

## NCUA: Examiners Will Evaluate Training Policies

*Board education policies should reflect CU business activities and risks.*

It is *not* NCUA's intent to increase examiner scrutiny of the financial skills of particular directors, the regulator writes in Letter to Federal Credit Unions No. 11-FCU-02. The letter is a follow-up to NCUA's January 2011 rule clarifying federal credit unions' fiduciary duties and specifying financial literacy requirements. The rule does not apply to state-chartered credit unions.

Rather, NCUA examiners will evaluate whether federal credit unions have a policy in place to make available appropriate training to enhance directors' financial knowledge. The letter points out that "a minimum of all directors must have the ability to read and understand the credit union's financial statements and income statement."

NCUA's letter says credit union policies should

■ **Opportunities** and funding for directors to acquire the skills needed to evaluate the credit union's finances. Some directors might come to the position with the necessary financial knowledge. Others might obtain these skills through internal credit union training, external training, college courses, or Internet programs.

■ **Education** alternatives for directors commensurate with your credit union's size and complexity.

■ **The time frames** for completing the training. By July 27, 2011, for directors currently serving who don't already have the necessary skills, and within six months for directors joining federal credit union boards after January 11, 2011.

'ONE TRAINING SIZE'  
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"One training size" can't fit all credit unions—and the same can be said for a board training policy, advises Kathy Thompson, CUNA's senior vice president of compliance. "That's why writing a board policy and including only the three points above probably won't

be sufficient for most federal credit unions. Any policy should at least mention the phrase 'and understand the credit union's internal control system,' and training should address internal controls."

The agency won't examine individual directors on their knowledge. But it will look at the federal credit union's policy to see how it's being followed, Thompson says.

The more complex your credit union is, the more NCUA will expect your policy to reflect the activities that can present greater risk to your credit union—and in NCUA's view, to the share insurance fund.

Thompson suggests the types of complex business

### QUICK FOR YOUR NEXT BOARD MEETING >>>

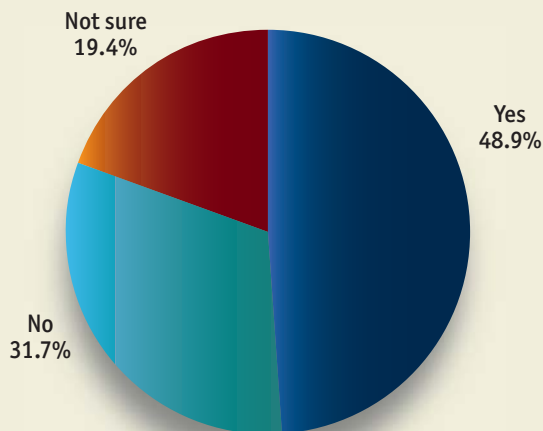
#### TURN TO SOCIAL MEDIA

Companies are turning to social media today for branding, networking, and customer relationship strategies.

But more than half of finance professionals surveyed say they don't have a social media policy or are unsure if one exists.

Understand social media risks and benefits. And consider incorporating social media strategies into crisis communication plans and policies.

### DO YOU HAVE A WRITTEN SOCIAL MEDIA POLICY?



Source: [Toolbox.com/PJA](http://Toolbox.com/PJA) Social Media Index



- CUNA's Board Financial Literacy Certificate: [training.cuna.org/boardreq](http://training.cuna.org/boardreq)
- NCUA: [ncua.gov](http://ncua.gov)

activities will include (but aren't limited to) indirect lending, loan participations, member business lending, credit union service organizations, and complex investments.

"Your policy should express directors' commitment to train on these activities and understand how they can affect your credit union's financial statements (after training on how to read the financials), and what steps your credit union will take to mitigate these risks," she says. This type of detail in your policy should meet NCUA's expectation that directors must "understand the specific activities in which their credit union engages.

"In particular, a director must understand not only how these activities generate revenue for the credit union but also, and perhaps most important, the various risks associated with these activities that could lead to a financial loss," Thompson explains. "A one-time training session for federal credit union directors sufficient

"If nothing at your credit union notably changes—for example, your credit union hasn't added any new business activities that could affect your institution's financial condition and increase risks—then it should be up to the credit union to decide if its policy should call for periodic training," Thompson says.

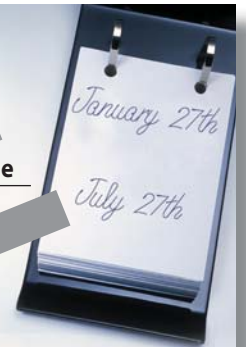
But if you add new lines of business—and new risks—NCUA will expect directors to receive training on the financial significance (and risks) of any new activities, she adds.

Visit [cuna.org](http://cuna.org) (select "regulations & compliance") for analysis of NCUA's financial literacy requirements for federal credit union directors. ■

## Financial Literacy Compliance Timetable

| Federal CU directors                                 | Financial literacy compliance date    |
|--|---------------------------------------|
| Current directors                                    | July 27, 2011                         |
| New directors elected/appointed before July 27, 2011 | July 27, 2011                         |
| New directors elected/appointed after July 27, 2011  | Six months after election/appointment |

Source: NCUA Update



## Questions to Test Your Financial Literacy

### *How well do directors understand your CU's balance sheet and income statement?*

Regardless of whether you're a new federal credit union director or a seasoned veteran, NCUA's new financial literacy requirements expect you to demonstrate an ability to read and understand your credit union's balance sheet and income statement.

So you're probably thinking: How will examiners assess this during our next examination? What questions will examiners ask to ensure we're financially literate? Will there be a quiz at the conclusion of the exit conference?

NCUA Chairman Debbie Matz said during the agency's December board meeting that examiners will not be "aggressive in quizzing" volunteers about their accounting knowledge.

But directors must be prepared and understand the basic concepts of credit union financials. The expectation of this rule is that you know enough

about the financials to ask thought-provoking questions of both management and auditors as appropriate. So take some extra time when preparing for your next board meeting, review your board packet, and ask yourself if you understand:

- **The basic accounting** equation within your balance sheet. (Assets = Liabilities + Equity/Reserves).
- **What an asset** represents. It's what the credit union owns, such as loans, cash, investments, and facilities. An asset account carries a debit balance.
- **What a liability** represents. It represents what the credit union owes, such as the members' shares, dividends payable, and accounts payables. A liability account carries a credit balance.
- **What equity/reserves** represent. Equity/reserves represent the members' ownership interests. Consider it this way: Assets – Liabilities = Equity/Reserve. An equity account carries a credit balance.
- **The relationship** between the income statement and balance sheet. They're joined through the net

income for the period and the subsequent increase, or decrease, in equity that results: Revenues – Expenses = Net Income (Loss). This net income or loss flows into the equity/reserves section of the balance sheet.

■ **That the balance sheet** drives the income statement. Strong loan demand and underwriting increases revenues and minimizes loan losses (expense). Strong equity/reserves provide a “cost-free source” of funds to make loans and investments.

■ **The function** of the allowance for loan and lease loss (ALLL) account. It's found in the asset section of the balance sheet and is considered a contra-asset that carries a credit balance.

The credit balance reflects the potential loan losses in your loan portfolio. Loan losses approved for charge-off are debited against the ALLL account. Required adjustments to ALLL are made through the provision for loan loss (PLL) expense by crediting the

ALLL account and debiting the PLL expense account found in the income statement. A charge-off recovery is posted as a credit to the ALLL account.

If you're not an accountant by trade and some of these questions have you wondering, then it's time for some training. There are several resources available, such as your credit union's internal accounting staff, credit union league, external auditors, and CUNA.

But the new financial literacy requirements give all directors an opportunity to review competencies they might need to improve to ensure continued success serving

your credit union's members. ■

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UNDERSTAND  
THE BASIC  
CONCEPTS  
OF YOUR  
CU'S FINANCIALS.



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BOARD BANQUET

'Do the Right Thing'

**My leadership style:** I try to be a facilitative leader—one who remains as neutral as possible in discussions and who asks questions to help the group move toward consensus.

**A valuable leadership trait:** I make decisions slowly. While this can annoy people in a restaurant or when playing Scrabble, it makes me open to all sides of an argument.

**What motivates me:** When I'm convinced that what we're doing is right but it's unpopular.

**How I learned about CUs:** From a new-employee orientation at Ohio University almost 30 years ago.

**Our No. 1 business challenge:** Earnings. While we remain well-capitalized at about 10%, we need to maintain our earnings to fund our growth. With margin compression, the loss of overdraft income, and the pending effects of the Durbin [interchange] amendment, we'll face significant challenges to produce sufficient revenue to fund our operations.

**How we demonstrate the CU difference:** We treat our employees fairly and well so they'll treat mem-

bers the same way. And we formally recognize great member service.

**"People helping people" means:** Helping our members make smart financial decisions and extending as many financial resources to them as we prudently can.

**Best advice I've received:** Do the right thing. If you do anything else, your regret will soon outweigh any short-term gain.

**Worst advice:** From someone who is still one of my dearest friends: The board chair position won't be much more work than just being a director!

**Person I admire most:** This is a tough question because I've been fortunate to know several great people. High up on that list, though, is Ohio University Credit Union CEO Phil Meyer. He's extremely focused on member welfare, is incredibly knowledgeable about the industry, and has the highest ethical standards of anyone I know.

**Hobbies:** I enjoy running, swimming, and playing Scrabble against my iPhone. ■



**HERMAN 'BUTCH' HILL**  
CHAIRMAN  
OHIO UNIVERSITY CU  
ATHENS  
\$250 MILLION  
IN ASSETS



For the complete transcript, visit [directors.cuna.org](http://directors.cuna.org)



## D&O Protection: Pass or Fail?

*Consider how your policies will respond if you actually need to rely on them.*

In December, NCUA passed a final rule on indemnification. The rule strips federal credit unions of the ability to indemnify officials or employees for liability associated with misconduct that's "grossly negligent, reckless, or willful" as deemed by a court.

Other rules on indemnification are pending. In light of the headlines, it's time for a quick review.

If your board is confused about where you go from here, evaluate your indemnification agreement and directors and officers (D&O) coverage in the following areas:

■ **Indemnification.** This is when the credit union agrees to reimburse officers or directors for expenses related to claims brought against them in their capacity as officers and directors.

The terms of each indemnification can be provided for in separate agreements or in your credit union's bylaws. Have a lawyer review all documents describing indemnification policies to ensure they're consistent, complete, in compliance with applicable law, and applicable to your unique needs.

■ **D&O insurance.** D&O insurance is an agreement between you and your insurance company. Consider multiple D&O limits either in the form of traditional coverage or management umbrella coverage. A management umbrella will give you broader coverage when indemnification and other insurance aren't provided.

■ **"Insured vs. insured" exclusion.** This basically excludes coverage for claims where one insured brings suit against another insured—if, for example, a director sues another director or an officer sues an employee for breach of fiduciary duty.

When the regulator takes a credit union into conservatorship, NCUA becomes the conservator or liquidating agent and succeeds to all the rights and powers of the credit union. In such a role, NCUA is acting as the credit union, which is an insured.

So if NCUA brings a claim against a board, as conservator, the "insured vs. insured" exclusion would exclude coverage under the D&O policy. Without a "carve-back" (which is an instance when an exclu-

sion doesn't apply) to the exclusion for bankruptcy trustee or examiner, your D&O policy is almost as restrictive as having a regulator exclusion.

■ **Cancellation.** D&O policies react differently to instances of insolvency, receivership, conservatorship, bankruptcy, and other changes. Understand how your policy reacts. For example, it might cancel, go into run-off, or go unchanged.

While having your policy go unchanged is ideal, it's fairly rare. How your policy responds is critical because it could be the time you'll need it most.

■ **Allocation.** D&O policies often address allocation because many actions against boards name covered and uncovered parties and covered and uncovered matters. Allocation provisions attempt to outline how these discrepancies are resolved.

Some allocation provisions only cover that portion of defense costs that are allocated to the covered claims or parties—leaving the insured to pick up the rest.

Another method for allocation that not all carriers provide is 100% allocation for defense costs. Given the potential for board suits to include both uncovered and covered claims and parties, without 100% allocation for defense costs you could find yourself in a situation where you're not getting all defense costs paid.

By having the allocation provision state that the insured will cover 100% of defense costs even if there's an allocation matter, you greatly improve the chances you'll have at least defense cost coverage through a claim.

In short, look at your D&O policy, and if you can get an allocation provision with 100% coverage for defense, you should strongly consider it. It will greatly reduce uncertainty.

Did your total protection pass or fail? Don't wait until you have a loss to find out your "protections" didn't make the grade. ■

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ADDITIONAL  
RULES ON  
INDEMNIFICATION  
ARE PENDING WITH  
NCUA.

SAMPLE