Towards a systematic approach to credit union governance

EXECUTIVE SUMMARY

This is the executive summary of the 2014 Stage One report.

The final CUEP governance report will be published in 2015 after the action research stage of the CUEP governance project

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Executive Summary

This executive summary records the findings of the stage one report of the CUEP action research project *"The development of a strategic governance model for credit unions*". Based on interviews with credit union directors, CEOs and senior managers, regulators and an international consultant, the report presents a model of governance appropriate to credit unions committed to growth.

Stage two will pilot and test the model. Stage three will see the publication of the governance model, as modified through the learning gained in stage two. This is now due later in 2015.

The research study was commissioned by Cornerstones Mutual Services as part of the DWP Credit Union Expansion Project. It was undertaken by the Research Unit of Financial Inclusion at Liverpool John Moores University between November 2013 and January 2014

The author would like to thank the credit union directors, CEOs and senior staff who participated in the interviews and in the Manchester research seminar. Credit union personnel participating in the interviews are listed below

He would also like to thank Robert Munro, Associate/Building Societies and Credit Unions, and Colin Wells, Associate/BSCU Thematic Team, at the Supervision Division of the Financial Conduct Authority who agreed to be interviewed as part of the study.

Particular thanks also go to Ralph Swoboda, Managing Director, of CUFA Ltd (Credit Union Financial Analytics), Dublin, who shared ideas on governance in practice in credit unions throughout the world and was kind enough to review the final text of the document.

The participants in the individual credit union interviews were:

Bristol Credit Union Ltd

Board: Harry Partington (Chair) and Andrew Barnes

Management: Kate Hanks, Deputy CEO

Manchester Credit Union Ltd

Board: Tim Prestwood (Chair)

Management: Christine Moore, CEO

Ipswich and Suffolk Credit Union Ltd

Board: Sally Chicken

Management: Chris Mole, Manager

London Capital Credit Union Ltd

Board: Helen Baron (Chair) and Donald Kehoe

Management: Martin Groombridge, CEO

Smart Money Cymru Credit Union Ltd

Board: Alun Taylor, (Vice-Chair)

Management: Adriana Davies, Manager

Leeds Credit Union Ltd

Board: Malcolm Christie (Chair) Jeremy Cross and Clinton Cameron

Management: Chris Smyth, CEO, Janet Burr, Deputy CEO and Paul Higgins, Head of Finance

NHS Credit Union (Glasgow) Ltd

Board: Hugh Sweeney (Chair)

Management: Robert Kelly, General Manager

Enterprise Credit Union Ltd

Board: Murial McCreadie (Chair) and Martin Fife

Management: Karen Bennett, CEO

Bridges Community Bank (South Tyneside Credit Union) Ltd

Board: David Fleetwood, (Chair)

Management: Gavin Hennessy, CEO

Findings of the Stage One report

Boards of directors as committees of management

Historically most credit unions were established as small co-operatives run by and for their members. Boards of directors were elected to direct, control, oversee, and usually to manage the credit union. The regulatory designation of boards as committees of management was an accurate description in many credit unions, as board meetings often focused mainly on operational concerns. With most directors also being volunteer staff members, the functions of governance and of management over-lapped and were often indistinguishable.

The transition to professional management

As credit unions grew, the complexities of running a financial institution required boards to hire professional staff and to delegate authority to them for managing the credit union. This transition has not always been easy for directors as they can find it difficult to let go of operational engagement and focus rather on the specific board function of governance.

Clarifying the nature of governance

There have always been definitions of the role and responsibilities of the board of directors. However conceptual understandings of governance are often so enmeshed with those of management that it can be difficult for directors to separate the two.

When boards of directors employ staff teams, a number of typical scenarios can sometimes ensue. Directors can find it difficult to let go of involvement in operations and they focus on micro-managing or on meddling in management decisions. Sometimes too, if the chair takes on line-management of the CEO, he or she can act in practice as the real CEO. Yet other boards, after a CEO has been appointed, may act as if there is little left to do but to approve and rubber stamp management decisions. All these scenarios arise out of not regarding governance as a distinctly defined function but rather as an upper-level tier of management

This report sets out to delineate the principles of a logical, consistent and integrated model of governance, which draws inspiration from The Carver Policy Governance Model (Carver 2006) but which arises out of the experience and practice of credit union directors and CEOs.

The purpose is to explore the dynamics of credit union governance, not as management one step removed (Carver 2006) but as a distinct theoretical and practical reality in its own right.

Towards a model of credit union governance

A model of credit union governance is not a list of do’s and don’ts, nor is it a code, nor is it one particular organisational structure; rather it is a systematic way to understand the principles that have to be adopted to embed good governance within credit union practice.

The challenge of the CUEP study is to bring together the diverse elements of governance into a dynamic and coherent model, based on a clear set of universal principles which can be implemented effectively throughout the credit union sector.

The first principle of governance to emerge from the study is the distinction between the function of governance and that of management within the governance framework.

This applies equally in all credit unions. However, the model is implemented most straightforwardly in credit unions where different people undertake the two distinct functions.

The function and authority of the board of directors

Credit union boards are elected by the membership and given stewardship, leadership and total authority over all aspects of credit union organisation and are tasked to ensure the credit union achieves its purpose, within the framework of legislation and regulation.

Boards are accountable to the members as owners of the credit union and are tasked to ensure the credit union achieves its objectives in the interests of the members. The function of the board is to direct and to control but not to manage the credit union and its operations.

A key principle of the governance model is that boards delegate elements of their authority to the CEO to manage the credit union. Authority is delegated to one designated lead staff member who is in turn accountable to the board for the management of the credit union. This lead staff member is the CEO (but could be called the manager in some credit unions).

It is fundamental to the logic of the credit union governance system that this delegation of authority to the CEO is the case in all credit unions, irrespective of their size.

The distinction of ends and means

In order to clarify the difference in the function of the board and of management, Carver (2006) introduced an important distinction between ends and means. This distinction is specific to Carver and, in broad outline, relates to the difference between what the organisation wants to achieve (ends) and the way in which it organises its activities to go about achieving it (means).

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 means concern all the management and operational activities that have to be put in place to achieve those ends.

As being ultimately accountable for all aspects of the credit union, boards are accountable and responsible for the achievement of ends and for the means that are employed to attain them. It must exercise control over both the ends and the means of the credit union, even though it properly delegates authority over the means, which are the management and operational activities, to the CEO

Based on the end/means distinction, Carver then sees the function of all board of directors divided between four key areas:

1) The writing of board policy on ends, that is on the vision, the values, the purpose, the direction, and the strategic goals of the credit union;
2) The delegation of authority over the strategic, organisational and operational means to the CEO and management. The board delegates all authority to the CEO to

achieve the purpose of the organisation, except where this authority is limited by the executive limitations policies of the board;

3) The board retains authority and responsibility for the governance structure and process. The board is accountable to conduct its own affairs in a proactive manner. The board cannot leave it to staff to manage the functioning of the board itself;

4) The board takes a proactive role in establishing its relationship with the CEO and senior management and in monitoring the performance of the credit union and the CEO. Boards are expected to take the lead and not to be dependent on the staff for establishing systems of oversight and control.

Demarcation of responsibilities between board and management

A key principle of the governance model is the demarcation of authority and responsibilities between the board and management. In the interviews, credit union participants were often concerned that it is not always in practice possible to draw a fine line between governance and management. Blurriness seemed inherent in all discussions about board and management responsibilities, so much so that a great deal depended on the quality of the board/CEO relationship in working around hazy lines of demarcation.

The importance of the end/means distinction is not in defining some external, objective measure by which the role of the board can be differentiated from that of the CEO. Rather, it aims to clarify the need for the board to focus on what it wants the credit union to achieve for its members and to delegate maximum possible authority to the CEO to manage the credit union. Unnecessarily holding back delegated authority is seen to significantly undermine the capacity of the CEO to deliver on credit union objectives.

The focus of the board needs always to be on the big picture and moving the credit union forward; and that of the CEO and management on making sure that the credit union works in practice and succeeds. Precisely where the line is drawn between the work of the board and that of the CEO, however, depends on each individual credit union situation and is ultimately a decision of the board.

Key areas of board oversight in a co-operative financial institution

In research discussions participants stressed that specifically in credit unions, as co-operative financial institutions, there are a number of areas for which stand out as being the direct responsibility of the board. In each of these areas the board's function is to maintain, critical oversight, to set board policy and strategic objectives and to monitor credit union and management performance. However, in each case, it is the function of the CEO and management to be accountable for credit union delivery against policy and objectives.

The three critical areas of oversight and policy as identified in research interviews were:

1) Culture, ethics and values

   Board policies need to establish and maintain a culture founded on credit union values and principles throughout the organisation. It is the function of the CEO to develop management policies and procedures to maintain a co-operative culture

2) Strategic and financial planning

At the core good governance is setting the direction of the credit union, establishing what it wants to achieve, who it wants to serve, with what products and at what cost. The board has the central responsibility of overseeing and approving the credit union's strategic planning process; and monitoring performance against objectives.

3) Risk and compliance

The board defines and establishes the credit union's risk appetite, within legislative and regulatory constraints, and its risk governance framework within board policy. It is not sufficient just to approve the plans of management; it must take responsibility for direct oversight of the control and mitigation of risk. This includes an understanding and a scrutiny of risk within board policies, strategic plans and budgets of the credit union.

The board is directly responsible for establishing and for the oversight of the external and internal audit process. It is critical that the board oversees the way in which the audit function informs the risk register and risk management plan.

In the model of governance there is less of a need for a supervisory committee in credit unions that are managed entirely by professional staff. Supervisory committees arose at time when directors were also operational staff and they were seen as providing effective, independent oversight of the credit union. When directors are no longer involved in management operations, it is the board itself that provides that independent oversight as the "eyes and ears" of the membership

The one voice principle

It is only the voice of the board, as determined in properly constituted meetings that has authority in the credit union. Individual board members do not possess any individual authority apart from that derived from his or her contribution to the collective voice of the credit union. This applies to the chair of the credit union, and to any chair of sub-committees of the board. Authority derives solely from the single voice of the board.

The role of the chair of the board

The chair of the board is a key lead individual within the model of governance. For it is the chair who has the responsibility for ensuring that the board carries out its responsibilities and functions efficiently and effectively, and that management is held to account through the effective oversight and scrutiny of the board as a whole.

As the lead member of the board, the chair has an important role in leading, directing and controlling the credit union. However, there is no particular authority vested in the office of chair. The chair can only reflect the voice of the board.

The chair has a particular role in acting as the primary liaison between the board and the CEO. However, the CEO remains accountable to the board not to the chair.

The function and authority of the CEO

The governance model turns on there being a designated lead person with authority for the strategic and operational management of the credit union. The term CEO is used to define

the lead senior staff member who is accountable to the board for the management of the credit union and for implementation of its strategic plan

The governance model works most straightforwardly in credit unions that engage a CEO and, as all research participants confirmed, credit unions that aim to expand require a lead staff member with executive authority for the business.

All credit unions expanding as co-operative financial institutions need to prioritise the appointment of a CEO with the leadership skills and strategic competence to manage the business. The CEO forms a core constituent element of the model of governance and as such, must be appointed directly by the board to which he or she is accountable.

The distinctiveness of governance and management within a systematic framework is highlighted in the division of responsibilities between the chair of the board and the CEO

The chair and the CEO are poles of two distinct functions within the credit unions and, as such, have a relationship that should be based on a sense of equality, rather than any idea of hierarchy. Both the chair and the CEO are accountable to the board. The governance model is based on the understanding that the CEO is accountable solely to the board, and not individually to any particular board member, including the chair. 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.

Delegated executive authority

In the governance model, the CEO is accountable to the board for the overall management of the credit union, for the implementation of its strategic plan and for achieving its strategic objectives as 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 governance principle is to give the CEO as much scope as possible in decision making in order to encourage creativity and innovation in taking the business forward. But 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.

In the interviews, most CEOs felt that their credit unions needed to do more to maximise and to clarify delegated executive authority. In the absence of written agreed board and management responsibilities and of defined levels of delegation, some CEOs said that they felt that they lacked the authority to move the business forward.

The CEO's delegated authority is constrained internally by board policies, including executive limitations policies, budgets and resources and externally by legislation and regulation. In terms of policy, everything is in the control of the board, and it is the board that decides where policy stops and CEO authority starts. The governance model turns on boards delegating as much as possible whilst maintaining board accountability and control.

Strategic leadership of the CEO

In the interviews, in all the larger, more developed credit unions, both directors and CEOs stressed the importance of the strategic leadership of the CEO, alongside that of the board.

The leadership of the CEO is an important element of the credit union governance model and is the foundation for the board's delegation of executive authority. In those credit unions, where the senior staff member is regarded as a manager rather than a CEO, boards hesitate to delegate real authority. It is in these credit unions that a member of the board, often in practice the chair, continues to act as the real CEO.

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 as a financial business.

It will be important for credit unions in Britain to focus much more clearly on the skill sets required of CEOs to lead and drive forward credit unions.

The board-management relationship

In the governance model, the board is not to undertake the work of management and the CEO should not undertake the work of the board. The board cannot delegate to the CEO and the staff its accountability to member-owners, its responsibility for oversight and control of the governance structure and process, for the setting of board policy, for the oversight of strategy, risk and compliance, for the establishing the relationship with the CEO and for the monitoring of credit union performance. The CEO cannot, likewise, pass back accountability for the leadership and management of the performance of the credit union to the directors.

These two functions of board and management do not however work in isolation; they are mutually inter-dependent and must work one with another for the success of the business. In all of the more developed credit unions in the study, directors and CEOs stressed that credit union success depended on building a relationship of mutual respect, trust and collaborative partnership working between the board and the CEO and other senior managers

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

Chair-CEO relationship

Central to board-management relations is the relationship between the chair and the CEO. In interviews all participants said that they considered the quality of the relationship between the chair and the CEO to be fundamentally important to the success of the credit union.

In the governance model, it is not appropriate to regard the relationship between the chair and the CEO in line management terms. The board cannot delegate authority over the function of the CEO to the chair. Seeing this relationship in line-management terms is a return to understanding governance as management one step removed rather than a distinct function directly accountable to the member-owners.

The relationship between chair and CEO is better understood in terms of mutual support in which ideas, plans and decisions can be explored and critiqued. It enables CEOs to ensure chairs and boards are not presented with surprises and it gives a forum to the CEO to check out what is best brought to the board for discussion and debate

The fact that the relationship between the chair and CEO is built on the basis of equality rather than on managerial hierarchy does not mean that the CEO is held any less

accountable for decisions or actions. But this accountability is seen as being directly to the board, not to the chair or any other individual board member

Clarity of expectations

A central principle of the governance model is 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.

In the governance model, board expectations are set out:

1) in board policy and 2) in the agreed and determined objectives of the credit union as set out in the strategic or business plan (including the budget and financial plan).

The governance model calls for a much more robust approach to the setting of board policy and strategic objectives. For without giving CEOs precise direction and measurable criteria of success, credit unions cannot realise their potential as sustainable financial co-operatives

The role of board policy

Central to the governance model is the development of board policy, for it is through board policy and the setting of the strategic objectives of the credit union that the board makes clear what it wants to achieve and to deliver for the membership.

In the governance model, it is important to distinguish board policy (about ends) from both management policy (about means) and management procedures (more practice detailed prescriptions for staff on areas of operational means). Where the line between board and management policy is drawn is ultimately a board decision, and will be decided by different boards differently.

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 brief board policy statements which can then be used to monitor the progress of the credit union.

Strategic planning and the setting of objectives

Central to the governance model is the process of strategic planning and the setting of organisational and financial objectives. Along with board policy, it is through the setting of these strategic objectives that the board makes its values and vision known to the member-owners and its expectations clear to the CEO and management. It is by the achievement of the strategic objectives, as set out in the strategic or business plan, that the board monitors, measures and evaluates the performance and success of the credit union and of the CEO.

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

The board and the CEO, and other senior managers, have to be actively engaged in the strategic planning process. Management provides information, data and analysis of the environment within which the credit union operates in order to ensure that the strategic objectives are specific, measurable, attainable, relevant and time-bound. Directors challenge, critique and advise to ensure that the objectives conform to the values, the purpose of the credit union and expectations of the board and the member-owners

The strategic plan is concerned with ends or the objectives which the board aims to achieve for credit union and the membership, along with its costs, resource requirements and priorities. Defining these objectives, with input of information, data and analysis from the CEO, is the main concern of the board. But embedded in strategic plans, there can also be actions, tactics and interventions to achieve the overall strategic objectives of the board. These action steps or means, or the how to achieve the objectives, are directly the remit of management. They should not be the focus of board decision making. In fact such action steps or means are more appropriately contained within a management operational plan rather than a strategic plan.

The use of the strategic plan is a critical aspect of the governance model and the monitoring of performance against the plan regularly at board meetings is central to good practice.

Monitoring performance through a balanced range of metrics

The regular monitoring and evaluation of progress against objectives as detailed in the strategic plan is fundamental to the oversight function of the board, and it is against these objectives that the performance of the credit union as well of the CEO is measured

In the governance model, the financial and non-financial objectives, as defined in the strategic plan are converted to a series of metrics by which credit union performance can be readily and easily measured in board meetings. Without such a rigorous monitoring system which sets progress against agreed objectives, boards can be reduced to just approving reports as submitted by management.

In some credit unions, the concept of a balanced scorecard has been introduced which sets out in a clearly accessible manner the metrics by which credit union progress can be measured monthly, quarterly and annually. By whichever metrics the board adopts, it then holds management to account for their achievement.

The clarity and simplicity of the balanced scorecard approach replaces the need for boards to spend inordinate amounts of time ploughing through management reports and financial statements without any reference to the objectives set out in the strategic plan.

Strengthening credit union governance

In the research interviews, directors and CEOs discussed a number of areas that would merit development if the credit union governance model were to be embedded throughout the sector. These areas were the capability and contribution of directors, the capability and contribution of the CEO, board meetings and decision making, the effective use of management information, the strategic planning cycle, oversight of risk and compliance, the role of a code of governance and sub-committees of the board.

Accountability to the member-owners of the credit union

The central principle of the credit union model of governance is that the board is primarily and ultimately accountable to the owners of the credit union; that is to its members. However boards of directors have to face into how they can be truly accountable to their member-owners and how can that accountability be prevented from degenerating into tokenism or basic compliance with legal or regulatory requirements.

As credit unions grow and recruit board members and professional staff from outside the credit union world, there is an inherent danger that members become increasingly to be regarded, by credit union directors and staff and by themselves, as just customers and not as owners of the credit union.

Directors and CEOs recognised the importance of engaging with the membership as owners as well as customers of the credit union.

Direct communication and involvement in social media or MRCs is one element of member engagement and participation, but perhaps the more important aspect of board accountability to the member-owners is in disclosure and accountability.

CUEP and the development of good governance

The model of governance introduced in this report is recommended to all credit unions within the Credit Union Expansion Project. It is maintained that the principles of the model are applicable to all credit unions throughout the sectors, but clearly it is more readily implemented in credit unions that have the capacity and resources to employ professional staff teams.

However, this report is only an initial exploration into the question of the development of a model of credit union governance for the sector. It sets out an initial set of principles and potential governance methodology gained from the literature and from the contributions of the credit union directors, CEOs and others who participated in stage one of the research study.

A much more important step is stage two, which is to last throughout 2014 and into 2015. This stage involves a number of credit unions that would be prepared to test out the implementation of the governance model in practice over that period.

Stage One report is available from the research team

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