

CORPORATE CREDIT UNION GUIDANCE LETTER

NO. 2005-02

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SUBJ: Governance Policies

TO: The Corporate Credit Union Addressed

The National Credit Union Administration's (NCUA) Office of Corporate Credit Unions (OCCU) believes all corporate credit unions should develop governance policies. The purpose of this letter is to provide corporates guidance in this regard. State-chartered corporates should contact their state supervisory authority (SSA) for additional guidance and information.

The FDIC 2003 Annual Report defines corporate governance as "...the fulfillment of the board stewardship responsibilities entrusted to the board of directors, officers (management), and external and internal auditors of a corporation (in this case, a corporate credit union)." Sound governance policies should provide for methods of measurement and monitoring as well as defining roles and responsibilities. Governance policies are designed to ensure this stewardship is clearly defined for all of the above stated parties.

The Basel Committee on Banking Supervision in its September 1999 report *Enhancing Corporate Governance for Banking Organizations* based on published reports from the Organization for Economic Co-operation and Development (OECD), defined corporate governance as involving "a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined." Basel also notes that there exist regulatory differences between financial institutions (nationally and internationally) and that specific requirements of corporate governance may vary as a result.

Corporate credit union stewardship can be clearly divided into three parties' responsibilities: the board of directors; internal and external auditors (including the supervisory committee); and management.

Board of Directors

The Basel report states the board of directors "...should establish the strategies that will direct the ongoing activities..." of the financial institution. Additionally, "It should also take the lead in establishing the 'tone at the top' and approving corporate values for itself, senior management, and other employees."

The Federal Credit Union Act and Corporate Federal Credit Union Bylaws indicate the board of directors is responsible for the general direction and control of the affairs of a federal corporate credit union. Additionally, Section 704.4 of NCUA's Rules and Regulations requires the board of directors of all corporate credit unions to:

- a) Approve comprehensive written strategic plans and policies;
- b) Ensure senior managers have an in-depth working knowledge of their direct areas of responsibility;
- c) Employ qualified personnel;
- d) Follow GAAP;
- e) Ensure accurate and timely risk assessments and financial statements are prepared;
- f) Audit systems periodically;
- g) Evaluate financial performance; and
- h) Retain external consultants to review technical, human, and financial resources used to support major areas of risk.

State-chartered corporate credit unions should consult their SSA for any additional specific state requirements and regulations.

The board of directors should focus a majority of its effort on the strategic objectives of the corporate credit union including meeting the needs of their members. It is OCCU's position that, with the exception of Item "a" in the preceding list, the board of directors may delegate the performance of the other items listed to the President/CEO. However, the board is not relieved of its responsibility for their performance.

The Basel report emphasizes that the board of directors must clearly define the authorities and key responsibilities for themselves, as well as senior management. As such, any delegated authority should be clearly defined. For example, if a board gives the President/CEO hiring authority the governance policy should state, at a minimum, the President/CEO is given authority to hire employees provided they meet the requirements of the job description and other criteria outlined in the personnel policy. Every board authority that is delegated to the President/CEO should have clearly defined limitations.

The Basel report notes, "Processes should be established that allow the board to monitor compliance with its policies and ensure that deviations are reported to an appropriate level of management." This includes performance as it relates to delegated authority. For example, if the President/CEO hired a controller to prepare the financial statements for the corporate and the controller made several material errors throughout the year and was terminated, the board would need to evaluate if the President/CEO met his/her obligation under the delegated hiring authority. If the President/CEO hired an individual that did not meet the requirements in the job description or criteria outlined in the personnel manual, and approved by the board of directors, then he/she failed to meet the obligation under the delegated hiring authority. However, if he/she followed the criteria outlined but the requirements in the job description were not adequate or funding was not provided to hire the most qualified candidate, then the failure is due to the board of directors, not the President/CEO.

In today's environment directors must have considerable knowledge and devote sufficient time to have an adequate understanding of a corporate's operations. In many cases directors may need extensive training in the corporate's unique operations (i.e., sophisticated investments and asset liability management). The information provided by management is normally extensive and complex. Directors need to dedicate a significant amount of effort to becoming familiar with these concepts.

Board Positions

Governance models encourage the elimination of board positions that mirror the duties and responsibilities of operational management. An example would be the role of Treasurer. The only required board positions (unless an amendment to the standard bylaws has been approved) for federal corporate credit unions are:

Chair;
Vice Chair;
Financial Officer; and
Secretary.

Board Unity – Speaking as One Voice

Healthy deliberations are a sign the board of directors is considering all facets of a decision, and are actively engaged. However, once a decision is made the board should speak as one voice. This gives committees and management a clear direction regarding the board of directors' intentions. However, directors should always feel free to express any individual concerns to NCUA examiners and other official government supervisory or investigative authorities.

Committees

Some governance models require the elimination of committees as they believe they are an end-around the board and the board's authority. However, the following committees are required by law or regulation:

Supervisory Committee;
Asset-Liability Committee; and
Credit Committee (if the corporate's bylaws require).

Members of the committees listed above work directly with staff. These committee members should work with staff only as it relates to the committee's activities. The only exception to this is the internal audit function. Internal audit should report directly to and only to the supervisory committee. This would include obtaining budget approval and receiving performance appraisals.

Having an executive committee is at the sole discretion of the corporate's board of directors.

Director Fiduciary Duties

Boards of directors are expected to meet their common law fiduciary duties of due care, loyalty, and good faith. Strict definition and interpretation of the fiduciary duties may differ somewhat from state to state. However, courts and regulatory agencies (including NCUA) have held directors liable if they determined the duties have been breached. Included in the duty of due care is the board's responsibility for the oversight and monitoring function. This function is particularly important in financial institutions.

External and Internal Auditors

The board uses both the internal and external audit functions to assist in its oversight responsibilities. The external auditors play a key role in governance, as they are one of many tools the board of directors uses to ensure compliance with policy. External auditors include not only the CPA firm contracted to perform the annual audit, but also third parties that review risk assessment models and other systems. Although the power to hire consultants may be delegated to the President/CEO, the board and/or supervisory committee must be responsible for hiring external auditors used to evaluate performance and ensure management is meeting its responsibilities outlined in the governance policies. The board and supervisory committee are encouraged to rotate vendors, including CPA firms. With consolidation within the CPA industry this may not always be possible; however, rotating the managing partner is another option.

As stated previously, the internal audit function must report to the supervisory committee. Internal audit should develop audit plans to ensure management is in compliance with the governance policies. This would include, but not be limited to, auditing management's compliance reports.

The supervisory committee presents the reports of both the internal and external auditors to the board. The board, through the supervisory committee, is ultimately responsible for the activities of the internal and external auditors.

Management

All authorities delegated by the board to management (President/CEO) of a corporate credit union should be clearly defined and in writing. Limitations for delegation should be detailed to the point that the President/CEO clearly understands what he/she can and cannot do without board approval. The President/CEO should seek further guidance when a limitation or delegated board authority is unclear or subject to interpretation. Evaluation criteria for compliance should be developed concurrently with limitations to avoid compliance issues down the road.

With clearly defined limitations and evaluation criteria the President/CEO should be able to manage the institution more effectively than an institution lacking sound governance policies. The President/CEO should provide (and the board must review) documentation regarding his/her compliance with the governance policies on a monthly basis. Compliance with governance policies should be a part of the President/CEO's annual performance evaluation.

Even if the President/CEO further delegates authority to staff, he/she remains responsible to the board of directors. As the Basel report indicates, “Senior management is responsible for creating an accountability hierarchy for the staff, but must be cognizant of the fact that they are ultimately responsible to the board for the performance of the financial institution.”

The Sarbanes-Oxley Act of 2002 imposed specific corporate governance requirements on publicly-held companies. Many of these requirements relate to the oversight function and might be appropriate for corporate credit unions to consider. NCUA Letter No. 03-FCU-07, dated October 2003, provides a summary of the Sarbanes-Oxley Act provisions.

Well written and organized governance policies ensure the board of directors, management, and committee members know their respective responsibilities. This combined with clearly defined position descriptions (including board and committee members) and committee charters should ensure efficient and effective use of the corporate’s most important resource, its staff and management.

Sincerely,

/S/

Kent Buckham
Director
Office of Corporate Credit Unions