Chapter 301

MANAGEMENT

Introduction

The quality of management is critical to the success of a corporate. Management consists of the board of directors (board), members of the various committees, and senior operational and executive management (senior management).

Together, the board and senior management are responsible for the ongoing management of the corporate's operations. Effective management entails the following:

- **Strategic planning**—A process to ensure current decisions consider the future operating environment, organizational goals, and performance measures.
- **Policy making**—The act or process of setting and directing the course of action to be pursued by an organization (e.g., government or business). Policies should be designed to implement strategic planning decisions.
- **Personnel administration**—The selection and retention of highly qualified management and staff. This includes appropriate recruiting, compensation, training, and personnel development activities.
- **Control systems**—The development or acquisition of systems to control and monitor delegated duties.
- **Management information systems**—The systems and reporting methodology which are designed to ensure relevant information is captured and delivered to decision-makers in a timely manner.

Since all corporate operations are unique and vary in degree of complexity, an examiner should not expect to find the same scope and documentation supporting the management process at each institution. However, there are minimum expectations at all institutions.

Board of Directors

The board has the ultimate responsibility for the corporate's strategic direction, policies and procedures, and risk management process. Recent trends have been toward a corporate governance structure whereby the board only develops regulatory and high level board governance policies. The board may delegate development of some operational policies to the corporate chief executive officer (CEO) and oversight of operations to senior management, but it remains responsible and liable for the consequences of unsound or imprudent polices and practices.

In today's environment, directors must have considerable knowledge and devote sufficient time to oversee a corporate's affairs. Although directors are usually credit union managers, their experience in these consumer financial organizations does not necessarily provide them with the experience needed to direct a liquidity facility and service organization such as a corporate. This can be true when the corporate has expanded authorities and/or engages in complex operations. In many cases, directors of corporate credit unions may need extensive training in the corporate's unique operations (i.e., complex investments, derivatives, and ALM). The information provided by management at board meetings may be extensive and complex. However, the information should be summarized in such a way as to provide directors with effective management tools. Directors must dedicate a significant amount of effort to become familiar with the subject matter.

Due to the emphasis placed on director duties, the evaluation of the board's effectiveness is an important examination function. When appropriate, regulators may facilitate this evaluation by direct contact with individual directors. The need to interview individual board members would be an exception rather than the rule and must be initiated by the examiner-in-charge (EIC). When this is done, it should be common courtesy to advise the board chair of the chosen course of action.

The determination of a board's effectiveness is based on evidence from various sources, including:

1. Review of written plans, policies, board and committee meeting minutes, and supervisory-related correspondence;
2. Interviews with board members and management; and
3. Assessment of the timeliness of board actions to address deficiencies and exceptions.

The board of directors should take appropriate actions to maximize strengths and to correct deficiencies discovered internally, or by regulators or independent auditors. Efforts to supervise an institution will be improved when the examiner correctly assesses the philosophy, degree of involvement, and capabilities of the board. Further, the performance of the board is often a useful indicator of future operating results and may reveal the need to revise the corporate's one-year supervision plan.

General Considerations

There must be an adequate system of checks and balances between senior management and the board. It is essential the board is promptly and fully informed of serious problems within the corporate. If directors are unaware of serious problems they will be unable to take adequate and timely corrective action to address risk or prevent large losses or even failure. Therefore, it is imperative management develop appropriate information and management reporting systems.

Board members are ultimately responsible for ensuring the corporate complies with all applicable laws, regulations, and rulings, as well as maintaining the safety and soundness of the corporate. The board is expected to exercise reasonable care and due diligence in carrying out these duties.

If directors fail to perform their responsibilities in an appropriate manner, they may be subject to various actions, including letters of understanding and agreement, cease and desist orders, orders of removal and prohibition, lawsuits by member, civil money penalties, and suspicious activity report filings.

Problems in financial institutions are usually attributed to a combination of the following items: self-dealing or other conflicts of interest, unsafe and unsound practices carried out by employees or management, unqualified management, lack of director participation, domination by one director or officer, or a disregard for the regulatory process. It is the responsibility of the board to prevent these situations from occurring through the development of sound strategies, internal controls, and policies.

Duties and Responsibilities of Directors

Section 704.4, and applicable state laws and regulations, delineate the duties and responsibilities of directors and limit certain types of activities. Statute and common law also assign broad fiduciary responsibilities to directors.

Assessing Board Performance

An assessment of board members' abilities to fulfill their responsibilities is essential. Although an assessment of the board is primarily qualitative, the following general considerations can be useful:

1. Focus analysis and discussion on the goal of continuous improvement and strengthening of risk management practices;
2. Concentrate on issues rather than on personal criticism. A critique of the board is a sensitive process that requires focusing on problem solving, not fault finding. Except where criminal violations might be cited, board member and/or employee names should not be used in the examination report; and
3. Determine accountability. Board members should demonstrate they are aware of and meeting their responsibilities.

Specific criteria should be considered in the examiner's analysis of the performance and effectiveness of the board. The directors should:

1. Operate independently from management;
2. Be informed of activities in which the institution is engaged;
3. Supervise activities by establishing policies, goals, and objectives;
4. Make strategic operating decisions;
5. Provide guidance for management;
6. Provide general business expertise;
7. Attest to reports of condition;
8. Maintain capital adequate for balance sheet and operational risks;
9. Avoid self-serving practices; and
10. Ensure the institution appropriately serves its members.

Although examiners are involved in ensuring corporates appropriately manage their risk activities, examiners do not manage their risk activities (i.e., this is the board's responsibility). Except where safety and soundness is at risk, examiners should refrain from expressing personal preferences or views.

Board Minutes

Significant financial, operational, risk management and strategic issues are discussed at the board and/or committee level, and should be documented in the board and/or applicable committee minutes. Minutes should be reviewed for:

1. Adequacy of reports. Reports submitted by senior management should be thorough and accurate. They should cover all aspects of the corporate's operations including capital, financial performance, and major operating reports. Reports should be provided in advance, allowing board review prior to the meeting, leaving time during the meetings for discussion;
2. Supervision of senior management's activities. Minutes should reflect the board's discussion and approval of any major strategic or operating decisions, as well as review and approval of all major operating policies. The board should ascertain senior management has developed procedures for all operational areas;
3. Attendance and participation by directors. Directors' attendance is usually outlined in the corporate's bylaws. Additionally, a corporate may have a board/committee attendance policy. Regular attendance is the only way directors can fulfill their fiduciary responsibilities. Minutes should also identify members who actively participate in discussions. Another indication of board involvement is participation on committees;
4. Evaluations of performance of executive management. Minutes should reflect review of senior management's performance and compensation package determinations. Note: This may occur in executive session and the examiner may have to request these minutes separately; and
5. Senior management's compliance with the board's directives. Systems should be in place to ensure senior management's actions conform to the policies and direction established by the board.

Executive Management

One of the most important decisions of a board in exercising its responsibilities is the selection of the corporate's CEO. The board should define in writing the CEO's duties and responsibilities as well as an adequate management succession plan. Additionally, the board should establish an appropriate compensation package given the size and complexity of the corporate and prevailing compensation for similar positions.

Compensation

In determining the compensation of senior management, the board of directors should consider the following:

1. The qualifications and experience of the individuals;
2. The compensation paid to other members of senior management;
3. The compensation paid to persons having similar duties and responsibilities in other institutions;
4. The size and complexity of the corporate and its operations;
5. The financial condition, especially capital position and income level, of the corporate; and
6. The value of the total compensation package provided to the employee (e.g., automobiles, club memberships, retirement plans, expense accounts, hospitalization and medical coverage, vacation, holidays, sick leave, life insurance, deferred compensation, etc.).

A competitive compensation program is essential in the recruiting and retention of highly qualified staff. The process for determining compensation may be based on market surveys provided by third party vendors or other sources. In any case, there must be an effective process to ensure compensation remains competitive with the passage of time and changes in the job markets.

Employment Contracts

Upon specific approval of the board of directors, a corporate may enter into employment contracts with its senior management and/or other employees. Contracts should clearly delineate performance standards and compensation. They should clearly define what actions or conditions may result in the termination of the employee(s). The board should review employment contracts and compensation arrangements, including renewals and extensions, for senior management, annually and shall document and justify its approval in the board minutes. This is generally performed as part of the annual performance appraisal process.

Sound Policies and Procedures

The directors must provide a clear framework of policies and procedures within which the CEO is to operate and administer the corporate's affairs. At a minimum such policies and procedures should cover all areas required by regulation, including but not limited to investments, credit risk, asset-liability management, OFAC, BSA, conflict of interests, and the Privacy Act. Other policies appropriate for board development and approval are code of conduct, membership, dividends, and personnel. The board may delegate approval of other operating policies to the CEO.

Policies are established guidelines for a corporate's activities based upon its strategic direction. Procedures represent the methodology for implementing an activity. Operating policies and procedures are necessary to establish management's strategy and to provide a basis for gauging performance. Properly developed policies and procedures generally result in effective and efficient operating performance.

The corporate's policies and procedures should:

1. Be tailored to operations;
2. Exist for all major operational areas;
3. Provide direction for activities;
4. Establish operational guidelines; and
5. Promote controlled and efficient operating practices.

Management's implementation of policies and procedures and adherence to operating standards may be an indication of the effectiveness of the board of directors. Positive indications of board effectiveness include:

1. Knowledgeable key personnel;

2. Clear strategic goals with established benchmarks for measuring performance;
3. Current, up-to-date policies and procedures;
4. Annual policy and procedure reviews;
5. Established internal controls to ensure adherence to plans;
6. Operations achieve stated objectives;
7. Personnel actions conform with policies and procedures; and
8. Monitoring of critical financial and operational functions.

Strategic and Business Planning

Planning is an organized and continuous process of ensuring projections of the future operating environment influence current decisions. Planning can be divided into two classifications: strategic (developing a strategy) and operational. Strategic planning focuses on the long-term deployment of resources to achieve corporate goals. Operational planning concentrates on short-term actions, which should flow logically from the strategic plan and be revised periodically.

The board should review and revise the corporate's strategic plan as necessary. A common practice is to update the strategic plan every three years.

Annually, the board is responsible for establishing a business plan that documents major financial goals and objectives designed to achieve the longer-term goals identified in the strategic plan. While management may develop such policies at the board's direction, the directors must thoroughly review and give final approval to each contemplated action. The board must also approve the budget and ensure it is realistic (in relationship to the corporate's operating environment) and provides for adequate capital.

Board and Committee Reports

To provide adequate oversight of corporate operations, the board must receive comprehensive, accurate financial and risk management reports from senior management and applicable committees. Reliance on only a few indicators such as benchmark financial statistics may result in erroneous evaluations of the corporate's condition. Key ratios are useful, but can be misleading without supplemental information or adequate explanation. The examiner should confirm the directors are receiving complete, understandable, and accurate reports for all significant financial and operational areas.

Each regular board meeting should include a review of financial reports. Directors should not simply accept questionable report figures at face value, but should question and verify them when necessary.

Committees

To carry out its functions, the board of directors may appoint and authorize committees to perform specific tasks and supervise certain phases of operations. Utilization of a committee does not relieve the board of its fundamental responsibilities. However, committees can assist the board in operating a safe and sound institution.

Contracts

The board has several major responsibilities in the area of contracts. Each contract must be legal and enforceable. Legal counsel should be well informed on credit union related issues and review all material corporate contracts. Once counsel reviews the contract, there should be no need to review it again unless there has been a significant change in a related law or the operations surrounding the contract. It is not necessary for the examiner to recommend that a board review its contracts periodically for legal purposes, unless changes in the law or operations have occurred.

Contracts need not be reviewed for legal considerations, solely because some or all of the board who signed the contract are no longer in office. The fact the current board is not aware of the financial impact on the corporate may be a reason for a board review, but not a legal review.

The contract must be beneficial to the corporate. The board has a fiduciary responsibility to protect the assets of the corporate. It must establish policies and require procedures that address the use, bidding, and awarding of contracts. Normally, a board will require that all contracts, over a certain amount considered to be reasonable, must go through the bidding and legal review process. Additionally, the board may require its own approval of contracts that commit the corporate to a significant level of expense.

Contracts that may require a bid or legal review include: employment contracts, purchase of computer hardware and software, leases on facilities and vehicles, insurance policies, and service contracts such as for audits, special reports, and operational evaluations.

The board is responsible for setting the bidding criteria, including the maximum amount of the contract. The contract need not be to the lowest bidder, but if not, other criteria must be clearly established and documented. The examiner should not take exception if the board has established clear policies and followed those policies.

Senior Management

Management includes senior management such as the CEO, chief financial officer, chief operations officer, chief risk officer, chief investment officer, controller, and any persons including division managers, who have the ability with or without explicit authority to implement and interpret a corporate's policies and procedures.

A major examination objective is to evaluate the quality and effectiveness of senior management. The success or failure of operations may relate directly to senior management. Senior management develops operational procedures and strategies and makes decisions within board policies, guidelines, and strategic plans.

In evaluating senior management's performance, examiners should consider the knowledge, skills, and abilities of the individuals, the results of their decisions, and the institution's regulatory compliance, financial soundness, and the adequacy of risk management processes. To assist examiners in this evaluation the following areas should be reviewed:

1. Strategic planning;
2. Policy and procedural compliance;
3. Personnel administration;
4. Adequacy of internal controls;

5. Investment review;
6. Asset-Liability Management;
7. Auditing;
8. Maintenance of management information systems; and
9. Loan review.

The major responsibilities of senior management are:

1. Proactive oversight of daily operations;
2. Developing procedures and processes to implement board policies and objectives;
3. Providing the board with accurate and timely information;
4. Filling staff positions with qualified individuals;
5. Ensuring there is adequate depth of staff (backup personnel) for all key areas;
6. Establishing sound and effective cross-training procedures; and
7. Identifying, measuring, monitoring, reporting, and controlling risks.

Planning

As noted previously, planning can either be strategic or operational. In either case, sound planning is fundamental to effective management and is key to anticipating and dealing with change. Management and the board should inventory the corporate's resources, examine changes in its operations, and determine its responses to those changes. Planning should be dynamic, carefully monitored, and well supported. Projections must periodically be revised as circumstances change and when new strategies are formulated.

Planning requires the collection and coordination of large amounts of information and the thoughtful efforts of all members of the management team. Written plans help ensure the board, executive officers, and all division managers share the same goals, objectives, and strategies. A common, shared perception of future strategic actions is critical to execution of a successful plan.

Examiners should note in the examination report management's failure to have a satisfactory planning process, to properly monitor and control adherence to a plan, or to adjust existing plans or risk management systems to address external factors such as economic cycles, interest rates, capital markets, and event risk. Examiners also should be alert for any deviations to strategic or operational plans that potentially may be detrimental to the corporate's financial and/or risk management soundness.

The Planning Process

As noted previously, strategic planning focuses upon the long-term, vision, direction, and allocation of resources to achieve goals and objectives. Operational planning, (e.g., the business plan), concentrates on shorter-term actions designed to implement the goals and strategies outlined in the strategic planning process. For an effective planning process, the operational plans must flow logically from the strategic plan.

The examiner must treat a corporate's strategic, operational, and business plans with maximum confidentiality. They contain sensitive and proprietary information that directly affect the corporate's market position and financial condition.

Human Resource Management

Human resource management includes establishing procedures for recruiting, selecting, promoting, replacing, appraising performance, devising a compensation system, and selecting staff for further development.

The following areas warrant attention in evaluating personnel management, as they are important indicators of an institution's viability:

1. Well developed personnel policies and employee handbooks;
2. Detailed position descriptions and performance standards;
3. Carefully planned recruiting and proper screening, including background checks, of new employees;
4. Appropriate training and cross-training;
5. Performance review and comparison to standards;
6. Salary and benefits administration; and
7. Employee turnover rates.

Management Succession

The examiner should evaluate the corporate's plans to maintain its present and improve its future condition. This should include an evaluation of the board and senior management's efforts to provide for succession of senior staff. The corporate should have an established succession plan for each key member of management.

Senior management and the board must anticipate the organizational knowledge, skills, and abilities needed to meet the corporate's strategic goals. Subsequently, internal staff may need to be developed and/or staff possessing the necessary skills must be acquired from external sources.

Response to Supervision

The examiner must determine an institution's compliance with findings and records of action. OCCU looks to management to implement corrective actions in response to regulatory requirements as well as safety and soundness issues. Management should establish policies and procedures to ensure continuing compliance. Corrective actions must be responsive to the cited weakness and implemented within agreed upon timeframes. If management disagrees with areas of concern and/or plans for corrective action, documentation supporting this position should be developed and provided to NCUA and the SSA (if applicable).

Conflicts of Interest

Avoidance of Conflicts of Interest

The phrase "conflict of interest" refers to any situation in which the safety and soundness or an opportunity for a corporate is in conflict with the personal interest of board members, committee members, management, the credit unions represented by board or committee members, or other persons with influence over the corporate's policies, procedures, and actions.

Conflicts of interest (and even the appearance of such) can adversely affect an institution's profitability, reputation and undermine public confidence in the corporate credit union system. A conflict could cause a financial loss if the individual involved considers self-interest and personal gain more important than the corporate's interests. Management has a fiduciary responsibility to avoid any conflicts of interest or appearance of conflicts of interest (see Section 704.5(i)).

Policies should address areas in which conflicts of interest could arise, including transactions involving the institution and parties related to directors or officers. It should also address controls to avoid abuses and establish procedures for dealing with policy violations. Some corporates cover such issues in code of conduct policy but it may also be covered in the personnel policy.

The examiner should comment on and specify appropriate actions on any actual or apparent conflicts of interest adversely affecting the corporate. Any conflicts of interest should be discussed with the EIC and the corporate field supervisor before being discussed with management.

Internal Controls

The board, senior management, and supervisory committee have important roles in an institution's programs of internal control and internal audit. Although the board has overall responsibility, senior management is charged with the duty of developing and maintaining a strong system of internal controls. Relying solely on the independence of auditors to establish the institution's internal controls is inappropriate. Senior management is responsible for the design and implementation of effective controls to prevent and detect errors, conflict of interest situations, and fraud. In addition, a strong internal audit and compliance function helps provide additional assurance regarding the effectiveness of such controls.

Meetings

Meetings with the Board of Directors

Meetings between examiners and the board provide an opportunity to discuss:

1. The examination process and findings;

2. The institution, its functions, and plans;
3. The general financial environment;
4. Industry-related concerns; and
5. Commitments for corrective action.

Exit conferences are held with members of the executive management team (and possibly the chair , other interested board members and supervisory committee members) to review technical and overall examination findings and to obtain commitments for corrective action. At this time the EIC should notify management of all examination related items slated for discussion with the board of directors.

Joint conferences may result from a regular or follow-up examination or a supervisory contact. Their primary purposes are to present and discuss examination findings and reach agreements on plans for corrective action. A secondary purpose may be to gather information regarding a new function or plans for the corporate. These meetings also may be used to enhance the board's understanding of the regulatory process and to establish and build lines of communication between the examiner and the board.

Joint conferences normally should be held in conjunction with the board's next regularly scheduled meeting or at another mutually agreed upon date. However, to ensure the timely delivery of the examination report, they should not be held later than 45 days after the conclusion of the examination's on-site fieldwork. The EIC should contact the board chair prior to the start of the examination to schedule the joint conference. When scheduling the meeting, the EIC should consider the time necessary to complete the examination report after the on-site contact is completed.

Ideally, the examiner and corporate management will have developed a mutually acceptable plan for correcting areas of concern during the examination. This plan will be discussed at the exit meeting. If that was not accomplished, it should be the major objective of the joint conference. If there are no major areas of concern to discuss, the examiner should use this opportunity to discuss with the board the general condition of the corporate and the board's view on its future operations. The board should be encouraged to discuss any matters of interest.

Meeting Preparation, Presentation, and Documentation

To ensure a successful meeting, the examiner should be thoroughly prepared, have adequate documentation to support the report's findings, and conduct the meeting in a professional manner. PowerPoint presentations are strongly suggested. The following are items to consider when preparing for a joint conference:

1. Determine a time and location;
2. Develop an agenda;
3. Ensure all participants (including ARDP of respective region) are informed of the meeting;
4. Meet with other examiners (if any) who are attending to discuss the agenda and their roles;
5. Prepare and organize supporting data, to illustrate significant points or trends; and
6. Prepare PowerPoint presentation and any handouts.

The following should be considered when making a presentation:

1. Conduct the meeting in a dignified, professional, and objective manner;
2. Present the agenda and follow it within reason;
3. Encourage board member involvement and questions;
4. Wait for the complete question to be asked and check for understanding before responding;
5. Do not attempt to answer questions without being able to offer complete and accurate information; and
6. Obtain commitments for corrective action from the board.

The effectiveness of the meeting is directly related to the extent communications is established and credibility maintained.

Meetings should be held with the entire board to ensure all directors are aware of regulatory findings and commitments to correct areas of concern. Any person or organization connected with the institution, such as an auditor or attorney, may attend a meeting subject to board approval. The confidentiality of the meeting should be stressed. If the examiner believes an individual present should not be at the meeting, those concerns should be addressed to the board chair. If the board wishes the individual to attend, the examiner should advise the board it is the board's responsibility to ensure the individual in question maintains the confidentiality of the issues discussed.

The examiner should prepare a detailed outline of the topics for discussion (PowerPoint presentations are one method.). Some of the issues that should be covered include:

1. Introductions;
2. Confidential nature of meeting;
3. Sign-in sheet;
4. Taping of meeting (NCUA would like a copy within a reasonable agreed upon time frame, if applicable);
5. Type of examination, scope, and other limitations;
6. Executive summary;
7. Document of Resolution;
8. Agreements;
9. Summary;
10. Other matters;
11. Questions from the board; and
12. Overall conclusions.

Examination Objectives

The objectives for reviewing management are to determine if senior management and the board:

1. Understand and adequately manage the corporate's operational and balance sheet risks;
2. Are qualified and understand their duties and responsibilities;
3. Carry out their duties and responsibilities in compliance with the FCU Act, NCUA Rules and Regulations, state laws, other federal regulatory agency rules and generally accepted business practices;
4. Develop and implement adequate policies and procedures for all financial and operational areas;
5. Implement a sound planning and decision-making process;
6. Address operational, examination, and audit deficiencies timely; and
7. Protect the assets of the corporate by sound contract administration.

Examination Procedures

See Corporate Examination Procedures – Management (OCCU 301P).

Examination Questionnaire

See Corporate Examination Questionnaire – Management (OCCU 301Q).

References

1. The Federal Credit Union Act;
2. Part 704 of NCUA's Rules and Regulations;
3. Section 701.14 of NCUA's Rules and Regulations;
4. Federal Corporate Credit Union Bylaws;
5. Corporate Credit Union Guidance Letter, No. 2003-05 Investing to Fund Employee Benefit Plans
6. Comptrollers Handbook – Management and Board Processes. http://www.occ.treas.gov/handbook/ss.htm