Filene

REPORT

Should Credit Unions Pay Their Directors?

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Acknowledgments

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Executive Summary

Overview

For credit union board directors, pay is never the primary motivator. This report sheds light on the current state of credit union director compensation and considerations you should keep in mind when exploring the prospects of paying board directors.

MEET THE AUTHOR

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$4,245: The price of a well-used Honda Civic or the average amount collected by a paid credit union director?

Some credit union directors are not technically volunteers. At 145 credit unions in 12 states, directors earn somewhere between $60 and $37,597 annually. Federal credit unions are allowed to compensate a single board officer, but are expressly forbidden from paying other directors. Otherwise states are free to write their own rules. Tennessee and Washington recently joined 10 other states that have long allowed compensation in various forms. In most cases, credit union director compensation is dwarfed by fees paid to directors of commercial banks, but the pay trend is slowly catching on, especially among large credit unions.

What Is the Research About?

Director pay is a divisive issue. Many feel that paying boards is anathema to the cooperative spirit of credit unions. This report acknowledges that dilemma while trying to quantify just what existing compensation trends look like: How prevalent is director pay? What does it look like? And how does it affect the performance of credit unions that use it?

We find that credit union board pay is still, on average, modest. Most credit unions that could compensate their boards do not, but compensation is more prevalent among larger credit unions. Larger credit unions pay directors more. Credit unions that compensate their boards perform, on average, better than credit unions that do not. That does not mean compensation *causes* better performance, but at least it doesn't seem to have large adverse effects.

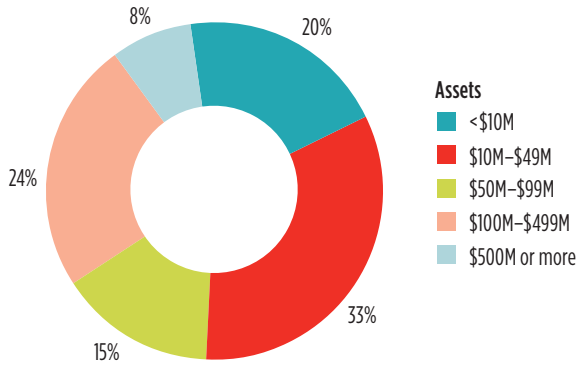
What Are the Credit Union Implications?

For every argument in favor of compensation, there's a corresponding caveat. Yes, board pay may help you attract and retain more qualified candidates, but it could also lead to greater entrenchment among existing board members. Yes, paying directors allows for greater director accountability, but it could also affect credit unions' tax exemption. And so on. This research lays the groundwork for a productive discussion: For each argument, for and against, the report offers discussion questions.

Beyond the discussion guide, consider these five recommendations:

- **Continually assess the flow of accountability and authority in your credit union.** Before you get to compensation, get the board on a solid leadership footing. Without a deep understanding of the board's legal, fiduciary, and philosophical duties, the impact of potentially valuable tools such as board compensation is limited and governance risks are magnified.
- **Assess the effectiveness of your board and directors on an ongoing basis.** The implementation of formal board and director evaluation processes is a good way to identify opportunities for improved effectiveness. With or without compensation, evaluation processes such as peer review yield similar opportunities at the individual director level, providing directors with guidance and highlighting when turnover may be necessary.
- **If compensation is important, petition your state league.** Recent compensation changes in Tennessee and Washington show that motivated credit unions can make the change.
- **Create and maintain a board skills matrix.** Monitoring the balance of your board's skills is a simple and highly valuable exercise. A simple skills matrix compares the skill sets of the current directors against the skills that the board as a whole needs to function effectively. This helps to illustrate areas of strength and redundancy and any current or emerging skills gaps. Use this information to inform the compensation discussion, guide your board's nomination processes, and search for ideal candidates.
- **Monitor your governance performance.** Although we do not have sufficient data to show that paying directors *causes* better performance, we believe that the true goals of good governance are effective leadership and decision making. With or without compensation, boards should optimize meeting time allocation, appropriately engage outside advisors, and manage the information gap between directors and staff.

SIZE DISTRIBUTION OF PAID BOARDS, BY CREDIT UNION ASSETS



Compensation can be a valuable tool. But before your board allocates real dollars for each director, make sure you can show how members will reap value from the expense.

Introduction

While preparing for this study, I reflected on my six years of teaching credit union board members at the Credit Union Executives Society (CUES) Governance Leadership Institute (GLI). In 2009, any conversation about board compensation split the class down the middle, with one side claiming that paying directors was more trouble than it was worth, and the other side finding the topic so offensive that it did not deserve a moment's attention. There wasn't one supporter in the bunch. In the summer 2014 program, every single participant supported the notion of paying their boards, with some even believing that doing so would soon be crucial to their ability to attract and retain effective board members.

This shift has had broad implications. Credit union leagues in Tennessee and Washington successfully lobbied for regulation allowing for board compensation in 2013, bringing the total number of states that allow board compensation to 12. The time is right for a deeper dive to provide credit unions with insights regarding the current landscape. In these pages I explore the who, where, why, and how of current credit union board compensation and try to lay some groundwork for the future.

- **Who:** Which credit unions are paying their board members? Are there trends with respect to size, performance, or board characteristics?
- **Where:** What are the differences in behavior from state to state? Where are credit unions most likely to pay their boards? Where do credit unions pay the most? The least?
- **Why:** Why have credit unions decided to pay or not to pay their directors? What outcomes are they expecting? Is it working?
- **How:** How much does a typical credit union board pay its directors? What are the differences in pay to chairs, board officers, and directors? How does this compare with the private sector?

The answers to these questions illustrate some of the benefits and risks associated with board compensation. More importantly, they suggest gaps in many boards' approaches to director pay, board renewal, and governance in general. In the end, even if credit unions are moving away from the tradition of volunteer boards, there is much work to be done in order to ensure that this very significant shift is not in vain.

Should Credit Unions Pay Their Directors?

CHAPTER 1

Methodology

Our data gathering processes involved three main initiatives: the identification of the states that allow credit unions to compensate their boards, the gathering of director pay data, and interviews with credit union board members and CEOs as well as representatives from state regulators. For the purposes of this study, we included only those states that allow boards to receive compensation above and beyond reimbursements for travel, education, conferences, or any other similar item (see Figure 1). See Chapter 5 for further information on individual states' policies.

This report represents findings prepared by the Clarkson Centre for Business Ethics and Board Effectiveness (CCBE) at the Rotman School of Management, University of Toronto. All first-person plural pronouns refer to the CCBE.

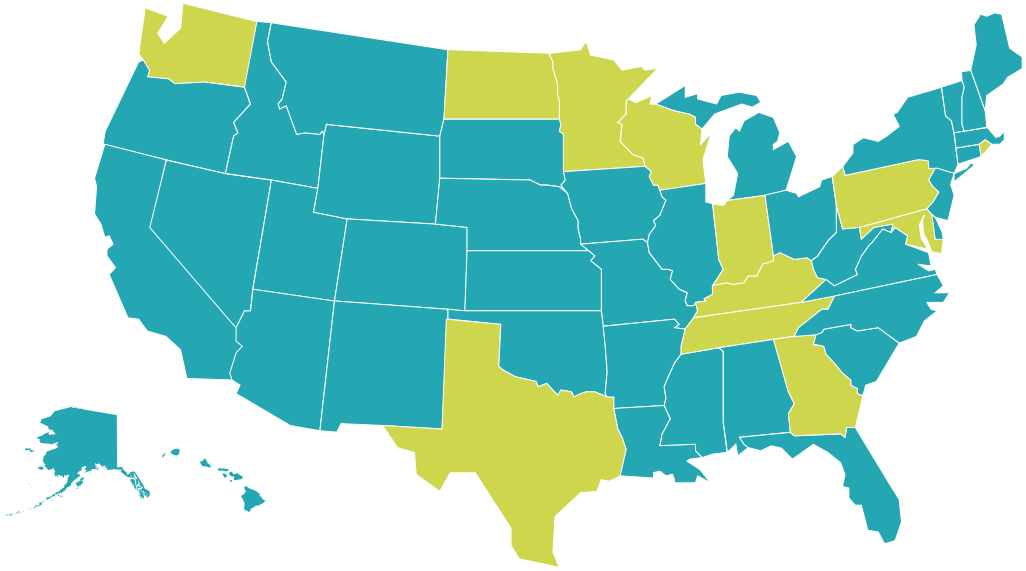
Identification of States That Allow Board Compensation

We examined the credit union acts of all 50 states, resulting in a list of 12 states that allow board compensation (see Figure 1):

- Georgia
- Indiana
- Kentucky
- Maryland
- Minnesota
- North Dakota
- Pennsylvania
- Rhode Island
- Tennessee
- Texas
- Washington
- Wisconsin

FIGURE 1

TWELVE STATES THAT ALLOW BOARD COMPENSATION



The statutes vary significantly from state to state, as described later in the report. And while Tennessee and Washington are recent converts, most other states' policies have been in place for decades.

Gathering of Board Compensation Data

Using IRS Form 990 filings from 2012 (the most recent year from which forms were publicly available), we gathered compensation data, basic information such as credit union names and addresses, and the names of individual directors and staff. We gathered data on each credit union for the most recent year, including assets, number of employees, return on average assets, revenues, and expenses.

FIGURE 2

CRITERIA FOR DETERMINING WHICH STATES COMPENSATE BOARD MEMBERS

Board compensation includes:	Board compensation does not include:
• Annual or monthly cash payments	• Travel reimbursements
• Meeting fees	• Conference fees
• Health insurance	• Equipment reimbursements
• Committee membership fees	• Spouse travel
• Chair fees	
• Any other compensation beyond routine reimbursements	

In total, we studied 684 credit unions; some had incomplete forms, leaving us with 539 credit unions for which we have complete data. Please note that compensation figures for board members are disclosed on Form 990 as a total, and no information is provided regarding any individual elements that compose this total. For the purposes of this report, all credit union director compensation figures are based on these total values as disclosed on Form 990.

Geographic Distribution

Only 12 states allow credit unions to compensate their boards of directors. In 2014, Washington and Tennessee became the latest states to amend their rules.

FIGURE 3

TEXAS AND WISCONSIN HAVE THE LARGEST POPULATIONS OF STATE-CHARTERED CREDIT UNIONS

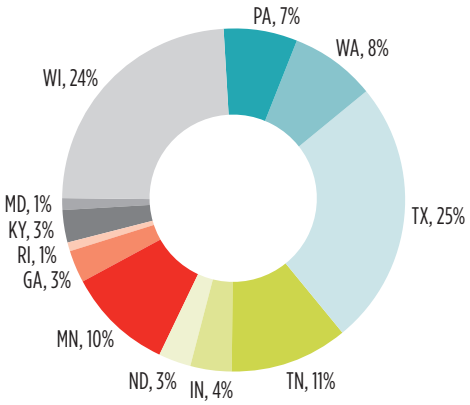
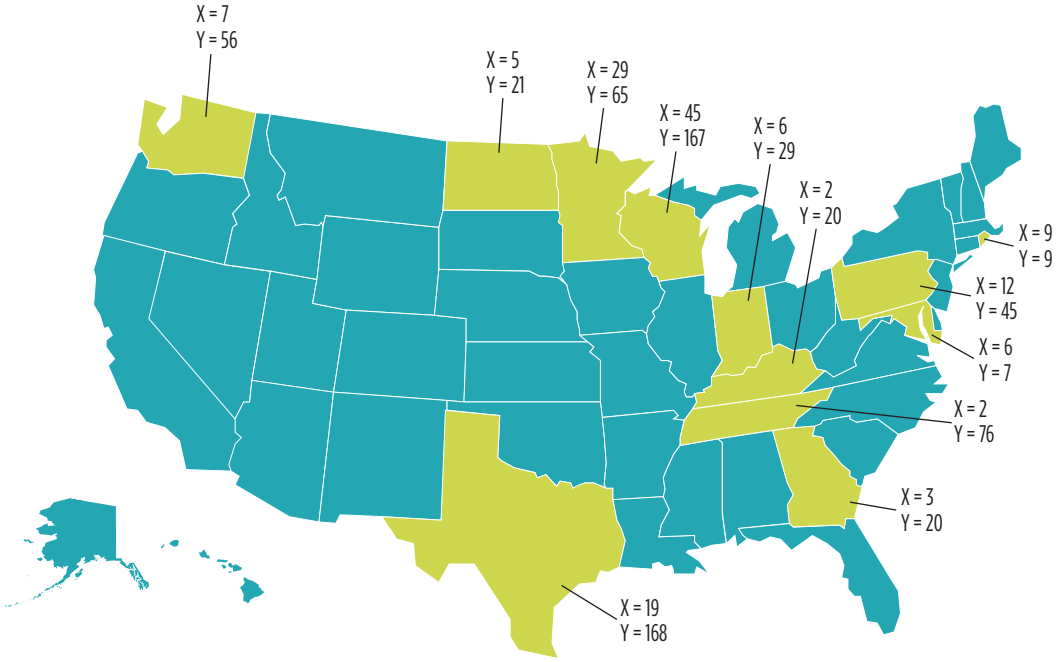


FIGURE 4

A TOTAL OF ONLY TWELVE STATES ALLOW CREDIT UNIONS TO COMPENSATE THEIR BOARDS OF DIRECTORS



X = number of credit unions with a paid board
Y = number of credit unions studied

FIGURE 5

CREDIT UNIONS IN SOME STATES ARE FAR MORE LIKELY TO HAVE PAID BOARDS THAN OTHERS

State	Number of credit unions studied	Number of credit unions with paid boards
Texas	168	19
Wisconsin	167	45
Tennessee	76	2
Minnesota	65	29
Washington	56	7
Pennsylvania	45	12
Indiana	29	6
North Dakota	21	5
Georgia	20	3
Kentucky	20	2
Rhode Island	9	9
Maryland	7	6

Note: In some cases, 2012 IRS Form 990 data contain compensation data that are problematic. For example, two credit unions in Tennessee included director compensation data for 2012 despite the fact that Tennessee did not allow director compensation until 2014.

Credit Union Size

A majority of state-chartered credit unions have less than $50 million (M) in assets under management. As we describe in further detail below, larger credit unions are more likely to pay their boards overall, and the amount of director pay is strongly related to credit union size.

Board Size

More than half of the credit unions we studied have between five and seven directors on their board, excluding board officers and any staff who might sit on the board.

FIGURE 6

SIZE DISTRIBUTION OF PAID BOARDS, BY CREDIT UNION ASSETS

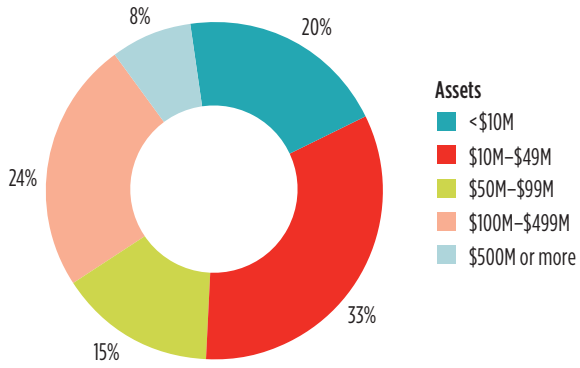
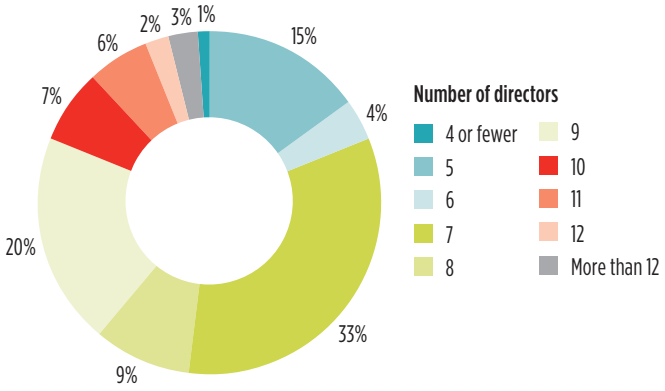


FIGURE 7

BOARD SIZE DISTRIBUTION



Interviews with Credit Unions and Regulators

We conducted interviews with senior managers and board members from 10 credit unions that have adopted board compensation policies, as well as representatives from six state regulators and one representative from Credit Union National Association (CUNA). The purpose of these interviews was to provide anecdotal context for the data we collected from the IRS filings.

CHAPTER 2

Credit Union Boards Today

Boards of directors fall along a spectrum ranging from being mostly hands-off to being heavily involved in the day-to-day operations of an organization. Following the major corporate and market meltdowns of the last 15 years as well as regulatory shifts such as Sarbanes-Oxley and Dodd-Frank, the expectations facing boards have evolved. While regulatory scrutiny falls disproportionately on publicly listed corporations, credit union boards have nonetheless embraced many of the newest best practices. As a result, credit union directors are better educated, are more professional, and bring a greater diversity of skills than ever before.

Credit union directors are better educated, are more professional, and bring a greater diversity of skills than ever before.

Most boards of directors now fall somewhere near the middle of the spectrum, playing a governance and oversight role rather than sitting on the sidelines or handling the operations. There are only three responsibilities that all boards, including credit union boards, believe are their own and nobody else's:

- Hiring and firing the CEO.
- Evaluating and compensating the CEO.
- Approving organizational strategy.

While boards play a part in many other important organizational responsibilities—such as risk management, monitoring financial performance, and human capital oversight—the responsibility for carrying these out is typically shared with staff.

Our interviews with CEOs suggest that credit union boards, even today, are more likely than their private-sector counterparts to be primarily hands-off. This is not inherently troubling: Boards of directors are free to delegate as much decision-making authority as they please within regulatory limits. Whatever the rationale, however, governance risks may emerge if boards become too distant from ongoing oversight. Filene Senior Scholar Bob Hoel expresses similar concerns in a 2011 report:

> *In credit unions, CEOs often are de facto chairs even though laws and regulations prevent them from officially being the board chair. Sometimes this occurs because the board is so impressed with the CEO's abilities that it acquiesces to his or her every desire. It also may occur when the official board chair is unable or unwilling to perform standard chair duties. Sometimes the entire board may be so weak that it will not stand up to an aggressive CEO. Whatever the cause, the result is a "rubber stamp" board.*[1]

In short, the decision to delegate significant authority to the CEO is well within a board's purview. But when the board or chair is, as Hoel says, "unable or unwilling to perform," this delegation represents a passive *non*decision and is a significant governance failure.

With many credit unions experiencing tremendous growth and increasing regulatory complexity, the spotlight is shining on their boards. Have they adapted their skills and composition to reflect the changes in their environment? Are the directors prepared to

commit sufficient time to provide effective oversight and contribute meaningfully to decisions? Most importantly to this study, what role might board compensation play in ensuring that boards are up to the task?

CHAPTER 3

Why: Reasons For and Against Adopting Board Compensation

In our years of research and education on the topic of credit union governance, no subject has been as divisive as board compensation. This disagreement manifested in many ways as we conducted this study. For example, many board members and staff feel that the idea of paid boards is fundamentally contrary to the cooperative philosophy and tradition. In fact, we encountered cases of directors who had refused to accept fees when their board adopted compensation policies, simply because they were opposed to the concept of paid directors. After many years, or decades in some cases, a significant majority of credit union boards still choose not to pay their directors regardless of regulation. During the first year of the rule change in Tennessee allowing board compensation, not a single credit union took advantage of the change, despite the fact that it had been driven by a petition from credit unions. Although the tone of the conversation has changed to be more receptive to board pay, it is far from popular.

The fears related to transitioning from a volunteer board are dramatic, and perhaps sensible:

- Every dollar spent on board compensation is a dollar that cannot be spent elsewhere.
- A paid director will have a strong incentive to stay on the board past his or her prime.
- Any step that narrows the differentiation between credit unions and banks is a threat to credit unions' tax-exempt status.

In short, those opposed to board compensation see it as a threat to strong performance, good governance, and the fabric of the credit union system.

Those on the other side of the argument appear equally convinced. Their reasoning tends to focus specifically on board effectiveness while dismissing the importance of other concerns. As we will see below, credit unions with paid boards tend to have stronger performance than their counterparts. Although this correlation does not in any way show causation, the fact that credit unions with paid boards are typically strong performers alleviates external scrutiny and also mitigates the internal financial impact of paying directors. When questioned about the risk to his credit union's tax-exempt status, one CEO replied, "Someday we might be taxed, and when that day comes we'll deal with it. . . . It's not going to move any faster as a result of board compensation." Proponents of paid boards believe that the benefit lies in the effectiveness of the board itself.

In every interview we performed, with credit unions and regulators alike, the participants cited effective board renewal as the key benefit of paying board members. Rather than seeing it as a perverse incentive for entrenched directors to hold on even tighter, they believe that paying boards empowers them—obligates them, even—to clean house when necessary. Our interview participants believe it is easier to expect more from paid directors and to hold them accountable for their actions, or lack thereof. One CEO quipped, "Are you trying to tell me that volunteer boards don't suffer from entrenchment?" Equally important is the idea that compensation provides boards with a tool to attract better directors. As one of our interview participants explained, "Candidates who are educated and have attained a level of profile in their field all have the expectation that there should be some [financial] return for their 'laboring in the vineyard.' "

In every interview we performed, with credit unions and regulators alike, the participants cited effective board renewal as the key benefit of paying board members.

After years of growth and increased regulatory scrutiny, particularly in the wake of the financial crisis, credit union leaders face greater expectations on many fronts. As a result, simply being a member is no longer a sufficient qualification for a berth on most credit union boards of directors. In addition, "rubber stamp" boards present an even greater risk when many millions, or even billions, of members' dollars are at stake. The credit unions that pay their boards are confident that even a small amount of compensation is enough to enable them to attract a higher caliber of director. If this is true, then the other concerns surrounding board compensation may need to take a back seat.

Simply being a member is no longer a sufficient qualification for a berth on most credit union boards of directors.

Which Credit Unions Are Paying Their Boards?

One trend stands out when examining the characteristics of credit unions that pay their boards: Size matters. While this echoes trends in the private sector, the connection between size and board pay is even more dramatic for credit unions.

Larger Credit Unions Are More Likely to Pay Their Boards

Director compensation is not unheard of among small credit unions. In our sample, Queen Employees Credit Union in Albert Lea, Minnesota, is the smallest credit union with a paid board at just over $2M in assets. Its highest-paid board member received $60 in 2012 for a reported 50 hours of work. This example is both an exception and a rule. The larger a credit union is, the more likely it is to adopt board compensation policies; with an average asset size of over $400M, credit unions with paid boards are nearly four times larger than their volunteer counterparts (see Figure 8). Queen Employees is a clear exception here.

FIGURE 8

AVERAGE ASSET SIZE OF PAID AND VOLUNTEER BOARDS IN STATES THAT ALLOW FOR COMPENSATION

Director Pay at Large Credit Unions Is Much Higher

Here, Queen Employees represents the rule: It is at the bottom of the list in terms of both size and board compensation. The boards of credit unions with over $500M in assets receive four times more pay than their smaller counterparts (see Figure 9). This trend parallels those we have seen in the private sector. In the United States, the largest publicly listed corporations, those with over $100 billion (B) in assets, pay their boards more than twice as much as corporations with less than $10B in assets (see Figure 10). Nonetheless, even the largest credit unions pay their boards significantly less than comparable firms in the private sector.

FIGURE 9

LARGE CREDIT UNIONS PAY THEIR BOARDS MUCH MORE

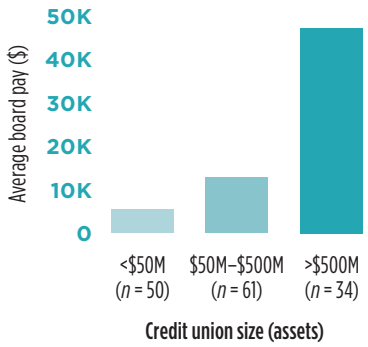
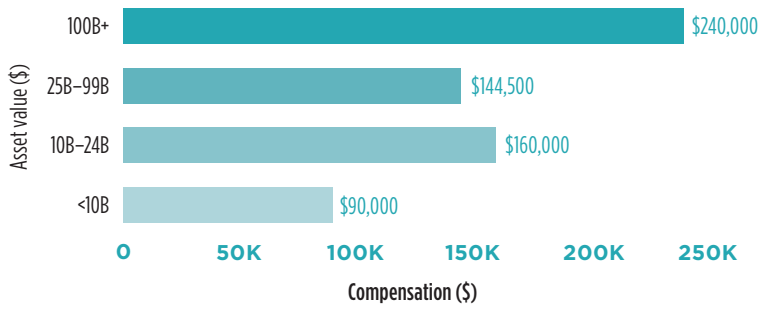


FIGURE 10

2011 US PUBLIC COMPANY MEDIAN TOTAL DIRECTOR COMPENSATION, BY ASSET VALUE



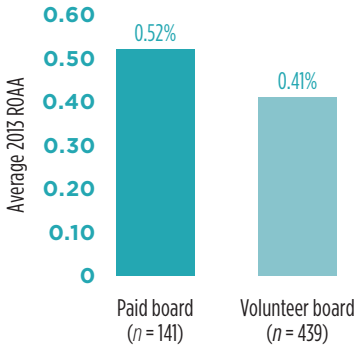
Source: Conference Board/NASDAQ OMX/NYSE Euronext, *Director Compensation and Board Practices: 2013 Edition*, February 2013.

Director Pay and Credit Union Performance

Representatives from six state regulators explained that they would interfere with individual credit unions' board compensation policies only if they were concerned about financial performance. In 2012, the average return on average assets (ROAA) of credit unions with paid boards was significantly higher than those with volunteer boards (Figure 11). The available data are insufficient for us to determine causation; however, our interviews with credit union leaders suggest that financial health drives the decision to pay directors rather than the other way around, at least in the beginning. These discussions revealed that credit unions are careful when deciding whether or not to pay, as well as the amount and type of compensation, to ensure that policies are not a financial burden to the organization.

FIGURE 11

CREDIT UNION BOARD PAY AND ROAA ARE ALIGNED



Interviews with credit union leaders suggest that financial health drives the decision to pay directors rather than the other way around.

None of the regulators we interviewed had found grounds, financial or otherwise, to involve themselves in credit union board compensation policies except in extreme circumstances such as administrative action.

Board compensation does not appear to have a negative impact on performance.

As tempting as it may be to assert that paying board members leads to stronger performance, we do not have enough evidence to do so. At the very least, board compensation does not appear to have a negative impact on performance. Moreover, some of the strongest performing credit unions in the United States have seen fit to adopt board pay policies.

CHAPTER 5

Board Compensation by State

Among the 12 states that allow credit unions to pay their directors, there are a variety of policies on board compensation, but the majority are not prescriptive. In the seven states marked "silent" in Figure 12, regulators have provided no rules governing the types and amounts of permissible compensation or the circumstances under which compensation is allowed. We interviewed regulators from some of these states, who explained that they wanted to give credit unions the opportunity to use their own judgment. Even those states with more restrictive regulations take a relatively hands-off approach, allowing credit unions a certain amount of leeway unless their behavior seems egregious.

FIGURE 12

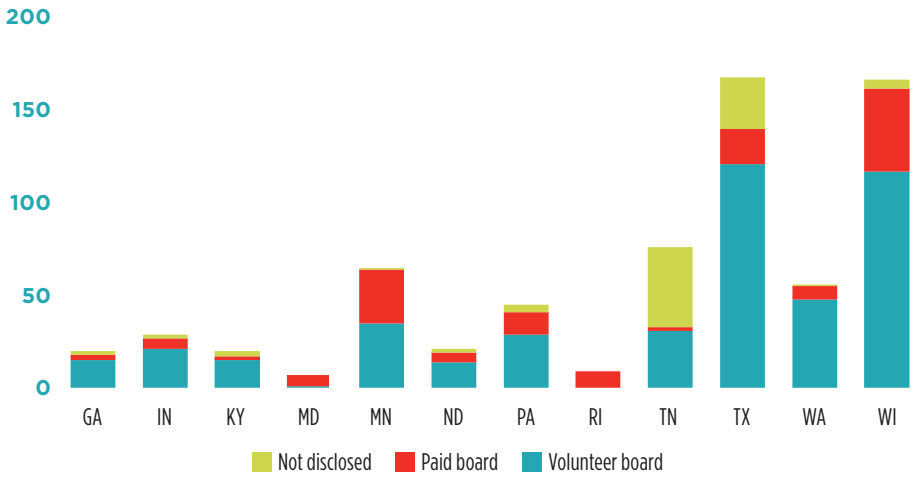
STATE-BY-STATE POLICIES ON BOARD COMPENSATION

State	Policy
Georgia	Silent
Indiana	Silent
Kentucky	Silent
Maryland	Silent
Minnesota	May be compensated at an hourly rate for official duties
North Dakota	Directors are immune from civil liability if not compensated
Pennsylvania	May pay directors if dividends are commensurate with market rates
Rhode Island	Silent
Tennessee	Silent
Texas	No salary allowed, but meeting fees and reimbursements are OK
Washington	Regulatory rules allow for "reasonable compensation"
Wisconsin	Health insurance only

Most states on this list have allowed board compensation for longer than current regulatory staff can remember. Even though the origins of the initial decisions have been lost, the staff we interviewed all agreed that it is generally not the regulator's job to influence credit union governance. In cases where the change is recent enough to remember, it was initially driven by the state credit union league, often at the behest of a small group of vocal credit unions rather than a united majority. The result in most states is that most credit unions still do not compensate their boards (Figure 13). Moreover, Wisconsin and Minnesota, two of the states with the

FIGURE 13

DISTRIBUTION OF PAID AND VOLUNTEER BOARDS BY STATE

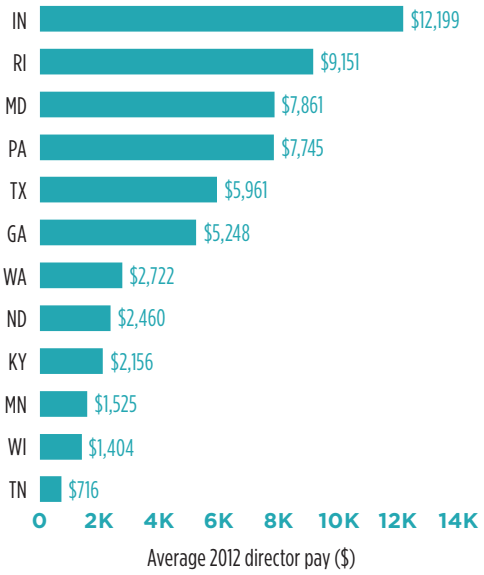


most restrictive director compensation regulations, have more than 50% of all paid boards between them.

Credit unions in Maryland and Rhode Island are most likely to pay their directors; all nine state-chartered credit unions in Rhode Island have paid boards, as do six of seven in Maryland. They are also two of the top three states in average director pay (see Figures 14 and 15). Average annual director fees in every other state are less than $2,000. Since the most recent available data are from 2012, they do not reflect recent regulatory shifts in Tennessee and Washington. According to state regulators in Tennessee, they have not yet received a petition from any credit union hoping to adopt board compensation policies. Washington, based on our confidential interviews, may appear at the top of the average board pay list in coming years despite only a small number of credit unions implementing board pay policies.

FIGURE 14

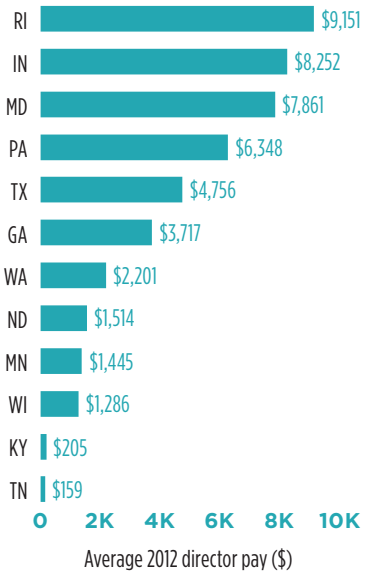
AVERAGE DIRECTOR PAY BY STATE, 2012 (PAID DIRECTORS ONLY)



Note: These calculations include only those directors who received compensation in 2012. Many boards reported that only some directors received pay.

FIGURE 15

AVERAGE DIRECTOR PAY BY STATE, 2012 (ALL DIRECTORS)



Note: These calculations include all board members of paid boards, including those directors who received no reportable compensation in 2012.

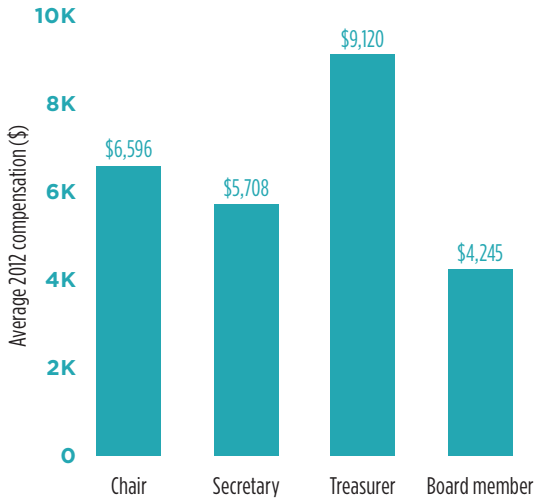
CHAPTER 6

Board Pay Structures and Comparisons

Since the available data on credit union board compensation are currently limited to IRS Form 990 disclosures, we cannot yet perform a granular analysis on types of pay (e.g., annual retainer/salary, meeting fees, insurance, reimbursements). Overall, however, the average paid board member receives $4,245 annually. Paid board officers are paid more than the average director, with treasurers receiving the highest pay at just over $9,000 per year (see Figure 16). It is very rare for credit unions in our sample to have paid board officers but not paid board members. Out of the 539 credit unions that disclosed compensation on their Form 990, only 25 (less than 5%) had one or more paid board officers and no paid directors.

FIGURE 16

AVERAGE BOARD OFFICER PAY

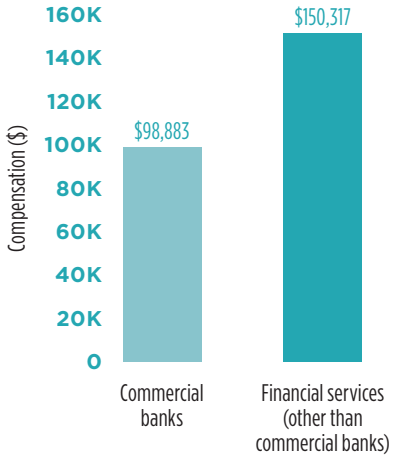


Overall, the average paid board member receives $4,245 annually.

Compared with the private sector, these figures are modest. Directors of commercial banks received an average of nearly $100,000 in 2011, while director pay in the rest of the financial services sector was even higher (see Figure 17). In addition, many smaller companies offer noncash compensation to directors such as stock options in order to reduce the immediate financial burden on the organization while still providing an incentive to current and prospective board members.

FIGURE 17

AVERAGE US PUBLIC COMPANY DIRECTOR COMPENSATION, 2011



Source: Conference Board/NASDAQ OMX/NYSE Euronext, *Director Compensation and Board Practices: 2013 Edition*, February 2013.

CHAPTER 7

Does Board Compensation Get the Job Done?

Our interviews reveal that the central rationale for adopting a director compensation policy is improving the effectiveness of board composition. All of the managers and board members we interviewed were confident that paying their board enabled them to attract and retain better board members. Participants admitted, however, that there is more to ensuring effective board composition than compensation.

Filene and CCBE will explore this topic in greater detail in an upcoming report on credit union board renewal. Our investigation of director pay, however, yielded some insights.

The list of board responsibilities that have become more complex in the past decade seems, and perhaps *is*, endless. Based on our conversations with credit union boards over the past two years, we have compiled a list of the five most challenging responsibilities facing directors. In no particular order:

- Hiring/firing highly specialized CEOs.
- Performing a meaningful evaluation of the performance of the CEO and the organization.
- Assessing, developing, and approving strategy with an eye on the present and the future.

- Ensuring appropriate board composition on an ongoing basis.
- Developing and maintaining effective governance structures, systems, and processes.

These conversations also reveal an overall lack of confidence that boards are sufficiently equipped to provide effective oversight on these matters. In the case of boards that are effective today, most are concerned about the future.

While the primary objective of board compensation, as described by our interview participants, is to attract high-quality board candidates, few of the participants have taken any additional steps to ensure that this goal is achieved on an ongoing basis. One participant explained that "the only policy more controversial than director compensation is term limits." A CEO of a credit union with a compensated board claimed that "nobody leaves the board except for health reasons or because they die." In short, although compensation may help to *attract* good candidates, it does nothing to help create new vacancies.

Although compensation may help to attract *good candidates, it does nothing to help create new vacancies.*

This is not to say that board compensation fails to yield improvements to credit union governance. In fact, the evidence we gathered throughout this study leads us to believe that any lingering concerns about director pay are largely overblown. A conscientious board will ensure that its pay does not meaningfully impede the performance of the credit union. In addition, rigorous board renewal processes can counteract director entrenchment much more effectively than questioning whether to pay or not to pay. As long as a board ensures that it monitors the appropriateness of its pay on an ongoing basis by reviewing internal financial data and external peer comparisons, there is little chance that sudden and urgent risks will arise. The most important step is to ensure that the board has sufficient and relevant information to make meaningful decisions. This monitoring is typically done by the board as a whole led by the chair, or by a specialized subcommittee (e.g., HR Committee or Governance Committee) with results and recommendations presented to the full board.

A credit union board's primary fiduciary responsibility is to protect the interests of the credit union's members. If this can be better achieved by implementing director compensation policies, then it is the board's duty to do so within the regulatory allowances.

Most importantly, a credit union board's primary fiduciary responsibility is to protect the interests of the credit union's members. If this can be better achieved by implementing director compensation policies, then it is in fact the board's duty to do so within the regulatory allowances. Each board must make these assessments for itself, and we believe that it can do so with a clear conscience no matter which side of the board compensation argument it chooses.

CHAPTER 8

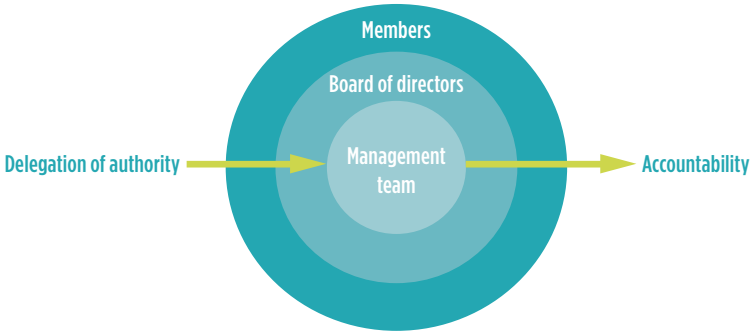
Recommendations for Credit Unions

Continually Assess the Flow of Accountability and Authority in Your Credit Union

Many boards behave as though they are accountable to the CEO and not the other way around. While this is sometimes a conscious cultural decision, it can become routine, and in many cases it is deeply ingrained in a board's behavior. Without a deep understanding of the board's legal, fiduciary, and philosophical duties, the impact of potentially valuable tools such as board compensation is limited, and governance risks are magnified.

FIGURE 18

THE FLOW OF AUTHORITY AND ACCOUNTABILITY IN A CREDIT UNION



Petition Your Credit Union League

If you or your credit union believes that board compensation is an important governance tool, engage your state credit union league. Recent developments in Tennessee and Washington show that you do not need critical mass to make the change. Our findings indicate that board compensation poses minimal risk to governance and financial performance. The fact that credit unions with paid boards are above-average performers suggests that, at the very least, director compensation is not detrimental to financial performance. Moreover, state regulators are closely monitoring the performance of credit unions with paid boards in order to safeguard against crises.

Assess the Effectiveness of Your Board and Directors on an Ongoing Basis

The implementation of formal board and director evaluation processes is a highly effective way for boards to identify actionable opportunities for improved effectiveness. A 2013 study we undertook with CUES revealed that 87% of credit union boards with formal evaluation processes were able to take concrete steps to improve their boards as a direct result of those processes. Director evaluation processes, such as peer review, yield similar opportunities at the individual director level, thus providing directors with guidance to enhance their contributions to the board and also highlighting when turnover may be necessary.

Create, and Maintain, a Board Skills Matrix

Monitoring the balance of your board's skills is a simple and highly valuable exercise. A simple skills matrix compares the skill sets of the current directors against the skills that the board as a whole needs to function effectively. This helps to illustrate areas of strength and redundancy and any current or emerging skills gaps. Use this information to guide your board's nomination processes and to search for ideal candidates.

Monitor Your Credit Union's Performance

Although we do not have sufficient data to show that paying directors leads to better performance, we believe that the true goals of good governance are effective leadership and decision making—neither of which shows up on an income statement. Nonetheless, regulatory bodies closely monitor the performance of credit unions that pay their boards. If you believe that director compensation is an expense that your credit union cannot afford, or if you already have paid directors, consider these options to enhance your board:

- **Optimize board meeting time allocation.** Ineffective agenda management is one of the key reasons boards struggle to provide effective strategic oversight. Circulate reading materials as early as possible (at least one week in advance), schedule important strategic items at the beginning of meetings, and implement the use of consent agendas.
- **Consider the occasional engagement of outside advisors.** Board consultants typically aid with the facilitation of important board processes such as evaluations, board renewal, and CEO succession. It is often helpful for boards to engage an experienced and impartial third party to provide perspective and context for high-level board matters such as overall governance structure, board and committee mandates, board size, and meeting structure.

- **Manage the "information gap."** The CEO spends all day every day thinking about and managing the credit union from the top down. A typical credit union board meets 12 times per year for a few hours. This creates a significant informational asymmetry between the board and management. Boards must be aware of this gap and must ensure that they have access to an adequate amount and quality of information to make fully informed and value-creating decisions. If the board believes that it does not have sufficient information, it must have the courage to insist on more complete material before moving forward.

Remember that even paid boards often fail to implement processes to ensure healthy board renewal. If there are never any vacancies on the board, how can board compensation help you to attract new and better directors?

Director Compensation Pros and Cons

FIGURE 19

TO COMPENSATE OR NOT? BOARD MEMBER COMPENSATION PROS AND CONS

Reasons to compensate	Reasons not to compensate
Board pay attracts and retains better board members • High-caliber professionals are more likely to join your board if there is a financial incentive to do so • Your board will have greater confidence when approaching strong candidates • A paid board will commit more time to formal board renewal processes • Your board will be better able to attract younger board members with busy new careers HOWEVER: Compensation alone is insufficient to achieve optimal board renewal. QUESTIONS FOR YOUR BOARD: To what extent will board compensation address our renewal challenges? What other processes and policies should be in place to identify and attract new directors?	**Board pay is contrary to the credit union philosophy** • Directors can better represent the interests of members as volunteers • A dilution of core credit union values dilutes the impact of the mission and hurts members • If we pay boards, does that make other core values vulnerable? What is next on the chopping block? HOWEVER: The central goal of a credit union is to serve the interests of members. If paying board members helps to do this, then it must at least be considered. QUESTIONS FOR YOUR BOARD: In what ways might board compensation impede the credit union's ability to carry out its mission? Are we interested in exploring ways to mitigate this risk?
Board pay engenders an increased time commitment • Your board can ask and expect more from paid directors • Longer board meetings have been shown to yield better results and greater time spent on strategy HOWEVER: Many volunteer boards achieve this by implementing rigorous formal processes. QUESTIONS FOR YOUR BOARD: Is the duration of our board meetings always sufficient to cover the entire agenda? Do directors commit enough time before meetings to ensure that they are fully prepared?	**Paying board members will lead to entrenchment** • Could exacerbate existing entrenchment • Directors with lower incomes would have an incentive to stay just for the pay • May do more harm than good to already difficult renewal efforts HOWEVER: Entrenchment is a significant problem for credit union boards even without director pay. Formal renewal processes are the solution. QUESTIONS FOR YOUR BOARD: Are any of our current directors long-tenured and underperforming? What processes could we put in place to deal with entrenchment before it happens?
Paying board members leads to greater board accountability • Can hold paid directors to stricter expectations • Easier to insist on formal board and director evaluations • More leverage to get rid of "dead wood" • Stronger motivation for directors to enhance their skills HOWEVER: Boards are accountable, whether they are paid or not. QUESTIONS FOR YOUR BOARD: Do our board members fully understand their fiduciary duties? Are these duties effectively integrated into our board activities?	**Paying board members costs money!** • Every dollar spent on board pay is a dollar not spent elsewhere • Financial commitments to the board may decrease organizational flexibility, especially in a crisis • Could lead to increased scrutiny from regulators HOWEVER: Good governance is not always free. If paying your board achieves the "pros," then it is a very efficient use of resources. QUESTIONS FOR YOUR BOARD: If we chose to pay our board members, what would the correct amount be? To what extent does this expense impact our financial well-being?
Board pay is a recognition of the contributions of directors • Directors are specialized professionals committing significant time • Board members face tremendous personal liability HOWEVER: Is a small amount of compensation enough to make a difference? QUESTIONS FOR YOUR BOARD: Are we confident that our board members are committed to fulfilling their responsibilities? Is recognizing and compensating for their time wise, or just a boondoggle?	**Paying board members threatens credit unions' tax-exempt status** • In some cases, differentiation from banks is already tenuous, and this could tip the scales • Gives banks potentially powerful lobbying leverage HOWEVER: Banks will keep looking for an edge regardless. The consensus among credit union insiders is that board pay will not tip the scales. QUESTIONS FOR YOUR BOARD: How prepared are we for changes to the tax-exempt status of our credit union? What measures can and should we take now and in the future to ensure that we are financially secure in case of such changes?

Endnote

[1] Bob Hoel, *Boards and CEOs: Who's Really in Charge?* (Madison, WI: Filene Research Institute, 2011), 10.

List of Figures

About the Author

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Matt Fullbrook is the manager of the Clarkson Centre for Business Ethics and Board Effectiveness (CCBE) at the Rotman School of Management, University of Toronto. Under his direction, the CCBE has evolved into the central hub of governance research in Canada. Matt has overseen the development and execution of all of the CCBE's projects since 2004, including the Board Shareholder Confidence Index, pay/performance assessment, SME governance ratings, and a newly launched study of the governance of family firms. The CCBE has studied credit union board effectiveness since 2007, focusing on the links between governance and performance, board renewal, strategy, and optimizing boardroom time allocation. Matt has also advised dozens of boards of directors, helping them to maximize their effectiveness through the formalization of important practices.

About Filene

Filene Research Institute is an independent, consumer finance think and do tank. We are dedicated to scientific and thoughtful analysis about issues affecting the future of credit unions, retail banking, and cooperative finance.

Deeply embedded in the credit union tradition is an ongoing search for better ways to understand and serve credit union members. Open inquiry, the free flow of ideas, and debate are essential parts of the true democratic process. Since 1989, through Filene, leading scholars and thinkers have analyzed managerial problems, public policy questions, and consumer needs for the benefit of the credit union system. We support research, innovation, and impact that enhance the well-being of consumers and assist credit unions and other financial cooperatives in adapting to rapidly changing economic, legal, and social environments.

We're governed by an administrative board made up of credit union CEOs, the CEOs of CUNA & Affiliates and CUNA Mutual Group, and the chairman of the American Association of Credit Union Leagues (AACUL). Our research priorities are determined by a national Research Council comprised of credit union CEOs and the president/CEO of the Credit Union Executives Society.

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