## Board Governance Boot Camp: How Do Directors Face the New Reality?

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## Brave "New World"

- So much has happened in the last few years
- We live in a VERY "Regulatory Rich" environment
- The basic business model for credit unions is evolving and becoming more complex
- Can you read an NCUA 5300 report and other financial information?

## What Does a Regulator Do?

- Just following orders
- Rising number of credit union failures
- All about Safety and Soundness
- Risk is the number their #1 enemy
- Risk is a simple game
  - Identify it
  - Categorize it
  - Deal with it

## Standard: US Supreme Court

### Briggs v. Spaulding, 141 U.S. 132 (1891)

 Directors of a national bank must exercise ordinary care and prudence in the administration of the affairs of a bank, and this includes something more than officiating as figureheads: they are entitled under the law to commit the banking business, as defined, to their duly authorized officers, but this does not absolve them from the duty of reasonable supervision, nor ought they to be permitted to be shielded from liability because of want of knowledge of wrongdoing if that ignorance is the result of gross inattention.

## Rule 701.4

- Adopted by NCUA Board in December, 2010.
- Clarification and standardization of key FCU director duties in one place.
- Only applies to <u>FCU</u> directors! BUT .....
- Best practices
- Rulemaking began about two years ago.

 (a) General direction and control of a Federal credit union. The board of directors is responsible for the general direction and control of the affairs of each Federal credit union. While a Federal credit union board of directors may delegate the execution of operational functions to Federal credit union personnel, the ultimate responsibility of each Federal credit union's board of directors for that Federal credit union's direction and control is non-delegable.

- (b)(1) Carry out his or her duties as a director in good faith, in a manner such director reasonably believes to be in the best interests of the membership of the Federal credit union as a whole, and with the care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances;
- (2) Administer the affairs of the Federal credit union fairly and impartially and without discrimination in favor of or against any particular member;

- (3) At the time of election or appointment, or within a reasonable time thereafter, not to exceed six months, have at least a working familiarity with basic finance and accounting practices, including the ability to read and understand the Federal credit union's balance sheet and income statement and to ask, as appropriate, substantive questions of management and the internal and external auditors; and
- (4) Direct management's operations of the Federal credit union in conformity with the requirements set forth in the Federal Credit Union Act, this chapter, other applicable law, and sound business practices.

- (c) Authority regarding staff and outside consultants. (1) In carrying out its duties and responsibilities, each Federal credit union's board of directors and all its committees have authority to retain staff and outside counsel, independent accountants, financial advisors, and other outside consultants at the expense of the Federal credit union.
- (2) Federal credit union staff providing services to the board of directors or any committee of the board under paragraph (c)(1) of this section may be required by the board of directors or such committee to report directly to the board or such committee, as appropriate.
- (3) In discharging board or committee duties a director, who does not have knowledge that makes reliance unwarranted, is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in paragraph (d).

- (d) Reliance. A director may rely on:
  - (1) One or more officers or employees of the Federal credit union who the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;
  - (2) Legal counsel, independent public accountants, or other persons retained by the Federal credit union as to matters involving skills or expertise the director reasonably believes are matters
    - (i) Within the particular person's professional or expert competence, and
    - (ii) As to which the particular person merits confidence; and
  - (3) A committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

## Which Laws

- Federal Credit Union Act 12 U.S.C. 1751 et seq.
- State laws
- National Credit Union Administration 12 C.F.R. Part 701 et seq.
- Charter & By-Laws standard?
- Structure of Credit Union
  - Who Can Remove a Board Member or Credit Committee Member?
    - The Supervisory Committee

## The All Seeing Eye



# Board Responsibilities - The Buck Stops With You!

- You are the all seeing eye at the top of the pyramid
- Being a Board member is NOT a spectator sport!
- Directors are the ultimate decision makers
- You can delegate the task, not the associated responsibility

## The Role of the Board

- CU governance NOT Management
- Strategy versus Tactics
- Development of Strategic Goals
- Board's Responsibility is to create the future not review the past
- Relationship with the CEO

## No Surprises

- Regulatory Alerts
- Letters to Credit Unions
- AIRES Questionnaires
- Board Meetings
- Board Member Statements/Releases
- Congressional testimony
- Examination process

## Financial Report Red Flags

- General Credit Union Performance
  - Income or Loss
  - Capital Asset
  - Return on Assets
  - Loan to Share
  - Business growth (loans, deposits and members)
  - Delinquency and Charge Off

## Financial Statements

- Income statement (Profit and Loss Statement)
  - Net income
  - How much we take in and spend
- Cash Flow Statement
  - Liquidity
  - Exchange of cash between CU and the world
- Balance sheet
  - Financial condition
  - What you owe and own

## Different View Points

- The income statement summarizes a Credit Union's financial transactions over an interval of time.
- The cash flow statement reflects a Credit Union's liquidity.
- The balance sheet is a snapshot of a Credit Union's financial resources and obligations at a single point in time.

## Financial Performance report



#### **National Credit Union Administration**

#### **Financial Performance Report**

Notice: Peer average ratios and aggregate FPRs are available approximately 6-8 weeks after the cycle date.

Welcome to NCUA's Financial Performance Report (FPR) System. Please select one of the following options:

o I want an FPR emailed to me for one credit union.

I want an FPR emailed to me that aggregates data from multiple credit unions based on credit union information.

o I want to view a 2-page FPR summary for one credit union online.



FPR Quick Tips

FPR User's Guide - PDF or MS Word

#### Note to Users:

Done

Financial Performance Reports are based on reliable sources. However, no guarantee is given as to data accuracy. Users are cautioned that any conclusions drawn from these reports are their own and not to be attributed to NCUA. The Call Report data that is used to produce FPRs is dynamic in nature. The FPR contents will change accordingly as data corrections are made. Peer average ratios for the current Call Report cycle are not available until the data collection is complete and validated. If you request FPRs prior to the release of peer average ratios, the current cycle data should be considered preliminary, non-validated data. NCUA will notify users when the peer ratios are available for the current cycle.

FPRs sent via email are attached as Excel files. If you do not have Excel software on your computer, you may download a free Excel viewer from Microsoft's website at the following link:

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NCUA Home

## What Is Trend Analysis?

### Trend Analysis:

- Compares the component parts of a structural ratio to itself over several periods
- Enables identifying, questioning, and evaluating the changes in results of operations
- Paints a financial picture of the credit union's actual performance
- Serves as pertinent statistical or quantitative data in evaluating performance over time

## Have You Considered

- Your credit union's financial trends
- Peer comparisons
- The best way to receive financial training
- The local economic conditions
- The continued viability of your SEG's
- Your competition and what that means to the credit union

## Specific Board Responsibilities

- Maintain general direction & control
  - Strategic Planning
    - Setting Goals,
    - Implementing controls
    - Monitoring Activity
    - Approving a Budget
- Meet at least monthly & maintain minutes
- Approve policies
- Elect officers
- Appoint credit committee/manager or loan officers
- Appoint supervisory committee
- Appoint membership officer & other committees as required by the bylaws
- Hold an Annual Meeting (Reporting & minutes)

## Responsibilities - Reviews

## Monthly review

 Financial Statements/ratios/trends, activity reports/delinquencies/charge-offs, investments, declare dividends (unless quarterly), budget expenditures and variances, SAR activity and membership numbers

## Quarterly Review

Supervisory committee reports, BSA Officer Update

## Annually Review

 Annual meeting dates/elections, bond coverage, insurance coverage, investment policy, BSA policy, security policy, conflict of interest policy, CEO evaluation, Supervisory Committee audit, strategic plan, and budget

## **Key Fiduciary Duties**

- Exercise Due Care
- Display Good Faith/Obedience
- Remain Loyal
  - Avoid Conflict of Interest

## **Duty of Care**

- Directors must exercise due care or due diligence in all their decisions
- Attend meetings
  - Miss three in a row (or four in a year) can be removed from Board
  - "I wasn't at the meeting" is not a defense
- Perform specific duties and responsibilities expected under bylaws, board policies, regulations, law and best practices
- Obtain necessary information

## Display Good Faith

- Directors must remain faithful to their duties and obligations
- Directors must have honestly in all dealings with the credit union
- Directors generally will be excused from personal ability if they acted "in good faith with honest intentions and with the absence of malice or design to defraud or to seek unconscionable advantage"

## **Duty of Loyalty**

- Conflicts of Interest must be recognized and disclosed
- Corporate Opportunities must first be presented to CU
- Confidentiality must be maintained

## Business Judgment Rule

- The legal doctrine that officers and directors cannot be liable for damages for a business decision that proves unprofitable or harmful to the business so long as the decision was:
  - within the officers' or directors' discretionary power and was
  - made on an informed basis,
  - in good faith without any direct conflict of interest, and
  - in the honest and reasonable belief that it was in the business's best interest.

## Business Judgment Rule

Your best defense to a liability claim!

Courts will not "second guess" board decisions

 Not a "gimme". You have to earn the defense through your actions.

## Do Your Homework

- Decisions must be based on reasonable inquiry
- Minimum level of due diligence
- Reports and opinions from outside professionals
- Attorney opinion letters, audits, accountant's reports, etc.
- Must act in good faith with no self dealing

## Creating an Effective Paper Trail

There is a need to illustrate Board compliance

 Proper and complete Board minutes are essential

Attach relevant documents to the minutes

## QUESTIONS?