Guiding Principles

Enhancing Governance of Cooperative Financial Institutions

International Credit Union Regulators' Network

These Guiding Principles[1] incorporate 17 elements considered desirable in facilitating effective governance of cooperative financial institutions. The principles are categorised into seven groups:

GROUP 1 – **Cooperative Principles**
GROUP 2 – **Board Practices**
GROUP 3 – **Senior Management**
GROUP 4 – **Risk Management and Internal Controls**
GROUP 5 – **Compensation**
GROUP 6 – **Disclosure and transparency**
GROUP 7 – **Role of Supervisors**

[1] While best efforts have been made to develop the Guiding Principles to recognize both the common law and civil law legal systems, the principles should be adapted to ensure they align appropriately with the legal system applicable in the jurisdiction.

COOPERATIVE PRINCIPLES

Guiding Principle 1[1]

MEMBERS' RIGHTS AND OBLIGATIONS

The values of a cooperative financial institution ("CFI") should be based on the following seven cooperative principles:

1. Voluntary and Open Membership

Cooperatives are voluntary organisations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2. Democratic Member Control

Cooperatives are democratic organisations controlled by their members, who, where applicable, actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organised in a democratic manner, which may provide for proportional voting based on investment/ownership. The Board should oversee the development and implementation of strategies that will result in member attendance and participation in General Meetings. The meeting agenda and other relevant information, including any Board candidates and the CEO where the members elect same, should provide for full disclosure and be readily available. In addition, election processes should be objective, transparent and consistent with the CFI's by-laws.

3. Member Economic Participation

Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members may receive limited compensation, if any, on capital subscribed as a condition of membership and, in order to build capital reserves, a dividend may be paid in the form of patronage or bonus shares. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4. Autonomy and Independence

Cooperatives are autonomous, self-help organisations controlled by their members. If they enter into agreements with other organisations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

[1] While Guiding Principle 1 is a restatement of The International Cooperative Alliance revised Rochdale principles, clarification has been provided regarding these principles in the Cooperative Financial Institution context.

5. Education, Training and Information

Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public and opinion leaders – particularly young people - about the nature and benefits of co-operation.

6. Cooperation among Cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

7. Concern for Community

Cooperatives work for the sustainable development of their communities through policies approved by their members that should additionally promote social responsibility and member education on cooperative and financial issues.

The board should ensure that these cooperative principles are incorporated into governance policies and practices.

BOARD PRACTICES

Guiding Principle 2

RESPONSIBILITIES OF THE BOARD

The board has overall responsibility for the cooperative financial institution ("CFI"), including approving and overseeing implementation of strategic objectives, risk strategies, adopting best corporate governance practices and values, and oversight of management. The board should approve and monitor the overall business strategy, taking into account long-term financial interests, and exposure to and ability to manage risk effectively. In discharging these responsibilities, the board should take into account the interests of members, other relevant stakeholders and, where permitted, non-member depositors and borrowers, and ensure an effective relationship is maintained with its supervisor.

Corporate Values and Code of Conduct

The board should lead in establishing the 'tone at the top' and in setting professional and ethical standards and corporate values that promote integrity for itself, senior management and other employees. The officers and board committee members owe a duty to the CFI to operate the institution with reasonable prudence and in the best interests of the CFI and its members. The directors owe the members a duty of fair dealing with respect to issues of membership, ownership and corporate governance. In addition, the board should ensure transactions with related parties are subject to appropriate restrictions. In discharging these duties, directors may rely on reports, advice, and other information provided by the CFI's employees, lawyers, consultants and committees of the board of which the director is not a member, unless the director has knowledge which would make such reliance unreasonable or in bad faith. These corporate values are communicated through a code of conduct that articulates acceptable and unacceptable behaviors.

Oversight of Senior Management

The board or, where applicable, members should select and, when necessary, replace senior management and have in place an appropriate succession plan. In carrying out its role of oversight, the board should:

- Meet regularly with senior management
- Monitor actions to ensure they are consistent with the strategy and policies approved by the board, including the risk tolerance/appetite;
- Question and review critically explanations and information provided;
- Set performance standards consistent with long term objectives, strategy and financial soundness of the CFI and monitor performance against the standards; and
- Ensure management's knowledge and expertise remains appropriate for the nature of the business and the CFI's risk profile.

The board should ensure the organisational structure facilitates effective decision making and good governance. This includes regularly reviewing policies and internal controls to determine areas needing improvement, as well as identifying and addressing significant risks and issues.

Guiding Principle 3

BOARD QUALIFICATIONS

The CFI should set out expectations desired regarding qualifications, for example, work experience, education, business oriented degrees and professional designation and training requirements for directors. Where appropriate, each director should conduct an annual self-assessment to confirm competency and identify potential areas for growth and development. Board members should be and remain qualified, when appropriate for their positions, including through training. They should have a clear understanding of their role in corporate governance and be able to exercise sound and objective judgment about the affairs of the CFI.

Qualifications

The board should possess, individually and collectively, appropriate experience, competencies and personal qualities, including professionalism and personal integrity.

Training

The board should ensure board members have access to programmes of tailored initial and ongoing education on relevant issues. The board should dedicate sufficient time, budget and other resources.

Composition

The CFI should have an appropriate composition of board members, for example, taking into consideration demographics, geography, and professional qualifications. This is achieved by identifying and nominating candidates to ensure appropriate succession planning and strengthening itself to meet the CFI's long term oversight needs. Recruiting members from a broad population of candidates helps to enhance board perspective and ability to exercise objective judgment independent of senior management and personal interests. In identifying potential board members, the board should ensure candidates are qualified to serve as board members and are able to commit the necessary time and effort to fulfil their responsibilities and to undertake any required training requirements within the timeframes established by the CFI.

Guiding Principle 4

BOARD'S OWN PRACTICES AND STRUCTURE

The board should define appropriate governance practices for its own work and have in place the means to ensure such practices are followed and periodically reviewed. The board should conduct an annual self-assessment to review and improve its performance, and the performance of Chairs and individual directors.

Organisation and Functioning of the Board

The board should maintain, and periodically update, organisational rules, by-laws, or other similar documents setting out its organisations, rights, responsibilities and key activities. Taking into account its size, the frequency of meetings and use of committees, the board should structure itself in a way so as to promote efficiency, sufficiently deep review of matters, and, robust, critical challenge and discussion of issues. To support board performance, the board should carry out regular assessments of both the board as a whole and of individual board members.

Role of the chair

The chair should ensure board decisions are taken on a sound and well-informed basis and should encourage and promote critical discussion. This includes ensuring dissenting views can be expressed and discussed within the decision-making process.

Role of Directors

Directors provide an important service to the CFI and to fellow members, who have entrusted them to oversee the organization. To best carry out their duties, directors should:

- Undertake appropriate established training requirements
- Regularly attend Board meetings and prepare for them by reviewing all material provided
- Actively participate at board meetings and question management so they fully understand their reports and actions
- Ensure that the best interest of the CFI are considered in all Board decisions
- Ensure management has developed, and the Board approved with member participation where appropriate, all policies and procedures required under applicable legislation
- Where appropriate, ensure an appropriate Enterprise Risk Management Framework has been established based on the size, complexity and risk profile of the CFI
- Fully understand the limits imposed on the CFI's business powers under applicable legislation and the CFI's by-laws, articles and policies
- Ensure controversial decisions involving conflicts of interest are carefully documented
- Review examination reports and other reports prepared by external parties and external auditors' reports to identify and correct deficiencies in the operation of the CFI and to ensure the best possible performance; and
- Develop a common view among Board members before making a public comment regarding controversial issues that concern the CFI.

Board Committees

The board should establish such committees as may be required in its jurisdiction and may establish other committees to have specialised responsibilities, for example, committees for compensation, nominations, human resources, governance, ethics, and compliance. Each committee should have a charter or other instrument setting out its mandate, scope and working procedures. Committees should maintain appropriate records of their deliberations and decisions. Where appropriate based on the size, complexity and risk profile of the CFI, board members may also have a seat on Executive Committees, for example, the Asset Liability Committee (ALCO).

Audit Committee

The audit (or supervisory) committee is typically responsible for the financial reporting process; providing oversight of the CFI's internal and external auditors; approving or recommending to the board for their approval the appointment, compensation and dismissal of external auditors, reviewing and approving the audit scope and frequency; receiving key audit reports; and ensuring senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with policies, laws and regulations and other problems identified by auditors. In addition, the audit committee should oversee the establishment of accounting policies and practices.

Risk Committee

It is appropriate for many CFIs, especially where warranted by their size, complexity or risk profile, to have a board-level risk committee or equivalent. The risk committee is typically responsible for advising the board on the CFI's overall current and future risk tolerance/appetite and strategy and for overseeing senior management's implementation of that strategy. This should include strategies for capital and liquidity management, as well as for credit, market, operational, compliance, reputational and other risks. To enhance the effectiveness of the risk committee, it should receive formal and informal communication from the CFI's risk management function and should, where appropriate, have access to external expert advice, particularly in relation to proposed strategic transactions, such as mergers and amalgamations.

Conflict of Interest

The board should have a formal written conflict of interest policy and an objective compliance process for implementing the policy. The policy should include:

- A member's duty to avoid to the extent possible activities that could create conflicts of interest of the appearance of conflicts of interest;
- A review or approval process for members to follow before they engage in certain activities so as to ensure that such activity will not create a conflict of interest;
- A member's duty to disclose any matter that may result, or has already resulted, in a conflict of interest;
- A member's responsibility to abstain from voting on any matter where the member may have a conflict of interest or where the member's objectivity of ability to properly fulfil duties to the CFI may be otherwise compromised;
- Adequate procedures for transactions with related parties to be made on an arms-length basis; and
- The way in which the board will deal with any non-compliance with the policy.

SENIOR MANAGEMENT

Guiding Principle 5

ACTIVIES ALIGNED WITH BUSINESS STRATEGY

The Chief Executive Officer (CEO)/General Manager/Manager or, where applicable, senior management reports directly to the board and is responsible for the day to day operations of the CFI, implementing board-approved plans to achieve desired strategic objectives and reporting on results. The board, through the chair, typically communicates directly to the CEO who may be supported by a senior management team. Senior management is responsible for ensuring the management and staff of the CFI apply the processes, procedures and controls necessary to prudently manage the risk and for providing the board of directors with timely, relevant, accurate and complete information to enable it to assess that delegated responsibilities are being discharged effectively. Under the direction of the board, senior management should ensure the CFI's activities are consistent with the business strategy, risk tolerance/appetite and policies approved by the board. Senior management contributes to sound corporate governance through personal conduct and by providing adequate oversight of those they manage. Senior management is responsible for delegating duties to staff and should establish a management structure that promotes accountability and transparency. Senior management should implement, consistent with the direction given by the board, appropriate systems for managing the risks – both financial and non-financial – to which the CFI is exposed.

RISK MANAGEMENT AND INTERNAL CONTROLS

Guiding Principle 6

EFFECTIVE INTERNAL CONTROLS AND RISK MANAGEMENT FUNCTION

Cooperative financial institutions should have an effective internal controls system and a risk management function, such as a chief risk officer or equivalent, with appropriate qualification, expertise, sufficient authority, stature, independence, resources and access to the board.

Risk management generally encompasses:

- Identifying key risks;
- Assessing these risks and measuring exposure to them;

- Monitoring the risk exposures and determining the corresponding capital needs on an ongoing basis;
- Monitoring and assessing decisions to accept particular risks, risk mitigation measures and whether risk decisions are in line with the board-approved risk tolerance/appetite and risk policy; and
- Reporting to senior management, and/or having unfettered access to the risk committee and/or board as appropriate, on all items noted above.

Guiding Principle 7
IDENTIFICATION AND MONITORING OF RISKS ON AN ONGOING BASIS

Risks should be identified and monitored on an ongoing basis, and the sophistication of the CFI's risk management and internal control infrastructures should keep pace with any changes to the CFI's risk profile (including its growth), and to the external risk landscape. Risk analysis should include both quantitative and qualitative elements. In addition to identifying and measuring risk exposures, the risk management function should evaluate possible ways to manage these exposures. Cooperative financial institutions should have an approval process for new products that includes an assessment of the risks.

As part of its quantitative and qualitative analysis, where appropriate, the CFI should also use forward-looking stress tests and scenario analysis to better understand potential risk exposures under a variety of adverse circumstances. In addition to these forward-looking tools, CFIs should also regularly review actual performance after the fact relative to risk estimates (i.e., backtesting) to assist in gauging the accuracy and effectiveness of the risk management process and making necessary adjustments.

Guiding Principle 8
ROBUST INTERNAL COMMUNICATIONS

Effective risk management requires robust internal communication within the CFI about risk across the organisation and through reporting to the board and senior management. Sound corporate governance is evidenced, among other things, by a culture where senior management and staff are expected and encouraged to identify risk issues. The CFI's risk exposures and strategy should be communicated throughout the CFI both horizontally and vertically with appropriate frequency. Information should be communicated to the board and senior management in a timely, complete, understandable and accurate manner so they are equipped to make informed decisions. Risk reporting systems should be dynamic, comprehensive and accurate, and board reports designed carefully to ensure information regarding risks is conveyed in a concise and meaningful manner.

Guiding Principle 9
EFFECTIVE USE OF AUDIT AND INTERNAL CONTROL FUNCTIONS

The board and senior management should use the work conducted by internal audit functions, external auditors and internal control functions in an effective manner. The board should recognise that independent, competent and qualified internal and external auditors, as well as other internal control functions, are vital to the corporate governance process. The board and senior management can enhance the ability of the internal audit function to identify problems with a CFI's governance, risk management and internal control systems by:

- Encouraging internal auditors to adhere to national and international professional standards;
- Requiring audit staff have skills commensurate with the business activities and risks of the CFI;
- Promoting the independence of the internal auditor;
- Recognising the importance of the audit and internal control processes and communicating their importance throughout the CFI;
- Requiring the timely and effective correction of identified internal audit issues by senior management;
- Engaging internal auditors to judge the effectiveness of the risk management function and the compliance function, including the quality of risk reporting to the board and senior management, as well as the effectiveness of other key control functions; and
- Receiving appropriate assurances that risks are being effectively identified, monitored and managed, including non-compliance with applicable legislation. For example, that the CFI has developed and implemented effective processes to ensure compliance with anti-money laundering legislation including "know your customer" requirements.

The board and management are responsible for the preparation and fair presentation of financial statements in accordance with applicable accounting standards in each jurisdiction, as well as the establishment of effective internal controls related to financial reporting. The CFI should maintain sound control functions, including an effective compliance function that, among other things, routinely monitors compliance with laws, corporate governance rules, regulations, codes and policies to which the CFI is subject and to ensure deviations are reported to an appropriate level of management, and, in case of material deviations, to the board. Senior management should promote strong internal controls and should avoid activities and practises that undermine their effectiveness.

COMPENSATION

Guiding Principle 10
ACTIVE OVERSIGHT
Compensation should be a key component of a CFI's governance and risk management. The board should actively oversee the design and operation of the compensation system, and should monitor and review it to ensure it operates as intended. Board members who are actively involved in the design and operation of the compensation system should be independent with appropriate knowledge about compensation arrangements and the incentives and risks that can arise. The board should monitor and review outcomes to ensure the compensation scheme is operating as intended. Owing to the importance and sensitivity on the subject of compensation, where appropriate, the CFI may elect to establish a Compensation Committee. The committee board members who are most actively involved in the design and operation of the compensation system should be independent with substantial knowledge about compensation arrangements, including incentives and impact on performance behavior, and related risks.

Guiding Principle 11
ALIGNED WITH PRUDENT RISK TAKING
An employee's compensation should be effectively aligned with prudent risk taking. The CFI should ensure variable compensation is adjusted to take into account the risks an employee takes, considering all types of risk over a timeframe sufficient for risk outcomes to be revealed. An appropriate compensation program includes both quantitative risk measures and human judgment. Compensation should be symmetric with risk outcomes.

DISCLOSURE AND TRANSPARENCY

Guiding Principle 12
ADEQUATE TRANSPARENCY
Governance should be adequately transparent to members, depositors and other relevant stakeholders.

Transparency is essential for sound and effective corporate governance. It is challenging for members, depositors and other relevant stakeholders to hold the board and senior management accountable when there is insufficient transparency.
The CFI should disclose relevant and useful information that supports the key areas of governance identified in these guiding principles. The disclosure should be proportionate to the size, complexity, structure and risk profile of the CFI, and, at a minimum, meet any disclosure requirements applicable in its jurisdiction.

ROLE OF SUPERVISORS

Guiding Principle 13
GUIDANCE ON EXPECTATIONS
Supervisors should provide guidance to CFIs on expectations for sound governance by establishing guidance or rules consistent with the principles set forth in this document, and requiring CFIs to have robust governance strategies, policies and procedures. Where appropriate, supervisors should share industry best practices and emerging risks that are relevant to the CFI's business practices.

Guiding Principle 14
REGULAR EVALUATIONS
Supervisors should regularly perform a comprehensive evaluation of a CFI's governance policies, practices and procedures and implementation of the principles that are proportionate to the size, complexity and risk profile of the CFI. Supervisors should have supervisory processes and tools for evaluating governance policies and practices. Evaluations may be conducted through on-site inspections and off-site monitoring and should include regular communication with a CFI's senior management, board and those responsible for the internal control functions and external auditors

When evaluating individual CFIs, supervisors should consider the need to adopt different approaches to governance that are proportionate to the size, complexity, structure and risk profile of the CFI.

Supervisors should obtain information they deem necessary to evaluate the expertise and integrity of proposed board members and senior management. The fit and proper criteria should include, but may not be limited to: (1) the contributions that an individual's skills and experience can make to the safe and sound operation of the CFI, including general management skills and (2) any record of criminal activities or adverse regulatory judgments that in the supervisor's judgement make a person unfit to uphold key positions in the CFI. Moreover, supervisors should require CFIs to have in place processes to review how well the board, senior management and control functions are fulfilling their responsibilities as set out earlier in these principles.

Supervisors should evaluate whether the CFI has in place effective mechanisms through which the board and senior management execute their oversight responsibilities. In addition to policies and processes, such mechanisms include properly positioned and staffed control functions, such as internal audit, risk management and compliance. In this regard, supervisors should assess the effectiveness of oversight of these functions by the CFI's board and ensure that the internal audit function conducts independent, risk-based and effective audits, including periodic reviews of the CFI's control functions and of the overall internal controls. Supervisors should assess the adequacy of internal controls that foster sound governance and how well they are being implemented.

Guiding Principle 15
MONITORING
Supervisors should supplement their regular evaluation of a CFI's governance policies and practice by monitoring a combination of internal reports and prudential reports, including, as appropriate, reports from third parties such as internal auditors. Supervisors should obtain information from CFIs on their governance policies and practices which should be updated at regular intervals and when significant changes have occurred. Supervisors should collect and analyse information from CFIs with a frequency commensurate with the nature of the information requested, and its size, complexity and risk profile. For monitoring and evaluation purposes, the supervisor should periodically review key internal reports of the CFI. To make meaningful comparisons between CFIs, the supervisor may also require a standardised supervisory reporting process, covering the data items the supervisor deems necessary.

Guiding Principle 16
EFFECTIVE AND TIMELY REMEDIAL ACTION
Supervisors should require effective and timely remedial action by a CFI to address material deficiencies in its governance policies and practices, and should have the appropriate tools for this. Supervisors should have a range of tools at their disposal to address material governance deficiencies of a CFI, including the authority to compel appropriate remedial action. The choice of tool and the timeframe for any remedial action should be proportionate to the level of risk the deficiency poses to the safety and soundness of the CFI. When the supervisor requires remedial action, a timetable should be established for completion. Supervisors should have escalation procedures in place to adequately address the deficiencies identified where further action is warranted.

Guiding Principle 17
COOPERATION WITH OTHER JURISDICTIONS
Supervisors should cooperate with other relevant supervisors in other jurisdictions regarding the supervision of governance policies and practices. The tools for cooperation can include memorandum of understanding, supervisory colleges and periodic meetings among supervisors. Information shared should be relevant for supervisory purposes and be provided within the constraints of applicable laws. Special arrangements, such as a memorandum of understanding, may be warranted to govern the sharing of information among supervisors or between supervisors and other authorities.

The **INTERNATIONAL CREDIT UNION REGULATORS' NETWORK** (ICURN) created this document in March 2013 as guidance for cooperative financial institutions to promote enhanced governance.

Recognizing that CFIs operate in a wide range of systems, the guiding principles may not always be applicable or relevant in all circumstances; ICURN encourages CFIs to focus on the guiding principles' goals.

These principles have been developed using the Basel Committee on Banking Supervision's Principles for Enhancing Corporate Governance. ICURN is grateful for the Basel Committee's ongoing support, although it wishes to emphasise that this document was developed independently by the ICURN steering committee and is not endorsed in any way by the Basel Committee.