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Executive Compensation: A Strategic Partnership Between Boards & Management - (As printed in the CU Times) - by Bridget McNamara-Fenesy, Client Consultant

In late January, the NCUA announced some new rules, and clarified others, applicable to boards of federally chartered credit unions. Everyone is focused on the new NCUA requirements for financial literacy in board members, but some may be overlooking an even more important pronouncement: The NCUA stated that while boards may (and in our opinion, should) delegate operational responsibility to credit union senior management, they cannot delegate their responsibilities for direction and control of the credit union.

The buck stops in the boardroom. The board “must directly exercise its authority to hire, fire, determine duties, set compensation, and discipline senior management. The board must also ensure that appropriate policies are in place to guide senior management in the execution of their duties.” A strong, clear, and strategic compensation policy is the cornerstone for all of this. This is one of the most important responsibilities of any board, and without it, any long-term strategic success is left to chance.

Where should a board start in “ensuring that appropriate policies are in place to guide senior management?” As a wise man once said, it’s best to start at the beginning. Usually the beginning is a clear definition of where the credit union is going in the long-term. Long-term goals must be clearly defined and understood by all members of the board and senior management. The senior leadership group’s goals must be aligned with the interests of the members. Alignment comes from shared values about the credit union’s direction, which then translate into well-articulated goals. Executives should understand how achievement is measured. What may be right for one credit union will not necessarily be right for another. A compensation philosophy and executive reward system must be “applicable and appropriate” and it is the board’s responsibility to design its programs to meet its own credit union’s objectives.

As a part of the development of a strategic compensation and benefit program designed for the long-term, boards must start with an honest view of their management team. This includes not just the CEO, but the rest of the senior team as well. A primary responsibility of the board is to establish an articulated succession plan, and then supplement that plan with clear policies related to senior management expectations. Well-prepared credit unions will develop the talent sets that can move the credit union forward, and then make sure the right programs are in place to retain and reward that talent for their contributions to the credit union’s success. Performance standards that are specific and measurable should be fundamental to both short-term and long-term compensation policies and practices, and must be clearly communicated and understood. The focus on the connection between executive compensation and strategic direction and success is not limited to the NCUA. State regulators are also entering the fray.

The California Department of Financial Institutions (“DFI”) recently announced that they will be paying closer attention to executive pay programs within credit unions under their jurisdiction,

to determine that compensation and benefit programs are “appropriate for the size, complexity and attributable to the performance of the credit union.” We expect to see other state regulators take similar positions. Whether boards welcome this regulatory involvement or feel it is overstepping is not relevant: Boards will need to address these issues, and they must formulate policies and practices that support their articulated long-term strategic vision for the credit union, regardless of whether a regulator is part of the conversation.

Well-articulated long-term, strategic, and performance-based compensation programs are far more likely to attract the right leaders to the credit union. They will also retain them for the long-term, and reward them for superior performance. This means that boards must establish clear, pre-determined and objective measurements against which the senior management team’s performance can be evaluated. The objectives should be visible so that everyone knows when they are on target, and when they need to correct course.

While boards have the responsibility for the alignment of leadership compensation with the strategic goals of the credit union and the best interests of the members, they rarely have the incumbent expertise to develop the systems, structures, and mechanics to get the job done. Credit union boards have access to outside consulting resources that can provide guidance in articulating their objectives, and structuring plans that keep compensation and benefits appropriate for the size of the credit union, consistent with the mission and vision of the credit union, and that are ultimately affordable.

All of the foregoing is consistent with the NCUA requirements for financial education and literacy for board members. An enhanced focus of credit union boards on their responsibility to intentionally and thoughtfully direct and control the credit union is the result of better board education that includes minimum standards for financial literacy, but board member responsibility goes well beyond those minimum standards. Increasing financial knowledge and setting strategic direction will strengthen the ability of credit unions to serve their membership, and will result in a stronger partnership between boards and senior leadership. But boards cannot be expected to go it alone. Credit unions must seek out expertise that helps provide boards with the requisite tools to do their jobs. One thing is certain: What is best for the membership must be the guiding principle for all strategic decisions about the continuity, succession, and compensation of the executive team.

THE SURVEY 2010: Employee and Executive Compensation and Benefits for the Credit Union Movement is available, at no charge, in book or electronic format. To obtain a copy please send an email to creditunion@ecs-m.com or call Executive Compensation Solutions at (626) 914-2333.

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