STRATEGIC INSIGHTS FOR POLICY MAKERS

Credit Union National Association

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Cultivate Your Board Recruits

Greylock FCU plays the long game in seeking potential board members.

Every board of directors periodically will have to recruit new members, and the process a board uses to recruit those members will depend on the credit union's needs.

But those processes always seek to find the same result: new ideas.

"The driving reason behind recruiting new board members is to get good, fresh ideas," says Jeff Rendel, president of Rising Above Enterprises. "On a board that has seven or eight members, a good rule of thumb is to have one or two of them new to the board."

At Greylock Federal Credit Union in Pittsfield, Mass., the board takes time to cultivate potential board members—sometimes spending a year or two engaging in dialogue. While the board's most basic requirement is to look for individuals with sufficient financial savvy to read and understand complex financial statements, it often looks for people with a specific set of skills that will add value to the board.

"We're always looking for synergy," says John L. Bissell, president/CEO of the $1.2 billion asset credit union. "Our current board has so many sources of experience and expertise that I feel blessed. It's a strong board that challenges our management in a positive way and is tuned in to our market.

"I have heard enough horror stories from other credit union CEOs about botched or failed board recruitment efforts," Bissell continues. "That's why we're careful and always mindful of the chemistry between board members and the level of the recruits' desire to commit and put their expertise to work in the community."

> 'JOINING THE BOARD TO EXERCISE STRATEGIC THINKING WAS AN OPPORTUNITY I COULDN'T PASS UP.'
> KRYSTLE GALLO

One successful recruitment story for Greylock Federal is Krystle Gallo, a mechanical engineer and integrated product team lead at General Dynamics Mission Systems.

A first look at her resume—which documents a long journey through a STEM (science, technology, engineering, mathematics) education—may not overtly indicate skills a credit union board would seek.

But Bissell saw qualities in Gallo he thought would be valuable to the board. This included her aptitude for understanding complex problems, involvement in volunteer activities, and her enrollment in an MBA program.

Gallo's decision to pursue an MBA in business development is motivated by a desire to understand the business side of engineering.

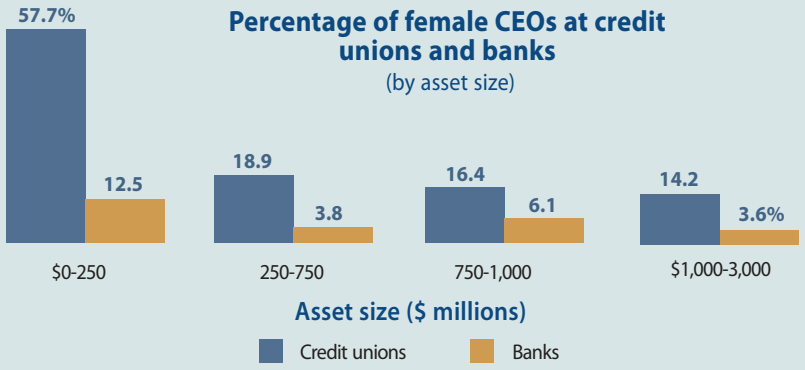
"I'm as fascinated by business as I am with science," she says. "There's a lot of strategic, higher-level thinking involved in business development. I see connections everywhere between what I'm doing at work and what I'm learning pursing an MBA."

Bissell first approached Gallo in September 2017—eight months before she actually joined the

QUICK TAKE FOR YOUR NEXT BOARD MEETING

Female CEO Representation

Fifty-two percent of credit union CEOs are women versus 5% at banks. And CEOs of large credit unions are four times more likely to be women than those at banks of comparable size. However, only 14% of CEOs at credit unions with more than $1 billion in assets are women, according to CUNA analysis.



Source: CUNA, NCUA, and SEC

CUNA board and committee resources: *cuna.org/board*

board. While talking during a leadership development program Gallo had planned, they discovered they were in the same MBA program. This sparked additional discussions that eventually led to an invitation for Gallo to join the board.

When she attended a Greylock Federal board meeting, members of the credit union's senior management team each spent about 10 minutes briefing Gallo on their specific roles and tasks. Each invited her to sit down with them for longer discussions on their fields of management and expertise.

"I'm still early in my career, so joining the board to exercise strategic thinking was an opportunity I couldn't pass up," Gallo says.

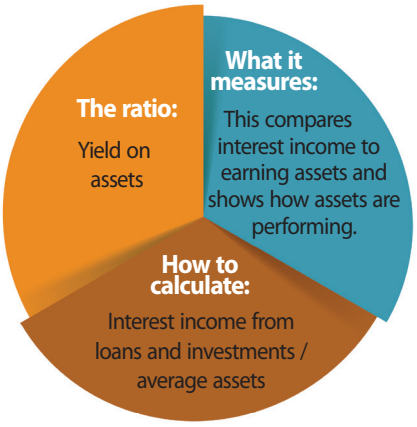
CUNA Professional Development Online: *cuna.org/cpdonline*

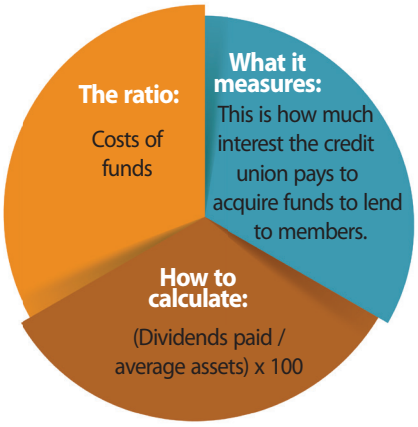
Ratios to Remember

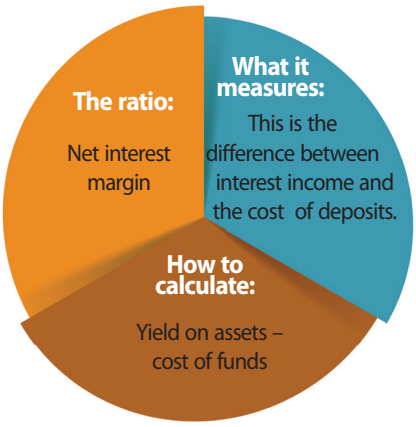
Financial statements—specifically the income statement and balance sheet—hold a wealth of information about the credit union. While the information is essential, these statements aren't that useful when taken alone.

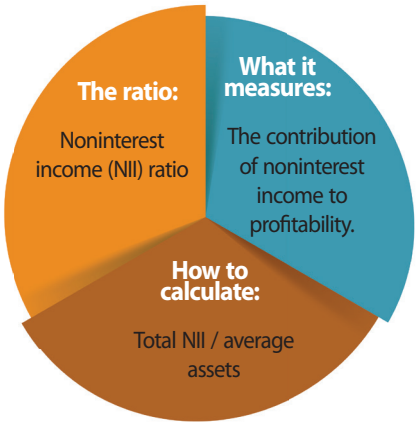
To get the most out of these statements, you must examine certain key ratios. *Credit Union Directors Newsletter* will explore key ratios board members should know, including what the ratio measures, how to calculate it, and why it's important.

This month, we'll examine the four pieces used to determine spread analysis: yield on assets, cost of funds, net interest margin, and noninterest income. In June, we'll examine three more pieces and see how to use all seven pieces to conduct a spread analysis.









Why it's important:

These are four pieces of information needed to calculate the spread analysis, which shows how credit unions make money. The spread analysis is a ratio of key balances from the income statement compared to the credit union's average assets.

Becoming Diverse and Inclusive

Changing demographics are an opportunity to affirm credit union values.

The U.S. will be a minority-majority by 2043, according to the U.S. Census Bureau, and credit unions must prepare for that shift by taking steps now to ensure their organizations are diverse and inclusive for employees and members.

In fact, the very ideas of diversity (the differences that exist among people) and inclusion (a work environment and culture where everyone participates and is valued regardless of differences) are embedded in the cooperative principles guiding credit union philosophy.

"As I look at my community of credit unions, I see an opportunity to reaffirm our values and explore new opportunities," says Maurice Smith, president/CEO of Local Government Federal Credit Union in Raleigh, N.C., and former CUNA Board chairman. "I think the time is right to officially recognize diversity and inclusion as part of the credit union philosophy."

CUNA and its member credit unions are committed to ensuring diversity and inclusion play a meaningful role in every aspect of the credit union system.

While diversity and inclusion aren't specifically included in the seven cooperative principals, Smith says the ideas of open and voluntary membership and democratic control imply diversity and inclusion are welcome aspirations for credit unions.

"We need to hold each other accountable for equality, equity, and opportunity for members, volunteers, and credit union professionals," Smith says. "It must be everywhere—from the grassroots of our communities to the top of our credit unions—or we will not fully serve our purpose."

Diversity is important among board members as well as staff, and the board should represent the membership.

To ensure your board is diverse, you should work to attract diverse candidates during the recruitment process, according to "Formalizing the Art of Board Composition," a report from the Filene Research Institute.

Research shows diverse groups are more effective: Racially diverse groups demonstrate less conformity, and groups with diverse professional backgrounds make better decisions during uncertain times. Having a homogenous board increases the risk of organizational failure because directors may be unaware of how their inherent biases work against diversity, according to the Filene report.

But while 40% of report respondents say they prioritize diversity when recruiting new board members, fewer than 30% believe diversity is among the most valuable traits in the boardroom.

"If your board decides to look for increased diversity but changes nothing else about the approach to composition and recruitment, your chances of success are slim," the report states.

To change your approach to recruiting and improve your board diversity, the Filene report offers these tips:

- **Rethink** the skills you're looking for. Work with the board to define the skills and characteristics that are valuable in the boardroom.

Look beyond the resume and demographic diversity and consider personality traits and soft skills. Placing a stronger emphasis on soft skills will give you a more diverse set of candidates.

- **Go** beyond your network. During the recruitment process, board members often reach out to trusted people in their networks as a first step. Go beyond these networks to identify candidates.
- **Set** high expectations. Set the bar high for the nominating committee. And remember, it's within your rights to refuse to accept nominees who don't fit the expectations—whether it's demographics, skills, or characteristics—the board has identified as valuable in a candidate.

"When we promote diversity and inclusion within our ranks, we signal our determination to outperform the competition," Smith says.

"Diversity expands the pool of capable candidates with valuable talents. Inclusion opens the door for advancements within the organization and the movement as a whole. Working together, diversity and inclusion create a powerful force for credit unions' success."

Filene Research Institute: *filene.org*

- CUNA compensation resources: *cuna.org/compensation*
- CUNA Mutual Group: *cunamutual.com*

Send us your comments: *directors@cuna.coop*

The 'No Surprises' Model of Executive Benefits

Answer three questions about the current health of deferred compensation plans.

If you have deferred compensation plans in place for one or more of your top executives, consider these recent developments that might impact those plans:

- **Federal Accounting Standards Board** (FASB) **changes** can affect some non-703 compliant investments on your income statements.
- **The excise tax** on executive annual income above $1 million, which began in 2018.
- **A prolonged low-interest environment** that has been a drag on permanent life insurance crediting rates.

Given these developments, review deferred compensation plans you have in place. If the board's investment and/or executive compensation committees haven't reviewed the potential impact of these three factors on deferred compensation plans recently, they should.

Three questions to answer about the plans:

1. Will the FASB accounting change regarding equities add significant volatility to your net income?

FASB now requires credit unions to categorize certain non-703 compliant equities—for example, stocks or mutual funds—as "trading securities" on annual income statements for fiscal years beginning after Dec. 15, 2018. This will also be required for interim income statements for fiscal years beginning after Dec. 15, 2019.

A common use for this type of non-703 compliant investment is to fund an executive's nonqualified deferred compensation plan, such as a 457(f). Previously, credit unions could book these investments as "available for sale." For investments in this category, changes in value from one year to the next don't affect the income statement. They're considered an "unrealized gain/loss."

Now that these investments are categorized as trading securities, however, credit unions must assign fair market value to them and record changes in value as an income or an expense.

The takeaway: If you have one or more executives with this type of deferred compensation plan—or if you use non-703 qualified investments for general employee benefits prefunding or charitable donation accounts—follow the new FASB accounting procedure and understand the potential for market-driven income swings. Be prepared to shift to more stable investments if necessary.

2. Will income from any of your executives' plans trigger the new 21% excise tax?

The Tax Reform and Jobs Act that took effect in 2018 created a 21% excise tax for credit unions on annual executive compensation in excess of $1 million, plus any excess parachute payments, to any one of a credit union's five highest-paid executives.

Even if you don't pay any executive an annual salary more than $1 million, a nonqualified deferred compensation plan could trigger the tax. In particular, 457(f) plans may activate the tax because these plans typically vest periodically, resulting in lump-sum vesting and payouts.

The takeaway: Review deferred compensation plan vesting dates and projected payouts. You may need to adjust these vesting intervals and amounts to avoid the excise tax.

3. Are life-insurance-based supplemental executive income plans still on target to produce the originally projected benefit goals?

Cash-value life insurance products are common funding instruments for deferred compensation plans because these products tend to produce more steady, predictable earnings than stock portfolios. But when bond rates remain low for many years—as they have since the Great Recession—these earnings are often affected.

Periodically review the accumulated cash value of life insurance policies and the current crediting rates.

The takeaway: If insurance-based plans underperform—or if the executive's circumstances have changed—you should be able to adjust the plan to achieve the new goals. You can make adjustments to rebalance executive deferred compensation or supplemental retirement plans. You'll want to act quickly, however, if the plan is due to vest within a few years rather than within a decade or more.

Make an executive deferred compensation plan progress report part of the board's annual review process—call it the "surprise aversion initiative."

ANDY ROQUET *is senior executive benefits specialist at CUNA Mutual Group. Contact him at* andy.roquet@cunamutual.com.

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Publisher: Ann Hayes Peterson, vice president and editor-in-chief, *apeterson@cuna.coop*

Editorial staff: Bill Merrick, deputy editor, *bmerrick@cuna.coop;* Jennifer Plager, senior editor, *jplager@cuna.coop*

Design and production staff: Carrie Doyle, graphic designer, *cdoyle@cuna.coop*

Editorial: 608-231-4211 **Subscriptions:** 800-348-3646, fax 301-206-9789, or *cuna.org/directors*

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