaire-based cues.
- They are independent, and therefore can deliver with less complication messages that directors might be uncomfortable to give or receive.
- They will bring fewer pre-conceptions to analysis of data and of discussion.
- With less of a stake in relationship-building and management with directors, they should be fully focused on keeping discussion on track for action-orientated outcomes.

The final outcome of an evaluation process should be a board report summarising the strengths and weaknesses of the board, and making recommendations regarding some or all of the following, as appropriate:

- Collective development and training
- The appointment of new directors
- The resignation of directors from the board or specific roles.

Individual directors should primarily focus on addressing feedback on their performance as directors and updating their personal development plan as necessary.

## 12.8 Toolkit materials

Sample evaluation materials have been developed and are included in the accompanying toolkit. These are:

- A spreadsheet template for an annual self-assessment, comprising a board performance evaluation, a director (i.e. self) performance evaluation and a training needs assessment
- A Word document template and sample online survey for a quarterly assessment.

## 12.9 Board and director training and development

Effective director and board evaluation should inform the credit union's board and director training and development programme. Credit unions that succeed operate as learning organisations and ensure that their directors and staff develop their knowledge, skills and competences in response to a changing financial market and regulatory environment.

In all credit unions, in Britain and Romania, there is a need for professional approaches to the development of training opportunities on offer for boards and board members.

Board and director training and professional development are at the heart of good governance and all credit unions need to consider how they can implement training and development individually or collectively as part of the national credit union movement.

In Romania, U.N.C.A.R.S.R. takes a lead in professional director development, in which credit unions need to engage. Trade associations in Britain undertake the same role. Directors are often busy people and sometimes consider that they do not always have the time to undertake training. Educational and training programmes need to be designed so that

directors see the value of training and are sufficiently flexible so that they have the time to attend. In Britain, credit unions in ABCUL have access now to an online training programme for all directors and staff members.

## **13 Director recruitment, nomination and election**

### **13.1 A strategic approach to director recruitment and succession planning**

A well-functioning and competent board of directors is critical to credit union success, and its strength must be planned, developed and managed. Central to board planning has to be a consideration of the recruitment of new directors and of the succession of those currently serving. If recruitment and succession is left to ad hoc opportunity, chance or even to the social and business connections of existing directors, boards are in danger of failing to ensure that they possess the required range of skills and competences to oversee the credit union in the interests of the membership. At worst, they become closed, undemocratic, organisations controlled by groups of friends or acquaintances.

There are eleven key elements, all of which have to be in place to ensure a coherent, integrated and strategic approach to director recruitment and succession planning. It is argued that these key elements are equally relevant in Romania and in Britain. The eleven elements of a recruitment and succession planning strategy are:

1. Definition of the purpose of the board of directors, including a statement on the roles and responsibilities of directors and a director job description.
2. Definition of the size and the composition of the board.
3. Identification of the skills and competences required of directors.
4. Identification of the specific competencies required to fulfil particular roles.
5. A system of director and board evaluation.
6. The introduction of term limits.
7. The effective use of a nomination committee.
8. An agreed approach to co-options, observer and independent advisor participation.
9. A recruitment and succession action plan

10. Transparent, clear and democratic election procedures.
11. A system of induction of observers, co-optees and elected board members.

### **13.2 The nominations or search committee**

Credit unions may appoint a nominations or search committee to manage the process of finding and recommending people for election and to develop and oversee a recruitment and succession strategy over the longer term.

The nominations committee is appointed by the board to ensure that only skilled and competent people are put forward for election or re-election to the board. Assessment of competence must be undertaken through a process of evaluation against the set criteria of essential and desirable competencies for directors as determined by the board.

The nominations committee must act in an impartial and objective manner, and must be assured as such by the board. To this end, best practice would indicate that the chair of the nominations committee should not be the chair of the board, nor should the committee include directors whose positions are up for re-election at the next AGM.

The remit of the nominations committee and its constitution must be decided by the board and documented and its membership reviewed by the board each year. The nominations committee is an important part of the governance process and it is significant to note that it is now required by law in Ireland.

In Romania, where boards are also responsible for selecting the voting representatives at the AGM, the nominations committee could also ensure that such representatives have the required skills and commitment to the credit union (see 13.3).

### **13.3 Election by the members at a general meeting**

The process of election of directors is different in Britain and Romania, insofar as in Britain each member has a vote at the AGM whereas in Romania, there is a system of area member representatives who vote on behalf of a group of members. The board has the responsibility of selecting those representatives.

But in both Romania and Britain, it is important that the people put up for election as directors have been assessed and deemed competent by the nominations committee.

In the past in Britain, it was possible, if there was a vacancy on the board, and nobody had been nominated and seconded in advance of the meeting, that someone could be proposed from the floor of the meeting. It is strongly recommended that practice no longer be accepted.

To accept nominations from the floor leaves a credit union vulnerable to people without the requisite skills and competencies being elected to the board. However, it could be objected that the removal of the possibility of nominations from the floor could leave the credit union equally vulnerable to a too powerful nominations committee which, if acting in collaboration with the board, could institute a self-perpetuating clique on the board.

### **13.4 Nomination by petition**

To counter this danger of cliques, many British credit unions have adopted a system utilised by Federal credit unions in the United States. In this system, nominations for election to vacancies on the board may also be made by petition directly from the members.

The petition needs to be filed with the credit union at least 90 days before the general meeting and signed by at least one per cent of the members, with a minimum of 20 and a maximum of 500. For example, in a 14,500 member credit union, a petition would have to be signed by 145 members before the nomination could be presented to the AGM for election.

Nominations by petition do not have to be agreed by the nominations committee or the board to be moved for election at the AGM.

This may be a practice worthwhile adopting also in Romania to ensure that credit unions do not become controlled by a self-perpetuating group of people.

### **13.5 The issue of term limits**

Increasingly in Britain credit unions are considering the advantages of term limits for the positions of directors and chairs of the credit union.

Traditionally in Britain credit union directors serve a three year term of office and then present themselves for re-election. This process can continue indefinitely with the result

that often boards are comprised of many of the same people over many years. In some cases, directors are re-elected continually and serve 20 or 30 years in the same credit union. It appears that this can happen in Romania as well,

The same process can take place with the chairs of the board who, with continual re-election, can serve many years in the same position.

This practice can bring benefits of continuity, but credit unions are concluding that it has more disadvantages than advantages. It can lead to self-perpetuating boards becoming fossilised in time and can result in a lack of drive and commitment to seek out new competent and imaginative people to serve on the board.

Term limits mean that directors must resign after the stated period of time. Some British credit unions have introduced a director term limit of three periods of three years. After that period, nine years, the director must leave the board. It can be that a director could present for re-election after a one or two year period of absence. The period of term limits and the time that needs to be elapsed before a director is eligible to stand again for election, is set by the board.

In some jurisdictions, director term limits have been introduced by legislation. In Ireland, by law, from March 2014, a person may not be appointed or elected to the board of directors if they have served more than 12 years out of 15 years in aggregate either as a member of the board of directors or the supervisory committee (the internal audit committee).

The introduction of term limits can have a significant impact on recruitment and succession strategies, as boards have to plan in the clear knowledge that the current board cannot carry on indefinitely into the future.

The objection that term limits could result in the loss of directors with important skill sets could be countered by credit unions introducing term limit waivers. Normally this would mean that a majority of the board in secret ballot, perhaps with a two thirds majority, could extend an individual's period of office for a further term. However, indefinite extensions would possibly lead to the same kind of problems term limits were designed to solve.

### **13.6 Co-options and observer participation in board meetings**

It is recommended that candidates for co-option to the board when a vacancy arises prior to an AGM be subject to the same assessment process by the nominations committee as candidates proposed directly to the AGM. The nominations committee must review all potential co-optees to the board against agreed competency criteria.

### **13.7 Recruitment and succession action planning**

It is recommended that the nominations committee has the responsibility of the development of a recruitment and succession action plan. The committee is in control of the assessment of applicants, but those applicants must be found and encouraged to apply for election in the first place.

The action plan would address such issues as making information on directorships available through social, business and community networks. However, applications should be encouraged directly from the membership, and all members should know that they can put forward people for nomination and election, even though all applications have to be assessed by the nominations committee against standard criteria. Directors who are recruited outside the membership must become a member of the credit union to be eligible for election.

Of particular importance in the recruitment action plan are issues concerning equality. The action plan will need to address issues such age, gender and race among director representation on the board. The aim is that board composition should reflect the nature of the communities the credit union serves.

### **13.8 Transparent and clear nomination and election procedures**

Transparency and clarity in nomination and election procedures is critical to good governance. It is the responsibility of the board to set out, agree and publish the processes and procedures for nomination and election. It is recommended that all credit union websites have a page on the board of directors' nomination and election process.

## **13.9 Induction of co-optees, elected board members, observers and independent advisors**

Good governance entails an effective system of induction for all co-optees, elected board members, board observers and independent advisors on board committees. Each board would need to decide its own system of induction but it would normally involve furnishing new people with a standard set of documents, arranging one-to-one induction meetings with the chair, CEO and any other directors or officers deemed appropriate and the offer of a training programme in various aspects of credit union governance.

## **14 CEO recruitment and professional development**

### **14.1 The process of recruitment and selection**

The term CEO is used to characterise the senior staff member who has the delegated authority of the board for running the credit union's business. This term is used because it has strategic connotations that are lacking in the term "manager". In Romania, the CEO is an executive director of the board, a role also played by some CEOs in Britain.

The CEO is accountable to the board for the management of the credit union, for the implementation of its strategic plan and for achieving the objectives set by the board. To do this, the board delegates executive authority to the CEO who, in turn, re-delegates authority and responsibility for aspects of the business to other senior managers and staff members.

The CEO role is therefore critical to the success of the credit union, and it is the responsibility of the board to define the role of the CEO, appoint an appropriate individual to that position, manage their performance and ensure that a succession plan is in place for their eventual retirement or other departure.

The role and responsibilities of the CEO, and the relationship of the CEO to the board, are outlined elsewhere in this manual. This section considers the board's responsibilities in recruitment and performance management of the CEO, and succession planning including contract termination. It seeks to cover issues from a board perspective, not in relation to operational management procedures.

Boards should if at all possible take professional advice through an appointment process. This might be from lawyers with employment law expertise or HR professionals.

## 14.2 Expectations and job description

The board appoints a CEO to bring dynamism, passion and drive to a credit union and to develop its vision and strategy. The first requirement for the appointment of the CEO is for clarity and agreement about what is expected of the post-holder.

There are standard expectations of a CEO, such as the business disciplines of strategy, management and organisational development. Each credit union, however, will have different emphases given its current situation and future strategy. For example, if the credit union is expanding rapidly and taking on numbers of new staff, it may want someone with considerable experience of building strong teams. If it is unclear about its future direction, it may need extensive strategy or business development skills.

An example job description for a CEO is to be found in the tool-kit.

Often a job description is accompanied by a person specification and, for a CEO, personal features and characteristics sought by credit unions are:

- Leadership direction and purpose
- Insight and creativity
- A strong sense of credit union values and principles
- An aptitude to work collaboratively
- Good communication skills
- The ability to think strategically and plan ahead
- A commercial and entrepreneurial orientation
- An understanding of the credit union business
- Technical skill in financial and organisational analysis
- Organisational and negotiating skills
- An ability to delegate and to inspire commitment and enthusiasm among the staff
- If relevant, the skills and experience to perform the role of board director.

### 14.3 Thinking about succession planning

Because of the key role of the CEO in governance, boards need to plan ahead for how they will go about appointing a new CEO when that becomes necessary. Through its chair, a board should stay in communication with the CEO regarding that individual's plans and intentions, so that the board can start detailed recruitment planning once they know the incumbent has decided to retire or move on to another job. A credit union should have a CEO succession plan that is reviewed and updated annually or even sooner if the credit union's circumstances change materially. The succession plan should include three components:

- **Executive Development Plan**

In general, successful organisations of all types aspire to recruit from within when it comes time to appoint a new CEO. As a practical matter, this simply may not be feasible for a very small credit union. However, in a credit union large enough to have a second level senior management team, it is wise for the board to assure itself that there is a training and development process to prepare one or more of the management team as the CEO's potential successor. It is good practice to encourage the CEO to have a qualified successor in waiting as this helps to assure continuity if the CEO retires or moves on to another job. It also makes for a much less risky transition in the event of the CEO's sudden death or disability. (Of course, no commitments should be made to such an individual except as part of a board-approved contractual succession process, under professional advice.)

- **Contingency Succession Plan**

Secondly, the board should confidentially document a "contingency succession plan" that will maintain business continuity in the event of the CEO's sudden death or disability. This part of the plan should be developed by the CEO together with the chair (and/or the board) to identify in advance the senior staff member (or possibly a director or other individual) who can step in immediately to serve as interim CEO until the permanent successor is chosen. Having this in place is an essential element of the credit union's overall disaster recovery and business continuity planning.

- **CEO selection process**

Lastly, the plan should describe how a permanent successor CEO will be selected. Because of the unique nature of this role, the CEO succession plan needs to reflect careful consideration of the following:

- A clear statement of the leadership needs of the credit union in the future, and how this affects the existing job description. A key part of the annual review of the plan is the board's consideration of how the job description should be amended in light of changed circumstances.
- The minimum and desired qualifications and experience that will be required of the new CEO, based on the foregoing.
- The specific salary range to be advertised, along with the standard employment benefits of the credit union (plus any that may be unique to the CEO.) As already noted, this should be based on a periodic review of market conditions.
- The degree, if any, to which the incumbent is involved in choosing a successor. Of course, the actual choice of a successor is solely the board's prerogative. However, when the current CEO is retiring, for example, and the board considers the credit union to be running on a smooth track, it may be highly desirable to closely involve the departing CEO in every step of the process. On the other hand, the board may choose to narrowly limit the departing CEO's involvement if it concludes that the credit union needs to transform itself under new and very different executive leadership.
- Whether or not an outside recruitment specialist should be retained to assist in the process. It is beyond the scope of this manual to discuss all the pros and cons of retaining such a resource. However, in general, the board should carefully consider the advantages of having professional assistance with the practical steps involved in the recruitment process (e.g. preparing legally compliant advertisements, seeking out potential candidates the board would not otherwise know about, access to benchmarking data on market salary ranges etc.) as well as the impartial perspective that a recruitment

professional can bring. While engaging such a consultant can involve significant expenditure, its cost pales when compared to the cost of getting the CEO choice wrong.

- The details of the search and interview process will depend on the degree to which an outside professional will be employed. If tasked with conducting the initial interviews, the professional will presumably be expected to then pare down the candidates to a short list. Those finalists should then be interviewed by a panel of directors, which should include the chair, given the future working relationship, and it might also include the recruitment professional, if there is one. Whether the panel includes the current CEO is very much a case-by-case question, as already discussed.
- Since the CEO should be encouraged to develop an internal successor if practical, there may be an identified, preferred internal candidate. In this instance, there should still be a formal interview process – it ensures that the appointee starts from a ‘proven’ position, and it helps directors to test their expectations of the individual against the job description and establish any areas for development. However, the question of whether to precede that final interview with a competitive search and interview process is very much a different matter. If there is only one fully qualified internal candidate whom the board plans to hire in any event, conducting what might later be characterised as a ‘sham’ search process could expose the credit union to legal claims by unsuccessful candidates. If one of those unsuccessful candidates is already a member of staff, the risk is even greater, and in any event, the new CEO might then inherit an unhappy subordinate and all the problems that can entail. It may also be difficult to retain qualified internal successor candidates if they believe they will be given no more consideration than an outsider upon the CEO’s departure. If in doubt on the relative risks involved, directors may wish to seek professional advice.

- Finally, the selection panel should present its recommended candidate to the full board for its approval of the final appointment decision.

## 14.4 CEO retention

Given the importance of the CEO role, it makes sense for a board to consider actively how to retain an effective employee in post. Obviously, competitive factors affecting the attractiveness of salary and other remuneration will be important to this. Beyond the cash components, there are other actions that a board can take to incentivise a CEO and strengthen their performance for the credit union, such as:

- A structured training and development plan
- A separate mentoring / coaching arrangement for the CEO
- Effective and clear delegation and escalation of responsibilities, so that a CEO can feel empowered to get on with the job
- Ensuring the critical role of the CEO in relation to the board is properly documented and actually reflected in how the board operates
- A robust performance management system by which the CEO is given clear authority, objective measurement of performance and progress toward goals, and on-going feedback and encouragement.

## 14.5 CEO performance management

It is a truism for all organisations that providing employees with understanding, recognition and appreciation for jobs well done are more important to retention than cash compensation and benefits. In practice, this translates into the need for robust performance management systems.

It is the CEO's job to manage the performance of the rest of staff. Only the board can provide performance management to the CEO.

The board relies on a capable CEO to contribute to the vision, culture, strategy and direction of the credit union, to provide accurate data and information on which the board can exercise sound judgement and make informed decisions, to manage effectively the operations

of the credit union, and to ensure that the credit union achieves its objectives as agreed by the board.

The CEO's performance is measured ultimately by the performance of the credit union against its strategic plan, within the constraints of board policy, legal compliance and ethical practice. All other interests and contributions are secondary to the achievement of credit union objectives. In monitoring these objectives, quantitative measures such as membership and financial indicators can predominate. Important qualitative considerations need to be included in the strategic plan and monitored accordingly. These measures might include organisational culture and employee retention, support and training. To the extent that these objectives are a part of the culture of the credit union, they may be embedded in board policy rather than plans. They would therefore still be a benchmark for performance.

If the board is clear about its performance expectations and objectives, is clear about CEO accountability, authority and responsibility for delivering on those objectives and if monitoring confirms that the CEO is achieving those objectives, the CEO is doing everything that is required.

Whilst the objectives for the CEO are clear – assuming these are set out in the strategic plan – effective performance management requires more than full board discussions of performance against target. These discussions must necessarily be focused on collective business issues, whereas there need to be occasions for specific focus on the CEO's personal contribution and impact, expressed through business performance.

The performance management approach to the CEO should as a minimum include:

- An annual training and development plan, agreed with the chair (or another nominated director) that aims to support the CEO's ability to deliver the objectives through the year.
- Quarterly reviews with the chair to consider the CEO's personal impact on the credit union. The chair is well advised to seek informal input from the other directors before each review session.
- At least at the end of the year, these meetings should be formal appraisals, with one or two directors additionally in attendance, using an agreed performance assessment

format. The results should be documented in writing and reported to the board, along with any accompanying actions.

There are various formats for documenting the formal appraisals. The board should consider utilising a form that documents the CEO's performance in the following areas:

- Objective measurement of performance against board-approved metrics, as reflected in the scorecard and other documentation of performance against objectives.
- Measurement of the CEO's performance of any individual goals that have been assigned by the board (e.g. completion of the CEO's personal development plan, progress on projects specifically assigned to the CEO, such as exploring merger possibilities, etc.)
- The CEO's compliance with board policy and legal requirements (primarily included for purposes of documenting when this has not happened).
- Subjective feedback on how the board assesses the CEO (e.g. how well the CEO has kept the board informed, how effective the CEO has been in providing strategic leadership or in building the staff team, and so on).
- Lastly, if applicable, a listing of any specific steps (or outcomes) the CEO is expected to take (or achieve) as a result of the foregoing.

Whilst the CEO's objective performance against strategic plan and other board-prescribed objectives should be of greatest importance, the unique role of the CEO requires that the CEO also enjoys the board's confidence and trust. To the extent the board is satisfied on any of these counts, the CEO should receive the positive re-enforcement that comes from recognition and appreciation.

However, if the board is unsatisfied on any of these counts, it is equally essential that the nature and reasons for that dissatisfaction be communicated to the CEO as clearly and unambiguously as possible.

## **14.6 The CEO contract of employment**

An appropriate employment contract is an important arrangement. The board should prepare this with professional legal advice and assistance: the details of how a CEO's

contract might be framed are beyond the scope of this manual. However, a few general observations on establishing and terminating the CEO's employment contract may be helpful.

The skills and experience to be recruited through the CEO may vary, depending on the stage of the credit union's development. Boards may want to consider offering a fixed term contract aligned to the strategic plan, such as a term of three years, for example. This gives a clear timeframe to plan for change, if required.

Given the pivotal role of the CEO, it is vital that boards retain flexibility within the contract of employment to terminate the CEO's employment when the CEO no longer enjoys the board's full trust and confidence. This may not be to do with competence or integrity, but could be a profound difference of view on the future direction of the credit union. If the relationship between the directors and CEO breaks down irretrievably, it will be impossible for the CEO to perform the role effectively. This may occur even if the business plan objectives are being generally delivered.

In these circumstances, it is important that there is the possibility of an adult, 'no fault divorce' between the parties. A suitable clause within the employment contract should be included. This will also need to address terms for appropriate compensation for loss of office. Boards should take professional advice in drawing up the employment contract with the CEO, and include this requirement.

This type of 'employment at will' contract is standard practice in other industries, both private sector and community-based, and it is particularly common in financial services companies. It recognises the unique role of the CEO, and is intended to avoid damaging and prolonged legal disputes. Without the ability to end the employment relationship on such a "no fault" basis, the credit union is exposed to considerable financial and reputational risk when the board concludes that it must replace an incumbent CEO in whom directors no longer have confidence.

In the long run, a one-off payment is likely to be far less expensive and disruptive than the litigation that often results because the terminated CEO is seeking reasonably to protect her / his reputation and the board is seeking, also reasonably, to employ a new CEO who will have their trust and confidence.

This kind of individual contractual arrangement may well mean that the CEO is not employed on the terms and conditions that are standard for other staff and this can be uncomfortable for credit unions (and sometimes CEOs). The CEO role, however, is different from other jobs in the credit union and this approach reflects that reality.

## **14.7 Considering remuneration**

The board also needs to consider what it is prepared to pay for the role. It is important that boards do not assume that the remuneration for a new CEO is simply the same as the last post-holder, especially if the dimensions of the role or the credit union are changing.

Boards should endeavour to understand the market for the skills they are seeking to appoint: if similar jobs attract higher pay in other places, it will be hard to incentivise candidates from other organisations to leave or talent from within the credit union to stay, even bearing in mind the advantages a credit union may have in terms of its values and culture.

If a board feels it does not have the budget to offer ‘the going rate’, it should look very hard at its other spending priorities and identify where enough savings can be achieved so that the credit union can afford the CEO it needs. The ‘cost’ of getting the CEO appointment wrong can make it the most expensive decision a board is likely ever to make.

## **14.8 CEO training and professional development**

It is important that the board, through the chair or other nominated director, agrees an annual training and development plan that aims to support the CEO’s ability to deliver the objectives through the year.

The CEO needs to be given space and time to develop his or her own skills and competences in the interests of the credit union as a whole.

## **14.9 Handing conflict between the board and CEO**

Rarely, a board may discover that the CEO has so egregiously violated a policy or legal requirement that immediate disciplinary steps, including termination, must be taken.

But in the far more common case where a CEO is simply not performing, it is critical as an ethical as well as a legal matter that the board's decision to terminate the CEO comes as no surprise to the CEO. Long before things reach that point, the CEO must be given a clear understanding of where performance is viewed by the board as unacceptable and what must be done to correct the deficiency. That is why the formal assessment process described in the previous section is so essential.

Accordingly, good practice in recruiting, managing and retaining a CEO must be combined with good practice in planning and preparing for the possibility of involuntary termination of the CEO's employment.

## **15 Accountability to the membership**

Credit union boards in Britain and in Romania are ultimately accountable to the members. It is the members as owners of the credit union who elect the board in general meeting and who have democratic authority over the rules and the purpose of the credit union.

But members are not just owners of the credit union; they are also its customers. This adds a dual dimension to board accountability - boards are accountable to members both as owners and as customers of the credit union. In relation to ownership, the board is accountable to the members for the safety, soundness and long term stable development of the credit union as a co-operative financial institution. In relation to custom, a board is accountable to its members for the quality of service they receive, which includes the dividend or interest on savings and the availability of suitable loan products.

### **15.1 Accountability to members as customers**

Board accountability is more tangible in relation to members as customers than as owners, as the board must ensure that the credit union gives its members a good deal on financial services. It is accountable for the credit union offering real benefits and added value to members/customers and contributing to their financial resilience, health and stability.

Board accountability to members as customers is more complex and challenging than the straightforward accountability to shareholders in a public limited company (PLC), set as it

is by the dividend and share price, both of which are equal for all. In a credit union, there are so many ways of returning value to members that there is always the possibility that some members will be more advantaged than others. A simple example is the pricing of loans compared with the interest or dividend given on savings – for boards the question is what deal do borrowers get in comparison to that of savers.

The real challenge for board members is to weigh up the competing wants and needs of the members and to achieve a balance that is equitable for all. The board is accountable to the members as customers for the policy guidance and decision making authority it gives to the CEO on the design of products and services for the membership as a whole.

## **15.2 Accountability to members as owners**

It is the members as owners who appoint the board at the AGM, and to whom the board is directly accountable by credit union constitution and legislation. Whilst the board in turn delegates management authority to the CEO, the board is accountable first and foremost to the members who elected it in the first place.

There are common challenges to the reality of this accountability, however. Frequent issues that arise among British credit unions, often in combination, include:

- Members' understanding of their status and rights as owners of the credit union can be weak.
- Treating members solely as customers, and referring to them as such, dilutes the awareness and reality of ownership within staff and membership.
- The level of active democratic participation in the form of voting on important issues can be low.
- Information to members as owners of the credit union is limited to reports furnished once a year at the AGM, so members have no sense of performance in between AGMs.
- Challenges to the value or authority of the AGM, such as

- Attendance is very low as a proportion of the membership, reducing the moral authority of the AGM and potentially the representative nature of the attendees in relation to the full membership.
- Little or no scrutiny of the board by the membership present at the meeting, and questions that do arise often concern customer issues rather than ownership concerns.
- Attendees nod through appointments to the board. Contested elections are rare.

It is undoubtedly the case that similar issues arise in Romania, despite the fact that attendance at the AGM is by representatives of the membership rather than the members themselves. These representatives tend to be chosen by the board rather than elected by members in their constituency, a reality that must dilute member democratic oversight of the credit union.

Weak oversight and democratic control by the members can risk the safety, stability and purpose of the 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.

Engagement with members as owners can create goodwill, contributing to a stronger member bond and a more resilient credit union. This is at the root of the credit union (co-operative) advantage: the customers are also the owners. In contrast to private companies, in co-operatives there is no inherent conflict of interest between owners and members because they are the same.

If the member-owners are not effectively engaged, however, risks can emerge. These can include:

- A conflict of interest between owner members and the staff, where – notwithstanding the best intentions of the latter – the credit union's approach can be focused on staff needs
- The challenge of treating members 'equally'. The benefits of ownership can come back to members in many different forms, such as lower cost loans, higher rates on savings, low or no transaction charges. Boards must provide guidance to management

on how to balance the benefits out, so they are fair and in some way equal, and owner member engagement – ideally, active endorsement – on this approach is important.

If directors are to be accountable to members, they will first have to build awareness among the staff team and the membership as a whole that members are owners as well as customers. This depends on having an effective member engagement strategy, which requires action on three key dimensions:

- **Information, transparency and disclosure** – sufficient volume and relevancy of information to ensure members are both informed about their organisation and engaged and stimulated
- **Meaningful democracy** – the role of the AGM, and action outside the AGM
- **Communication and participation as owners** – which is different from ‘member as customer’ communications.

### 15.3 Information, transparency and disclosure

Many people join credit unions primarily, or even solely, to gain access to financial services. Relatively few are attracted primarily by the co-operative ownership structure. All new members, therefore, must have their rights and responsibilities explained to them together with the governance structure of the organisation they now co-own. This is best done verbally by a member of staff, but, for those credit unions have online membership applications, it can be done through a brief summary of membership rights and responsibilities to be read as part of the online process.

Members-owners cannot engage in contributing to the credit union unless they have the relevant information at their disposal. Disclosure includes making available for the membership as a minimum:

- The rules of the credit union
- A fully documented annual report including audited accounts
- A management discussion and analysis report on the credit union’s financial and operating results
- Background information on directors and their qualifications and experience

- Attendance records of directors at board meetings.

In very large credit unions, the salary of the CEO and other senior managers may also be disclosed.

These are the basic components that enable member owners to interrogate effectively the performance of their credit union, primarily through the AGM. Members need to feel they have a measure of control and influence. One means to achieve this, is to publish a summary of the strategic plan for discussion at the AGM. In this way, the members are given an opportunity to see how their credit union is being directed for the future.

## 15.4 Meaningful democracy

Boards should consider the opportunities for members to be directly consulted on significant decisions. The AGM is the most obvious opportunity, but need not be the only means to do this. As outlined above, members attending AGMs should have access to relevant information. Most credit unions provide the annual report and accounts, some commentary on the credit union's performance and information about the directors. A minority provide the business plan, while some make a presentation. The salary of the CEO is disclosed very rarely.

In addition to approving the accounts and the dividend, and electing the directors, boards should request from members:

- Endorsement for the strategic direction, including the vision and mission and the strategic plan – this will require a summary of the strategic plan to be made available. Note this would involve presenting the strategy, taking questions and noting points raised in the AGM but not promising to make any immediate changes. Control of the strategy remains with the elected board.
- Approval for the dividend policy, i.e. the board's plan for dividend payments in the medium term – this will engage members with pricing, profitability and investment.

Beyond these areas, there are other business and organisations decisions that must involve members at the AGM. Some example includes:

- Changes to the common bond / field of membership

- Changes to the rules
- Changes to product and service policy
- Merger with another credit union

But credit unions must also recognise there are likely to be significant limitations to meaningful democracy. Citizens in contemporary society are much less inclined to attend meetings, and for credit unions with expanding geographies there will be less willingness and capability to travel. There can also be biases in terms of the groups of people who do turn out for AGMs, who may have different perspectives from the much larger groups of members who do not.

With this in mind, credit unions must explore alternatives, such as

- Postal voting
- Online or social media voting
- Remote access facilitated by technology such as webcasting (there are also real time voting mechanisms to run alongside, although these are more expensive)
- Local consultation meetings in advance of AGMs.

The alternative voting mechanisms are particularly important to ensuring wider democratic participation. In the USA, some credit unions use lottery or raffle competition entries as an incentive to postal voting. Technology provides new ways of enabling people to join in, and the best solutions will come with the necessary technical safeguards to maintain integrity to the process.

Good attendance at the AGM remains a positive aspiration, however, and actions need to be planned to support this. Boards should give sufficient advance notice of the time, date and venue, so attendance can be planned ahead, together with the documents for review.

The board will be taking strategic and major policy decisions throughout the year. By seeking approval, endorsement or feedback from members on some of these, boards enable democratic participation beyond the AGM, reminding members of their ownership rights and responsibilities. Issues might include whether to merge with another credit union, or major investments in, for example, technology. Members might be asked for views, or to approve a proposal.

Mechanisms for effecting such consultations include:

- Paper communication
- Email communication and online (including online voting facilities, as noted above)
- Special / Extraordinary General Meetings.

These forms of consultation should not be over-used, however, as members can feel bombarded by communications, and interest may diminish. The board has been elected to take decisions on behalf of the members and must accept that responsibility – judging which issues should be aired publicly. A policy should be drafted that sets out when and why the board might choose to poll the members; this could be presented to the AGM for agreement.

## **15.5 Communication and participation as owners**

Most communication with members focuses on members as customers, including surveys and feedback. This is, of course, necessary to ensure the credit union is providing the products and services that the members want.

It is vital that the fact of the members' ownership role is communicated through this process – feedback from members on products and services is not just “market research”, as it might be in a non-co-operative business, but is soliciting the voice of the owners in determining the offer. Members need to know that this voice is heard, both through how consultation is communicated and through the demonstration of change as a result.

Engaging members about responsibility for the ownership and direction of the business may be less straightforward, but remains a necessary task, and should be made easier if the practical benefits of membership as discussed above are clear. Regular communications with members, such as newsletters and social media, should provide information and updates on member-owner issues. These include:

- Financial performance
- Issues and risks and proposed management
- Governance, such as director opportunities / resignations / co-options.

One important opportunity to increase member participation is to foster community by bringing members together in members' meetings. Credit unions in other countries have facilitated local forums, sometimes known as Member Relations Committees, to provide a focus for engagement with members as owners and customers (see Ketilson and Brown 2011).

These forums build links and connections within communities and promote member engagement and participation. They reinforce the credit union's role as an actor in its field of membership, and builds a sense of tangible connection with the organisation among members. Boards should consider the suitability of such forums within its approach to members.

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