FOSTER PEPPER

Symposium on Current Issues in Credit Union Board Governance

PRESENTATION MATERIALS
September 15, 2017

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Presented by:

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Presentation

SYMPOSIUM ON CURRENT ISSUES IN CREDIT UNION BOARD GOVERNANCE

Friday, September 15, 2017

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Introductory Remarks

Brad Thoreson – Foster Pepper

Culture and Governance: Washington Mutual Case Study

Bill Longbrake – University of Maryland

CULTURE & RISK MANAGEMENT

Washington Mutual Case Study

University of Washington – Professor Holland

Bill Longbrake

Executive in Residence

University of Maryland, Smith School of Business

September 15, 2017

Culture
Definition

- A system of basic shared assumptions of ***meaning/purpose*** within an organization shaped by internal and external opportunities and challenges that are internalized by members
  - May be shaped by senior management to align with strategic goals
  - Or, may evolve in emergent fashion
- ***Beliefs***, ***values*** and ***behavioral*** (conduct) expectations shared by members
- Culture is what tells your members ***why*** they should work
- ***"The way we do things around here"***

Culture
Attributes

- Passes across generations of members
- Stable over time – changes usually occur slowly and in small increments
  - Change can accelerate in the face of existential threat
- ***Why*** members work is what determines ***how well*** they work (importance of ***engagement***)
  - Provides members with a way of giving meaning to their daily lives, setting guidelines and rules for how to behave;
  - Reduces/contains anxiety of dealing with an unpredictable and uncertain environment

Culture
Leadership Challenges

- How does ***"the way we do things around here"*** get maintained, either across people or across time, or both?
  - ***Normative base for decisions*** – basic assumptions about what are the "right" and "wrong" kinds of behavior
  - ***Cognitive base for decisions*** – basic assumptions about how the world works
- Exercising control while simultaneously delegating decision-making authority

Types of Cultures

- ***Strong*** – basic assumptions are widely shared and deeply held by members
  - Strong cultures have higher levels of performance
- Inspire ***creativity/enthusiasm***
- ***Fear/stress***

Strong Cultures Outperform

- Consensus and endorsement of values and norms facilitates ***social control***
  - Informal social control is more effective and lower cost than formal control structures (e.g., incentive systems, reporting, compliance, audit, etc.)
- Enhance goal alignment – facilitates ***coordination***; less room for debate about what is in organization's best interests
- ***Engagement*** **–** Enhances member ***motivation and performance*** **due** to perception that behavior is more freely chosen rather than required and enforced

Strong Culture – Risks

- May hinder timely adaptation when culture's basic assumptions conflict with rapidly changing external environments (***e.g. emergence of smart phones and rapid changes in payments behaviors***)

Creating and Maintaining a Strong Culture

- ***Selection***
  - Members' personal attributes "fit" the culture
  - Hard to maintain in large, complex organizations with large number of members passing in and out
- ***Socialization***
  - ***Leaders*** – forcefully and consistently articulate and enact the organization's core values
  - ***Co-workers*** - importance of congruence between leaders and co-workers
- Cultures more likely to persist if they are ***institutionalized*** – expressed concretely in organizational practices, espoused values, and tied to visible symbols and leadership signals, which are used to remind members of core values and beliefs

Reinforcing a Strong Culture

- ***Rewards – Incentive Compensation Programs***
  - Can reinforce desired outcomes
  - Can be damaging when it motivates work rather than work well done
- Members need a degree of autonomy but they also need guidance and support

Culture – Leadership Behaviors

- ***Purpose*** – Help members understand how his/her work is important and meaningful – formal statements of philosophy and values
- ***Signals*** – Make it clear what it means to be performing well – articulate vision and symbols
- ***Story Telling & Rituals***
- ***Generate Commitment*** – Provide members with more responsibility as his/her skills increase (***increase potential***)
- Ensure that members don't waste effort on nonproductive activities (***overcome potential for inertia***)

Culture – Leadership Behaviors

- ***Balance*** between ***executing*** the plan and ***adapting*** to changing external forces – ***open feedback***
- Encourage ***experimentation*** and meaningful work and resist the urge to "over engineer"
- Design physical ***work spaces***
- ***Recruit, select, promote, retire*** … in support of culture
- Allocate ***rewards and status*** consistent with cultural beliefs and values and expected behaviors
- ***Always, always "walk the talk"***
- ***Measure, assess, and adjust***

Washington Mutual Case Study

- ***Strong culture*** and ***tightly focused business strategy*** enabled company to grow rapidly from a small regional retail financial services company to the sixth largest bank in the U.S., much admired and envied by competitors
- But in 2008 Washington Mutual was the ***largest bank ever to fail*** – ***how did success turn to disaster?***
  - ***Strategy*** shift
  - External ***environment*** changed
  - ***Culture*** corrupted in pursuit of market share and profits
  - ***Leadership*** conduct did not "walk the talk"

Washington Mutual Case Study – Chronology

- 1981 – Threat of Failure
- Lou Pepper Era – 1981-1990
  - Survival
  - Building the Foundation
- Kerry Killinger Era Part I – 1990-2002
  - Expansion Through Acquisitions and free checking
- Kerry Killinger Era Part II – 2002-2008
  - Strategy shift/corruption of culture – decline and failure

Essential Elements of a Successful Enterprise

- Strategic Plan
  - FOCUS: Consumer Banking – High Touch Service
  - 5-Year Plan; Annual Review
- Culture - Values
- Compensation Programs
- Leadership
- Operational Execution
- Risk Management

Emergence of WaMu as a Dominant Bank

- ***1981 – Tough Environment***
  - Inflation
  - High interest rates
  - Dwindling deposits
  - Huge losses
  - Plummeting capital
- ***Lou Pepper's charge*** – save the bank from failure or sell it

Emergence of WaMu as a Dominant Bank

- ***Bold Actions***
  - ***Cut costs*** **– survive**
  - ***Imagine the future***
  - ***Convert from mutual to stock ownership***
- ***Lou's vision*** – develop a "Consumer Bank"
  - Satisfy most consumer financial needs in one place
  - Focus on amazing customer service – "Go and sell"

Lou Pepper Era: Building the Foundation

- A crisp, focused mission and strategy – ***do a few things well***
- Solid values, balancing ***shareholder***, ***customer***, ***employee***, and ***community*** needs that are reflected in your brand*
- ***Build a strong infrastructure*** with good information, performance measurement, technology, and streamlined processes
- Build executive management team ***right people on the bus***
- ***Empower employees*** to do what's right for the customer – engaged employees ***act like owners***
  - Reinforce through values – ***ethics***, ***respect***, ***teamwork***, ***innovation***, ***excellence***
  - Reinforce through compensation programs – franchise profit model

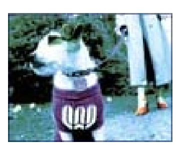
*** This is broader than maximizing shareholder value** ***stakeholder capitalism***

Values – Washington Mutual

- ***Ethics***: All actions are guided by absolute honesty, integrity and fairness
- ***Respect***: People are valued and appreciated for their contributions
- ***Teamwork***: Cooperation, trust and shared objectives are vital to success
- ***Innovation***: New ideas are encouraged and sound strategies implemented with enthusiasm
- ***Excellence***: High standards for service and performance are expected and rewarded

Killinger Era Part I – Acquisitions & Free Checking

- Growth through acquisition (***eat or be eaten***)
- Growth through new products (***Free Checking***)
  - Designed around customer pain points
    - No minimum balance requirement
    - No monthly fees, transaction charges
    - No embarrassment from bounced checks (but fees for overdrafts)
  - Designed to be a market disruptor
    - Huge consumer demand
    - Against conventional wisdom
    - Highly profitable
    - Strong cross-sells of other products



Growth Through Acquisition – 1993-2002

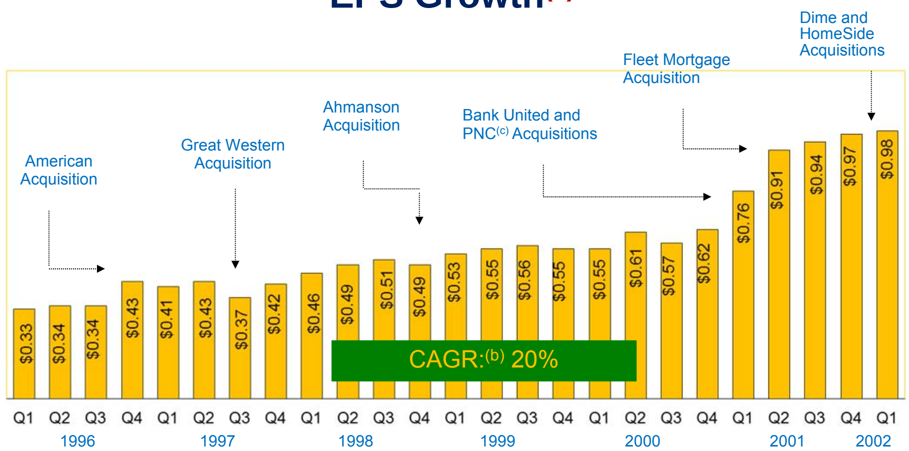
- ***From $7 billion in assets to $270 billion***
  - 1993 Pacific First Bank, OR/WA (doubling size of WaMu)
  - 1996 American Savings, CA (redoubling size of WaMu)
  - 1997 Great Western, CA (redoubling size of WaMu)
  - 1998 Home Savings, CA (nearly redoubling size of WaMu)
  - 2001 Bank United, TX
  - 2002 Dime Savings, NY

National Expansion – 1993-2002

- ***Unique Market Positioning***
  - Free Checking – good deal
  - Looking out for customer needs
  - Great customer service
  - Humor

Creating Shareholder Value

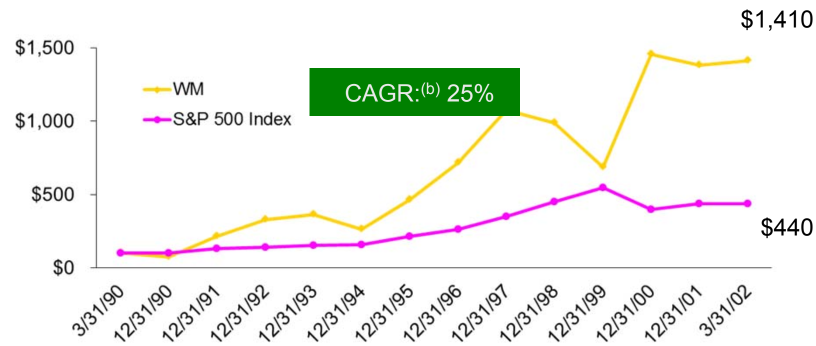
EPS Growth[(a)]



(a) Excludes SAIF assessment in Q3 1996 and transaction-related charges (all applicable periods); includes acquired companies only after date of merger
(b) CAGR calculated from Q1 1996 through Q1 2002
(c) PNC acquisition refers to the acquisition of the mortgage operations of The PNC Financial Services Group, Inc.

Creating Shareholder Value

Cumulative Value of Investments[(a)]



(a) Assumes an initial investment of $100 at 3/31/90 and reinvestment of dividends since 3/31/90 when current management team was formed.
(b) CAGR calculated from 3/31/90 through 3/31/02
Source: Bloomberg

The New Millennium Brings Loss in Momentum

- Major competitors copied Free Checking
- Many began building similar new branches
- No more sleepy thrifts of size available for acquisition
- WaMu had to change or be marginalized

Killinger Era Part II – Strategy Shift, Decline, Collapse

- ***Essential Elements of a Successful Enterprise – What Changed***
  - **Strategic Plan**
    - **FOCUS: Consumer Banking; Mortgage Banking**
    - **5-Year Plan; Annual Review**
  - Culture - Values
  - Compensation Programs
  - Leadership
  - Operational Execution
  - Risk Management

Real People, Real Results

Distinct Market Position

Real People, Real Results

Distinct Market Position

Strategy Shift, Decline, Collapse

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Cultures - Values

- ***Original Values***
  - Ethics
  - Respect
  - Teamwork
  - Innovation
  - Excellence
- ***Redefined Values***
  - Dynamic
  - Driven
  - Fair
  - Caring
  - Human
- ***Deliberate Cultural Change*** - "The goal was to change the culture from one that was 50% person/support and 50% task/achievement to one that was at least 80% task/achievement. The problem with that kind of culture is that it becomes all about greed and ethics can be thrown out the door and that was what happened." *Andrea Ridgely-corporate leadership development trainer*

Strategy Shift, Decline, Collapse

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Strategy Shift, Decline, Collapse

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  - Compensation Programs
  - **Leadership**
  - Operational Execution
  - Risk Management

Leadership

- ***CEO Leadership Style***
  - Strong visionary
  - Marketing/promotional communication style
  - Powerful motivator
  - Highly analytical – (inquiry vs. advocacy)
  - Avoided conflict and confrontation
  - Indecisive in resolving operational issues
- ***Constructive Conflict Discouraged***
- ***CEO Weaknesses Took on Increasing Importance Over Time***
  - Growth in size and complexity of company
  - Change in composition of executive leadership

Strategy Shift, Decline, Collapse

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Strategy Shift, Decline, Collapse

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CULTURE & RISK MANAGEMENT

Washington Mutual Case Study

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Current Themes in Governance: Avoiding Group Think, The Value of Assessments, and More

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Credit Union Board Governance

CU Board Governance Symposium

September 15, 2107

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Why Governance is a Timely Topic

1) **Credit unions have grown in size and complexity**
2) **Many CU Boards are facing succession events**
3) **Board compensation has emerged as a key issue**
4) **Board meeting frequency options are now available**
5) **New approaches to board committees are emerging**
6) **Board composition and diversity are critical themes**
7) **Excellence in governance is a perennial quest**

The Role of the Board

"Governance is not management."

Kenneth Dayton

Source: Kenneth Dayton, Former Chairman, Dayton-Hudson Corporation

What Distinguishes Nonprofits from For-Profits?

"Mission is what distinguishes nonprofits from their for-profit cousins. Nonprofits have missions instead of owners or shareholders. While the primary directive for for-profit directors is to ensure the highest possible value for owners, by contrast nonprofit Board members' prime directive is mission fulfillment."

Source: Lesley Rosenthal, *Nonprofit Corporate Governance: The Board's Role*

Nonprofit Board Role - Overview

- **Governing Boards in for-profit and nonprofit contexts share many legal precepts:**
  - Oversight role
  - Decision-making power
  - Place in the organizational structure
  - Members' fiduciary responsibility
- **However, nonprofit Board governance places a <u>heightened</u> demand on Board members due to:**
  - A larger mix of stakeholders
  - A more complex economic model
  - A lack of external accountability

Source: Lesley Rosenthal, *Nonprofit Corporate Governance: The Board's Role*

Two Primary Duties

- **At the highest level, a Board has two primary duties:**
  1. Ensure that the right CEO is in place
  2. Watch over the fiduciary interests of the organization, and all other stakeholders who are impacted by the decisions of the Board

Source: Browning & Sparks, *The Director's Manual,* Wiley, 2015

Nonprofit Board Role - Specifics

- **The Board of a well-governed nonprofit organization, similar to that of a for-profit corporation, will do all of the following:**
  - Formulate key organizational policies and strategic goals
  - Authorize major transactions
  - Oversee matters critical to the health of the organization – not decisions about specific matters, which is the role of management – Board-level matters include:
    - The viability of the business model
    - The integrity of internal systems and controls
    - The accuracy of financial statements
  - Establish risk parameters and monitor adherence to those
  - Steward the resources of the organization for the longer run
  - Hire the CEO and ensure the succession plan is robust

Source: Lesley Rosenthal, *Nonprofit Corporate Governance: The Board's Role*

3 Critical Questions a Board Should Ask

1) **Is the right CEO running the company?**
This is not a single event, but part of a continuous evaluation process.

2) **Does the organization have a robust succession process, and does the plan include the appointment of a strong short-term successor?**

3) **Does the organization have the right strategy? If so, is that strategy being implemented effectively?**

Source: Browning & Sparks, *The Director's Manual,* Wiley, 2015

The Board's Role vis-à-vis Strategy

"The Board does not run the organization. Board members expect the CEO and the CEO's management team to present an effective strategic plan and to execute it effectively…. The most effective Boards find ways to devote sufficient time to this critical subject."

Source: Browning & Sparks, *The Director's Manual,* Wiley, 2015

The Board's Role vis-à-vis Strategy

"The main thing is figuring out the main thing."

Prof. Richard Chait

Source: Richard Chait, Harvard Graduate School of Education

Ten Mistakes to Avoid

- **Charity Lawyer lists the following Top 10 Nonprofit Board Governance Mistakes:**

1. Failing to understand fiduciary duties
2. Failing to provide effective oversight
3. Deference to Executive Committee, Board Chair or Founder
4. Micro-managing staff
5. Avoiding the hard questions
6. Insufficient conflict management
7. Lack of awareness re laws governing tax-exempt entities
8. Operating with outdated, inconsistent governing documents
9. Airing disagreements outside the Boardroom
10. Failure to cultivate Board diversity

Source: Charity Lawyer, *Nonprofit Law Simplified*

Value of Board Self-Assessments

"Assessing performance is the most effective way to ensure your Board members understand their duties and utilize effective good governance practices."
BoardSource

"To check your Board's vital signs, or to put in place practices and strategies for a healthy and energized Board, the best place to start is with a Board self-assessment." *Maine Association of Nonprofits*

"A self-assessment can identify issues needing clarification, gaps in skills Board members need, and topics for Board education, and can measure the Board's own effectiveness." *National Council of Nonprofits*

Board Participation

"Courage is what it takes to stand up and speak. Courage is also what it takes to sit down and listen."

Sir Winston Churchill

Tips to Optimize Board Decision Making

- **Conformity pressure can lead to "non-synergy" and a failure to aggregate collective knowledge when making decisions.**
- **Group size is often inversely correlated with individual participation.**
- **Board cohesiveness is critical to maintaining productivity, performance and director engagement.**
- **Boards must be alert to avoid *"Groupthink"* and the *"Abilene Paradox"* in making critical decisions.**
- **Establishing clear ground rules and expectations for participation is vital.**

Source: Browning & Sparks, *The Director's Manual,* Wiley, 2015

Board or Management?: You Decide

- **Which of these issues are Board level and which are Management level?:**

1. Deciding where to open the next branch
2. Reviewing and approving the overall risk policy
3. Determining which core data processor to use
4. Discussing and agreeing upon the key strategic priorities
5. Developing the annual strategic plan
6. Approving a new staff diversity plan
7. Approving the annual strategic plan
8. Developing the annual budget
9. Determining what an appropriate growth target should be
10. Discussing and agreeing upon a merger strategy
11. Deciding whether to remove cash from branches

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STRATEGY *LEADERSHIP* *CULTURE*

The Board-Management Relationship

Steve Peltin – Foster Pepper

FOSTER PEPPER

Board-Management Relationship:
Hitting the Sweet Spot
September 15, 2017

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Governance vs. Management

- Sweet spots are at different locations depending on the bat
- The sweet spot is "a region, approximately 5-7 inches from the end of the barrel, where the batted-ball speed is the highest and the sensation in the hands is minimized."

Physics and Acoustics of Baseball & Softball Bats
Daniel A. Russell, Ph.D., Graduate Program in Acoustics, The Pennsylvania State University

Governance vs. Management

- For credit union boards, the sweet spot in the management relationship is the area where effectiveness of governance is the highest and pain is minimized.


Governance vs. Management

- Board of Directors (governance)
- CEO and other executives (management)
- Perfect balance between Board governance and staff management – the sweet spot

Board-Management Relationship

- General rules
  - Board supervises the CEO
  - CEO supervises the staff
  - If Board is unhappy with staff or Credit Union performance, it should replace the CEO
- Next slides will cover employment issues in Board governance
- Quiz later, with John Lass

Employment Issues in Governance

- Selection and hiring of CEO
  - Role of the Board
  - Role of outside recruiters
  - Role of compensation consultants
  - Role of inside or outside attorneys

Employment Issues in Governance

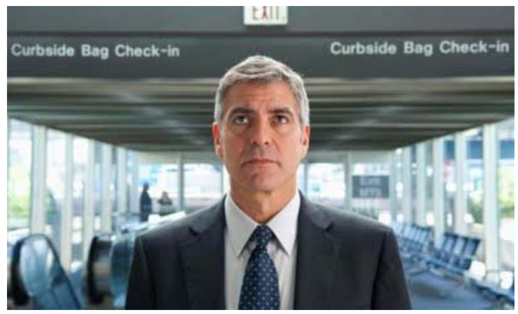
- CEO employment agreements
  - Level of detail
  - Bargaining leverage
  - Tone
  - Timing

Employment Issues in Governance

- Board supervision of CEO
  - Feedback loop
  - Performance/compensation reviews

Employment Issues in Governance

- Board termination of CEO
  - No surprises
  - Who decides
  - Who implements
  - Role of separation agreement



Employment Issues in Governance

- Board role in:
  - succession planning
  - selecting other executives
  - responding to employee complaints/reports
  - setting personnel policies
  - benefits plans

Board-Management Relationship:
Hitting the Sweet Spot
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Lunch

The Role of Board Committees

Parker Cann – Parker Cann, LLC

THE ROLE OF BOARD COMMITTEES

September 15, 2017

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Board Committees

Overview

A. Boards of state credit unions (SCUs) and federal credit unions (FCUs) have legal authority to establish committees as they feel are necessary to conduct the business of the board of directors (BOD).

B. If you haven't re-visited your BOD Committee structure in the last 5-10 years, it probably needs to be refreshed.

BOD Committees

BOD Committees should be adding strategic value to your credit union. Are your BOD Committees:

- Effective? Are your Committees getting the job done and adding value?
- Efficient? Are you efficiently using the time spent by directors on Committee business?
- Meeting regulatory requirements and expectations?

Typical Committees

Some typical Committees, in addition to the Supervisory (or Audit) Committee:

- Nominating
- Governance
- Risk
- Comp/HR
- Compliance
- Pension
- Credit/Loan
- Exec
- Finance
- Investment

Expanding Role of BOD Committees

A. Since the Great Recession, Board work has increased substantially. And so have regulatory expectations. Regulators are more comfortable dictating to CUs, particularly in corporate governance.

B. Naturally, BODs are looking to delegate more of their work to their Committees.

C. By delegating responsibilities to their Committees, BODs potentially realize several benefits:
   - Better decision-making with deeper expertise/deeper review at Committee level
   - Creates efficiencies for full BOD by saving BOD time and effort. This works best if the BOD can fully delegate decisions to its Committees. Much less efficient if the Board has to give a full review and re-approval of every issue decided by a Committee.

What Are the Regulatory Limits on Delegating to BOD Committees?

A. Of the NCUA statutes and rules that require BOD approval of an action, they fall into two basic categories:
   - Most do not mention delegation to a BOD Committee
   - There are a few that expressly allow for a BOD to delegate certain decisions to one of its Committees, like the capital planning and stress testing (CPST) rule.

B. Regulatory guidance at the state and federal level on this topic in inconsistent and haphazard at best. And because there does not seem to be any overarching regulatory principle to it, it is difficult to predict what an examiner might insist has to go to the BOD for approval.

C. Despite the regulatory uncertainty here, it is reasonable to establish written delegations to BOD Committees. If an examiner objects, ask what the basis for the objection is. Is there a statute or rule that the objection is based on?

Some Suggestions to Support Your Delegation Practices

- Your BOD-approved policies should rationalize the BOD's philosophy on delegation to Committees.
- Each BOD Committee should have a written charter (or policy) describing its responsibilities. The Charter should be approved by the BOD and the subject Committee.
- You are in a better position if the Committee is comprised of a majority of directors
- You should recruit or train directors for strong Committee expertise
- You should encourage Committees to take deep dive on significant subject matters. Add more detail to Committee meeting minutes to ensure that they reflect a deeper dive. Minutes should go to the Board for informational purposes.

Role of Directors on BOD Committees

Even with a deeper dive into the subject matter, the role of a director as a Committee member remains the same as the director's role on the BOD: still at policy, strategic or oversight level, not at operational level.

Role of Nominating Committee

- The Committee has taken on greater importance as the selection of nominees for the BOD has become more important
- Who serves on the Committee? Are they in touch with the direction of the BOD?
- Does the Committee make final nomination decisions? Or does the BOD?
- Does the CU develop and maintain a desired skill set matrix for directors? Is it used by the Committee in the recruitment and nomination process?
- Does the Committee use a recruiting firm?

Role of Nominating Committee

- Do incumbents have to apply for nomination for re-election? Is nomination of incumbents pretty much assumed? Does the Committee review director assessments when considering nomination of incumbents?
- Application process
- Petition process
  - How many CUs have a petition process to get on the ballot?
  - Ever used?
- Contested races?
- Is the Supervisory Committee viewed as a training ground for directors? Is there an expectation that Supervisory Committee members will eventually serve on the BOD?

The Supervisory Committee: What's In A Name?

Constituting the Supervisory Committee (SC)

By election or appointment? Who can serve?

A. Federal Credit Unions (FCUs): SC members are appointed by Board (BOD), but only one can be a director

B. In Washington, state credit unions (SCUs) have options:
   - Election by members, all can be directors if bylaws so provide; or
   - Appointment by BOD, but only one can be a director (by virtue of parity statute in WA State Credit Union Act)

The Basic Role of the SC

The basic role of the SC, under the Federal Credit Union Act (FCUA) and NCUA rules

A. "The management of a federal credit union shall be by a board of directors, a supervisory committee, and where the bylaws so provide, a credit committee." (FCUA)

B. The SC is responsible to ensure that the BOD and management

- Meet required financial reporting objectives; and
- Establish practices and procedures sufficient to safeguard members' assets.

The Basic Role of the SC

C. The SC must determine whether accounting records and financial reports are promptly prepared and accurate

D. The SC must, as required by other NCUA rules, perform or obtain an audit

Not entirely clear which of the NCUA's audit requirements for SCs apply to SCUs

In addition, for SCUs, there is state law overlay – probably something similar to NCUA's

Questions Remain about the Role of the SC

Unfortunately, some of these powers/duties are very broad or at least ambiguous, and can lead to different conclusions by examiners about the appropriate role of the SC. Some of the questions here:

- The SC needs to be independent of management to perform its basic functions. Is it supposed to be independent of the BOD?
- Is the SC a "Board Committee"? This may be important for various purposes – state or NCUA regs, credit union bylaws, D&O insurance.
- Does the Chief Audit Executive/Internal Auditor report only to the SC, or is it acceptable to split CAE reporting, with a solid line to the SC, and a dotted line to management? Who hires the CAE? … does the CAE's annual review? … sets the CAE's salary and other benefits? SC alone, or C-suite member with input of SC? If the latter, which C-suite member? Can the CEO and other C-suite members attend/participate in SC meetings?

Realizing the Value of SC

Does your SC add value to your corporate governance processes? What is the highest and best use of your SC? Is it a strategic asset or just a check-the-box for regulatory purposes?

- BOD should adopt SC policy or charter outlining the responsibilities of the SC with some specificity.
- BODs have a lot of flexibility in setting the responsibilities outside of those prescribed by statute or regulation. These may include oversight of various matters, such as:
  - Financial performance
  - Credit union follow-up on exam and audit deficiencies
  - Outside audits and reviews (in addition to the annual audit)
  - Enterprise Risk Management (ERM)
  - Conflict of interest determinations, at least for senior management and directors
  - CPST
  - Compliance

Outside of the Audit Function, What Does the SC "Supervise"?

Regulators seem to view oversight of the BOD as part of the SC's role. This view flies in the face of a basic tenet of corporate governance, that the BOD (and the BOD alone) manages the affairs of the company.

The name of the Committee itself can create role confusion. Makes it harder to recruit and retain qualified people who understand the role.

Extraordinary Powers of SCs

A. Suspend directors, subject to member vote at special membership meeting
B. Call special meeting of members to consider:
   - Removal of directors; and
   - Other
C. Contrast with the role of audit committees in the business (and bank) world.

The Concern

- These extraordinary powers may lead some SC members to conclude that they have the authority to challenge BOD decisions or take on an operational role, outside of the audit function. There have been instances where SCs have attempted to override BOD decisions. These turf battles can easily become public and are damaging to the CU's reputation.

The Recently-Enacted California Statute

- California amended its CU Act effective this year to allow CUs to opt in to a BOD-appointed Audit Committee (AC), along traditional AC lines. In order to do so, CUs must amend their bylaws, with member and state agency approval. The AC may be comprised entirely of directors, but at least a majority of the AC must be directors. The AC does not have extraordinary powers.

Advantages of a True AC

- No election – members appointed by Board – may be all directors
- Better understanding of role of the Committee
- Less confusion about the difference in BOD and Committee roles
- No extraordinary powers (suspension of directors; calling member meetings)
- But may require amendment of statutes or regs for FCUs and SCUs outside of CA

An AC in Name Only; All-Director SCs

A. NCUA has expressly recognized the ability of SCUs to call their Supervisory Committee an “Audit Committee”. This helps Committee recruits and members to appreciate the primary role of the SC. Of course, in WA, the Committee still possesses extraordinary powers. And the Committee must still comply with NCUA requirements for SCs of SCUs.

B. In WA, if SC (or AC) members are elected by the members, the Committee can be comprised entirely of directors. This aids in the alignment of the BOD and Committee and greatly reduces the chances of turf battles between the bodies.

THE ROLE OF BOARD COMMITTEES

September 15, 2017

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Board Composition, Diversity and Succession Planning

Rafael Stone – Foster Pepper

Panel Discussion: Planning for the Future

Closing Remarks

Brad Thoreson – Foster Pepper

FOSTER PEPPER PLLC