

HANDBOOK  
FOR  
CREDIT UNION  
DIRECTORS:

*A Job Description*

*September 2005*

MASSACHUSETTS CREDIT UNION

**MSIC**

INSURED  
SAVINGS

SHARE INSURANCE CORPORATION

September 2005

To Directors of Credit Unions:

MSIC is pleased to publish and distribute this informative and useful *Handbook for Credit Union Directors*. Since the last version of this handbook (April 2003), there have been a number of new regulatory developments and trends both in the governance of credit unions, and in corporate governance generally. We have summarized these developments for your information in this new version.

This guide provides important information for directors of both Massachusetts and federal credit unions, and will assist you in understanding the general rules that govern your conduct as a director, the risks and liabilities that you incur and the protections you have against those risks.

Over the past few years there has been a close examination of the role and function of corporate directors. A number of high profile corporate scandals, involving publicly traded institutions, has caused a reaction in Washington and across the nation to provide new rules and restrictions on corporate activity. While credit unions were not involved in the recent financial scandals, a number of these new requirements apply to credit unions or are prompting a closer review by credit union regulatory officials.

Additionally, the pace of technological change continues to quicken. Not only does this make the operation of a credit union more complex, it raises new and difficult issues for our members such as protection of their privacy, their data and their identity. As a result of the continuing expansion of the Internet, new and unique criminal activities such as “phishing” have arisen on a monthly basis.

The threat of continuing international terrorism also imposes new restrictions on financial institutions, including credit unions, in the area of Bank Secrecy Act compliance and anti-money laundering. Now, more than ever, directors and management of credit unions must be aware of and strive to seek compliance with new regulatory requirements and guidelines.

This *Handbook for Credit Union Directors* was prepared for MSIC by former Massachusetts Commissioner of Banks Michael C. Hanson, of the law firm of Hanson Associates of Norwell, Massachusetts. Hanson Associates is counsel to MSIC.

Although the information in the *Handbook for Credit Union Directors* has been distilled from applicable requirements of statutes, regulations, court cases and administrative rulings, this publication is a director’s handbook, not a legal document. Its purpose is to provide general information and practical, “hands-on” advice. We hope it is useful to you and your credit union.

Sincerely,



John F. Buddle,  
President & Chief Executive Officer

## INTRODUCTION

*These are interesting times to be a director of a credit union.* Over the last few years, major national and international events have caused the pace of change to quicken dramatically for credit unions and other financial institutions.

- Corporate scandals of the recent past have prompted a new review of the role of directors in corporate governance and have spawned a number of new accounting and regulatory requirements.
- The threat of international terrorism has created a heightened awareness of Bank Secrecy Act, anti-money laundering, data control, and privacy issues for credit unions and their members.
- The continued growth and expansion of the Internet has provided business opportunities, but also has provided opportunities for identity theft and “phishing” of customer financial data. New forms of fraud arise monthly.
- Competition among financial institutions, including credit unions, continues to increase at a rapid pace. Credit unions are called upon to provide new products and services at the lowest possible cost to the member.

Over the last 25 years a number of modifications to traditional forms of corporate governance have been implemented in order to improve the management and control of the Board of Directors of corporations. Generally, compensation committees, personnel committees, the independence of directors, the independence of outside auditors, the use of auditing committees and financial disclosure rules have all been developed or improved to secure more adequate corporate governance. One of the troubling features of the recent scandals is that all of the corporations involved had implemented all of these previous changes. Yet still these corporations failed dramatically. What went wrong? More importantly, what lessons can be learned from these activities so that other corporations, including credit unions, will avoid the same fate?

Now, proper corporate governance requires improvement in the conduct as well as the structure of the Board of Directors. Accountants, auditors, and directors must properly conduct their activities to maintain independence, impose monitoring procedures upon management, and maintain adequate knowledge of the corporation’s accounting and operating functions.

It is not just the structure of the Board of Directors or its legal duties and obligations that determine the success or failure of a corporate entity. Rather, it is how the Board of Directors conducts its affairs that determines whether the corporation will be successful.

Additionally, it is now clear that successful corporations have Boards of Directors that focus not just on current legal or regulatory requirements or monitoring the activities of management. Rather, they must also maintain focus on the trends in their industry, the coming regulatory and legal issues that will lead to new requirements, and the competitive needs and risks faced by their customers, shareholders or members.

This revision of MSIC's *Handbook for Credit Union Directors* will describe current thinking on the methods and procedures that credit union directors should follow, and it will also describe the duties and responsibilities of directors of credit unions chartered under Massachusetts and federal law, the legal risks that such directors incur, and the protections available against those risks.

Also included is a new section that addresses current developments affecting credit unions and their members. Credit union directors should review these issues as they conduct their normal activities.

The *Handbook for Credit Union Directors* identifies restrictions on financial and other transactions between directors and the credit unions they serve, as well as numerical limits relating to various aspects of a credit union's business, such as the maximum amount that may be loaned to any one borrower, and the required regulatory process for dealing with insider transactions. These insider restrictions and numerical limits, which are highlighted and summarized in the text, are particularly important for credit union directors to be familiar with, since failure to adhere to them is all too frequently a source of liability.

The information contained in the *Handbook for Credit Union Directors* is general information, intended to convey an overall understanding of fundamental concepts, including legal requirements that apply to credit union directors. Directors with specific issues or concerns, or dealing with problems in specific circumstances, must consult with their credit union's management, counsel and auditors to determine the legal and regulatory issues associated with any specific situation.

## **I. THE DUTIES OF A DIRECTOR**

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### **A. HOW SHOULD A BOARD BEHAVE?**

Later in this handbook we will discuss the legal obligations and the practical regulatory requirements of board conduct. But first, if it is true that good board governance can't be legislated but rather is a function of the manner in which the Board of Directors operates, we should discuss the proper *behavior* for a Board of Directors. Applied to a process of board

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