Credit union boards are fiduciaries. They are stewards. They stand on guard to guide the organization, bound to watch over it in the best interests of the member-owners.

How can the member-owners trust that boards will do the right thing? Boards are bound by centuries-old duties that align them with the interests of the member-owners. In this chapter, we’ll touch on those duties, and on the general concept of ethics.

DUTIES?

Now, let’s delve into the two major duties that affect credit union volunteers. These duties flow from the common law, from hundreds of years of judicial opinions that carved out basic responsibilities for mankind. It does not matter that you are volunteers. You have the same duties that apply to bank directors.9

The first duty is the duty of care. Put simply, you owe a duty to exercise good business judgment and to use ordinary care in the operation of your credit union. You must act in good faith and in the best interest of the credit union, exercising the care an ordinary person would use under similar circumstances.

---

9 NCUA issued its own regulation on fiduciary duties for federal credit union directors. In general, it tracks the basic duties that have applied to directors through the years. While it touches on many subjects, it does the following: 1) it establishes a fiduciary-duty standard; 2) it requires that directors administer the affairs of a credit union fairly and impartially; 3) each director must obtain financial literacy (the ability to read balance sheets); and 4) it requires directors to direct credit union operations in conformity with certain laws, regulations, and sound business practices.
This duty is appropriate to the circumstances. For example, you should take greater care in hiring a CEO than you would in reviewing last month’s board minutes. And your duty is a bit different if you are a director than if you were a supervisory committee member.

The **duty of loyalty** is similar, yet distinct. You have a duty to place the interests of your credit union first when making decisions that affect the credit union. You need to put away your own concerns, biases, interests and goals. The credit union comes first. This duty is fairly constant. It does not necessarily shrink or get larger depending on the circumstances.

**GENERAL STANDARDS FOR LIABILITY**
With these duties come potential liability. Yes, you can hypothetically be sued by the membership for failing to live up to these duties. What are some of the general standards for liability? The lack of good faith is one. But what is good faith? Here’s a good definition.

“Good faith means acting with honesty and sincerity of purpose. It requires the cooperation to achieve objectives and to act reasonably in the administration of the agreements and negotiations.” So, if you act with dishonest and insincerity, if you do not cooperate to achieve objectives and act unreasonably in the administration of agreements and negotiations, you open yourself up to some liability if someone gets hurt.

An unreasonable belief could form the basis of another standard for liability. If, for example, you make a decision that harms your credit union, and that decision was based on some outlandish belief, you open yourself up to liability. The thought here is this: if you had done your homework and due diligence, there’s no way you could hold an unreasonable belief. Want an example? Your credit union agrees to do indirect lending with some automobile dealerships. You agree to a contract after doing no due diligence, and that contract gives your credit union few rights if the dealership engages in fraud or other dishonest acts. Your reason? The dealership said it was honest. Your belief that this contract protects the membership adequately could be seen as unreasonable by others.

Along those lines, if you make decisions without relevant data, you may increase your liability risk. Shooting blindly is something courts do not appreciate.

Finally, if you lack objectivity, you increase your risk of liability. If you have any financial or personal interest in a business transaction, you must remove yourself from the decision process.

**GENERAL DEFENSES**
On the flip side, if you follow the “business judgment rule,” you will almost always shield yourself from liability. Courts do not want to second-guess corporate actions. Business decisions entail taking risks. Some decisions will fail no matter how careful the parties may be. The business judgment rule is a judicial doctrine that states simply, courts defer to businesses in certain circumstances.

If it is a business decision, courts will generally defer to your judgment. If the parties are disinterested, meaning there are no conflicts of interest, courts will defer. In addition, if you act in good faith, make informed decisions based on reasonable beliefs, and if you feel the decision is in the best interest of the credit union, courts will generally not second-guess you.

Again, your job is to identify risk and manage it. You’ll never eliminate it. Some of your decisions will fail. The business judgment rule acknowledges this.

**THE DUTY OF LOYALTY**
Volunteers must get non-preferential treatment on loans. Don’t expect better rates, terms or conditions because you are a volunteer. NCUA regulations actually prohibit it. The rationale for this is obvious: you want loan officers to make decisions based on the credit union’s underwriting standards – and nothing else. If a loan officer is pressured by outside parties, he or she will make bad loans. And bad loans are a threat to the credit union’s net worth.

No credit union official can get compensation that is tied to a loan. That includes situations where you have an ownership stake in a business that works with your credit union’s lending program in some way. For example, you may be a bankruptcy attorney. If that is the case, you shouldn’t do collections work for your credit union.

NCUA bylaws require you to take yourself out of any discussion or vote where you have a direct or indirect financial interest in the outcome of the decision. For example, if your spouse is a consultant, you should not be involved in any decisions or discussions regarding whether the credit union should hire him or her.

The Bank Bribery Act requires each credit union to create a policy that outlines what its directors and
other volunteers may accept from third parties in the form of meals, drinks or entertainment. The key thing is this: read your credit union’s policy and adhere to it.

**SUMMARY: DUTY OF LOYALTY**
A summary of the duty of loyalty is quite simple. Put the credit union first. Don’t vote if you have a dog in the hunt. Pass up personal gains. If a situation presents itself where you have a financial interest in the outcome, you should remove yourself from that discussion. If you stick to these simple rules, you should never have a problem with the duty of loyalty.

**EXAMPLES: DUTY OF LOYALTY**
Here are some real-world ethical questions that have arisen at credit unions.

Can a board hire an attorney who is the son of one of the directors who sits on the board? NCUA ultimately said that there was no conflict of interest in this situation. The attorney in question did not live with his parents, so there was no clear pecuniary interest for the parent in the hiring of his or her son. That being said, would you feel comfortable in this situation? One possible way to minimize any claims of a conflict of interest would be to have the director in question remove himself from the decision and discussion regarding the hire.

What about a director who works for a man who owns a number of companies – one of which is doing business with the credit union. NCUA didn’t see a problem. The director did not have a financial or personal interest in the company owning the property being considered for purchase by the credit union. The director merely worked at a company that had the same majority owner as the company involved in a sale of real property to the credit union. The director was not the majority owner of the two companies and is not a director of either of the companies.

What about a director’s ownership interest in companies that provide indirect lending services and through which the credit union has sold insurance? NCUA sees a big problem here. In this situation, a director was an owner of a number of affiliated companies. One of these companies provided services to the credit union in connection with its indirect lending operations. The credit union pays the company a fee for these services on a per loan basis. Again, NCUA had a major problem with this, as the director would gain income at some level, based on fees from the credit union in relation to its lending program. This is an important letter to remember. When it comes to lending, board members cannot be compensated directly or indirectly. And there is no small-dollar exception.

**ONE LAST THOUGHT ON THE DUTY OF LOYALTY**
I love the duty of loyalty. As a concept, it is extremely powerful, yet highly underrated.

Unfortunately, the power of the duty of loyalty gets lost in discussions of case law and litigation. We focus on trees, but ignore the forest. And that’s too bad, because as I stressed above, it is powerful stuff.

The concept of the duty of loyalty often is tied to financial interests. For example, a director shouldn’t vote on whether to hire a vendor that is partially owned by his son. His loyalty is to the credit union as a director. He cannot show any loyalty to his son, so he should announce the conflict and sit that vote out.

(Soapbox warning!) I wish, however, that the duty was extended, or in a way, amplified. If I were King, here’s how I’d rework the duty of loyalty.

As a director or officer, you must remove “you” from your thoughts. When you walk into the credit union, check your baggage – your hunches, dislikes, biases, and the like, at the door. Feel free to pick them up later. But when you work for the credit union, you’ll make decisions that are best for the membership.

That sounds simple, but it is anything but. To be truly loyal, you’d...

1. **Listen to dissenting views.** Someone else might have an idea that would better serve the membership.

---

10 This comes from a legal opinion issued by NCUA. NCUA Legal Opinion Letter 91-0115 (February 13, 1991). Yeah, I actually read this stuff. Think of it this way, I read it, so you don’t have to!

11 NCUA Legal Opinion Letter 06-0608 (July 6, 2006).

12 NCUA Legal Opinion Letter 06-0210 (May 1, 2006).
2. **Approach decisions with no preconceived notions.**
   An internal bias might shield you from something that would better serve the membership.

3. **Listen more than you speak.** You’ll never learn anything new by listening to yourself. By listening more, you might pick up something that would better serve the membership.

4. **Ignore rank.** I don’t care where an idea comes from, as long as it lets you better serve the membership.

5. **Tackle tough problems.** Not easy, but my guess is that while the process is tough for you, it would better serve the membership.

6. **Check your ego.** Ego is about you. Not about what is best for the membership.

7. **Be respectful to colleagues.** Being petty, condescending, rude or inconsiderate is selfish and destructive. It stops progress and crushes morale. Probably not what is best for the membership.

8. **Be self-reflective.** There are likely ways that you could do better, which would better serve the membership.

During your career, I bet you’ve come across people that would do anything for the team. Anything to help a member. They give up their time at the drop of the hat. It is never about them. It is always about the team or the credit union. They are selfless. They are servants. They are loyal.

And to me, that might be the highest compliment possible.

**DUTY OF CARE**
Board members should hire quality managers. This decision is probably the largest one you can undertake, as the manager/CEO will be responsible for putting your credit union’s strategic plan in motion. This isn’t an easy process. What skills does your credit union need? How will you compensate your new CEO? What amount of compensation is fair? Do you hire from outside or from within?

Credit union volunteers must stay informed. Here are some ideas. You can read credit union trade publications and newsletters. You can visit your credit union and learn how it operates. Stay abreast of national trends in the economy and financial services industry. For example, I try to read the Wall Street Journal whenever possible. Our economy is very interconnected. Events on Wall Street or in Washington, D.C. can create ripples that will affect your credit union. Reading a national newspaper can keep you in the loop. Don’t forget conferences and training sessions. This is a great way to learn from other volunteers and hear from industry experts.

Ask questions if you don’t understand something. Many new board members are hesitant to ask a question for fear that it will highlight their ignorance. You’ll need to get over that fear. As a board member, you have a duty to be informed. If something isn’t clear, raise your hand.

That being said, that’s no excuse not to be prepared. Read your board pack before meetings. Understand the materials. Call fellow board members to see if they have similar questions.

All of these actions will help you meet your duty of care.

**SUMMARY: DUTY OF CARE**
You must also accept the responsibility that comes with the position. Being a director or supervisory committee member isn’t easy, and it isn’t for everyone. Attend meetings. This might include subcommittee meetings, or other less-than-glamorous outings. Vote. Be involved. And as I said earlier: read your board pack and prepare for the votes and decisions that will affect your credit union.

Also, you need to leverage yourself. You can’t do the actual jobs at your credit union. You can’t perform the transactions. As a board, you can’t get down into the weeds. You are supposed to think strategically. That’s why you must ensure that appropriate policies and procedures are in place.

In addition, you need to make sure that your credit union is complying with applicable rules, policies and procedures. This can be done through audits and a strong compliance team at your credit union.

**EXAMPLES: DUTY OF CARE**
Here are two examples from the real world that show how courts view these duties. Note that both situations took place in the world of publicly traded companies. Those companies are very different from credit unions in that stockholders can always allege damage when their stock price goes down. That creates an easy avenue to shareholder lawsuits. Credit union members find it more difficult to prove damage based
on the actions of credit union directors. There's no stock price that members can pin to a lawsuit. That being said, these two examples provide a good overview.

**Van Gorkom**

This case involved a proposed leveraged buy-out merger of TransUnion in 1980. The defendant, Jerome Van Gorkom, was the TransUnion chairman and CEO. He chose a proposed price of $55 without consulting with outside financial experts. He only consulted with the company's CFO to determine a share price that would support a leveraged buyout. Van Gorkom and the CFO never bothered to determine an actual total value of the company. The proposed merger was subject to board approval. At the board meeting, several items were not disclosed. Key among those items was how Van Gorkom arrived at the proposed price of $55. Also, previous objections by management were not discussed. The board approved the proposal after minutes of discussion and without having an independent entity review the proposal.

The Court found that the directors were negligent because they quickly approved the merger without substantial inquiry or any expert advice. The court held that the board of directors breached the duty of care that it owed to the corporation's shareholders. The Court stated, "The (Business Judgment Rule) itself 'is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.' ...Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one."

**Disney**

In 1995, Walt Disney hired Michael Ovitz to be the company's president. From the very beginning, the relationship was flawed. In 1996, after 14 months of service, Disney terminated Ovitz’ employment. His severance package for 14 months of work? It was $140 million. It was no shock then when the Disney board was sued by shareholders claiming that the members of Disney's board at the time of his hiring did not properly understand his employment contract. The court sided with Disney, in contrast with Van Gorkom, which we discussed earlier. In a 175-page opinion, the court indicated that despite the "spectacular failure" of Ovitz’s employment, Disney's directors did not breach their fiduciary duties. What was different about Disney's situation when compared with Van Gorkom?

The court’s decision noted that Disney’s board had been given advance notice of the board meeting where Ovitz’ employment contact would be considered. They had a detailed fact sheet about the agreement. In addition, the court noted that the sale of a corporation was an even more important decision than the hiring of an executive.

What are the lessons to be learned from these two cases? First, boards must understand the matters that are before them. The Van Gorkom board had very little information about the sale of its company. The Disney board had many, many more details. Second, your duties do give you potential liability as directors. While the threat of lawsuit is very, very slim, it should never be ignored. Finally, the duty of care grows with the importance of the decision. The sale of a company and the hiring of a president demand more care than the review of a policy.

**ETHICS**

NCUA has recommended that credit unions train volunteers on the issue of ethics. With that in mind, let’s take a few minutes to talk about ethics, and how it relates to credit union volunteers.

First, what are ethics? This definition comes from the dictionary.

1. a system of moral principles: the ethics of a culture.
2. the rules of conduct recognized in respect to a particular class of human actions or a particular group, culture, etc.
3. moral principles, as of an individual.
4. that branch of philosophy dealing with values relating to human conduct, with respect to the rightness and wrongness of certain actions and to the goodness and badness of the motives and ends of such actions.

The 4th definition is the one that most of us relate to. For many of us, ethics involves rightness and wrongness of conduct, decisions, and actions. But the other definitions are worth thinking about. They imply that ethics might change given on a given culture, individual or group.

So, what does ethics mean at your credit union? I can’t give a definitive answer, but I would look to your policies and procedures. Did you sign an ethics policy when you joined your board or supervisory committee?
What rules of conduct did you agree to abide by?

**REASONS TO BE ETHICAL**

Why do we care about ethics? Here are some thoughts.

You may recall the famous oatmeal commercial from Wilford Brimley. Why do you eat oatmeal? Well, it's the right thing to do. For many, that's a good enough reason to comply with ethical guidelines.

The United States Sentencing Commission has weighed in, as well. Chapter eight of the Federal Sentencing Guidelines is devoted to organizations. In short, the Commission established the organizational guidelines to help courts dole out just punishment and to deter illegal activity when dealing with organizations – including non-profits. In an overview of the organizational guidelines, the Commission noted that courts must weigh six factors when sentencing an organization. Four of the factors increase the punishment, and two mitigate or lessen the sentence. One of the factors is the existence of an effective compliance and ethics program. In the Commission's own words - “The potential fine range for a criminal conviction can be significantly reduced - in some cases up to 95% - if an organization can demonstrate that it had put in place an effective compliance and ethics program and that the criminal violation represented an aberration within an otherwise law-abiding community.”

The Sentencing Commissions created a road map for those seeking to implement an effective compliance and ethics program. Such a program would have:

- Standards and procedures to prevent and detect criminal conduct.
- Responsibility at all levels and adequate resources, and authority for the program.
- Personnel screening related to program goals.
- Training at all levels.
- Auditing, monitoring, and evaluating program effectiveness.
- Non-retaliatory internal reporting systems.
- Incentives and discipline to promote compliance.
- Reasonable steps to respond to and prevent further similar offenses upon detection of a violation.

The Bank Bribery Act and NCUA guidelines encourage federally-insured credit unions to adopt codes of conduct designed to prohibit officers and directors of credit unions from seeking or accepting anything of value in connection with credit union business. Credit unions can create exceptions to this general rule, though. The credit union may specify appropriate exceptions to the general prohibition of accepting something of value in connection with credit union business.

There are a number of instances where a Credit Union Official, without risk of corruption or breach of trust, may accept something of value from someone doing or seeking to do business with the credit union. In general, there is no threat of a violation of the Bank Bribery Act in the following situations:

- The acceptance is based on a family or personal relationship that is independent of any business of the institution.
- The benefit is available to the general public under the same conditions on which it is available to the Credit Union Official.
- The benefit would be paid for by the credit union as a reasonable business expense if not paid for by another party.

NCUA doesn't recommend setting dollar thresholds in the areas of “business purpose entertainment or gifts.” What is reasonable in one part of the country may appear lavish in another part of the country. In doing this, a credit union may establish in its own code of conduct a range of dollar values, which cover the various benefits that its officials may receive from those doing or seeking to do business with the credit union.

As I said earlier, find your Bank Bribery Act policy and read it! That will give you a roadmap for compliance.

NCUA issued guidance after passage of the Sarbanes Oxley act. While the vast majority of Sarbanes Oxley does not apply to federal credit unions, NCUA did address ethics in its guidance. Section 406 of Sarbanes Oxley requires public companies to disclose whether its executive officers had signed an ethics policy. If not, the company had to say why. In its guidance, NCUA encourages each federal credit union to consider adopting a written code of ethics for its chief executive officer and senior financial officers. While it doesn't address boards, ask yourself this: is there a good reason why your board shouldn't sign an ethics policy?
The FDIC issued guidance on implementing an effective ethics program. Sure, the FDIC does not govern credit unions, but the document is a must read for anyone committed to ethics and compliance matters. The FDIC document stresses, among other things, the safeguarding of confidential information, strong internal controls, providing candor in dealings with auditors and examiners, and the observance of all applicable laws and regulations. FDIC or not, that’s a good road map for credit unions.

TO SUMMARIZE
Like it or not, you help lead the credit union. You are a steward, bound by the duties of care and loyalty. Also, your regulator suggests you strongly consider ethical issues when guiding your credit union. I hope none of this overwhelms you. Here are some good rules of thumb: work hard and prepare; put the credit union first and strive to adhere to ethics and Bank Bribery Act policies at your credit union. If you keep these simple rules in mind, you should be fine.

\textsuperscript{13} FIL-105-2005.