

Fit and Proper Requirements for Directors and Senior Management of Credit Unions

Fitness & Propriety

- **Fitness - noun**
 - the quality of being suitable to fulfill a particular role or task.
 - synonyms: suitability, capability, competence, competency, proficiency, ability, aptitude
- **Propriety - noun**
 - the details or rules of behaviour conventionally considered to be correct.
 - synonyms: correctness, rightness, morality, decorum, respectability, decency, appropriateness
- **Fit & Proper**

What's in a name?

Co-operative

a co-operative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

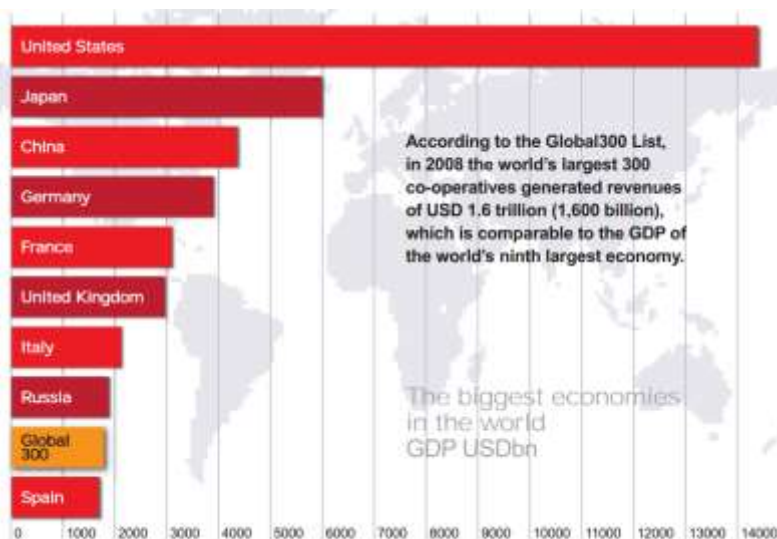
Credit Union

a co-operative financial institution

Mutual

an enterprise owned by its members, providing a variety of services to the members for the sole benefit of the members.

Global co-operative impact



Where are these successful co-operatives?

T. 4 COUNTRIES BY TOTAL TURNOVER OF CO-OPERATIVES OVER 100 MILLION USD

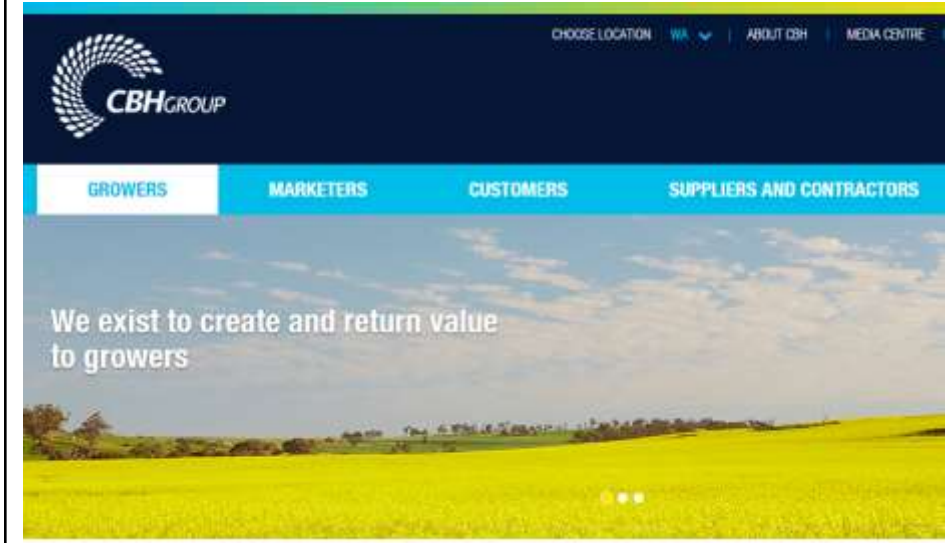
	turnover (billion USD)		turnover (billion USD)
USA	669.86	BELGIUM	29.47
FRANCE	377.13	SWEDEN	26.61
JAPAN	360.54	AUSTRALIA	17.48
GERMANY	291.73	SINGAPORE	14.41
NETHERLANDS	132.56	BRAZIL	7.22
SPAIN	85.21	POLAND	5.46
UK	83.48	INDIA	5.07
SWITZERLAND	78.62	IRELAND	4.88
FINLAND	66.13	COLOMBIA	4.46
DENMARK	64.85	ARGENTINA	3.63
ITALY	54.92	CZECH REPUBLIC	2.31
SOUTH KOREA	54.44	MALAYSIA	1.98
CANADA	51.19	SAUDI ARABIA	1.50
NORWAY	33.35	TURKEY	1.06
AUSTRIA	33.25	OTHER COUNTRIES	7.13
NEW ZEALAND	33.07		

Who are these successful co-operatives?

T. 15 THE 15 LARGEST CO-OPERATIVES IN THE BANKING AND FINANCIAL SERVICES SECTOR BY NET BANKING INCOME

RANK 2012	RANK 2011	ORGANISATION	COUNTRY	INCOME 2012 (BILLION USD)	SOURCE
1	1	GRUPE CRÉDIT AGRICOLE	France	40.90	CoopFR
2	2	GRUPE BPCE	France	28.96	CoopFR
3	3	GRUPE CRÉDIT MUTUEL	France	19.26	CoopFR
4	5	RABOBANK GROUP	Netherlands	15.04	WCM questionnaire
5	4	DESJARDINS GROUP	Canada	12.57	WCM questionnaire
6	-	THE NORINCHUKIN BANK	Japan	11.19	Euricse
7	6	FEDERAL FARM CREDIT BANKS FUNDING CORPORATION	USA	6.48	Euricse
8	7	RZB	Austria	4.66	Euricse
9	8	DZ BANK	Germany	4.30	Euricse
10	10	NAVY FEDERAL CREDIT UNION	USA	3.65	NCB
11	12	SWISS UNION OF RAIFFEISEN BANKS	Switzerland	2.29	Euricse

Australia's biggest co-operative?



Second biggest?



Table 1: Top 100 Australian Co-operative and Mutual Enterprises 2014 by Turnover (FY2012/13)

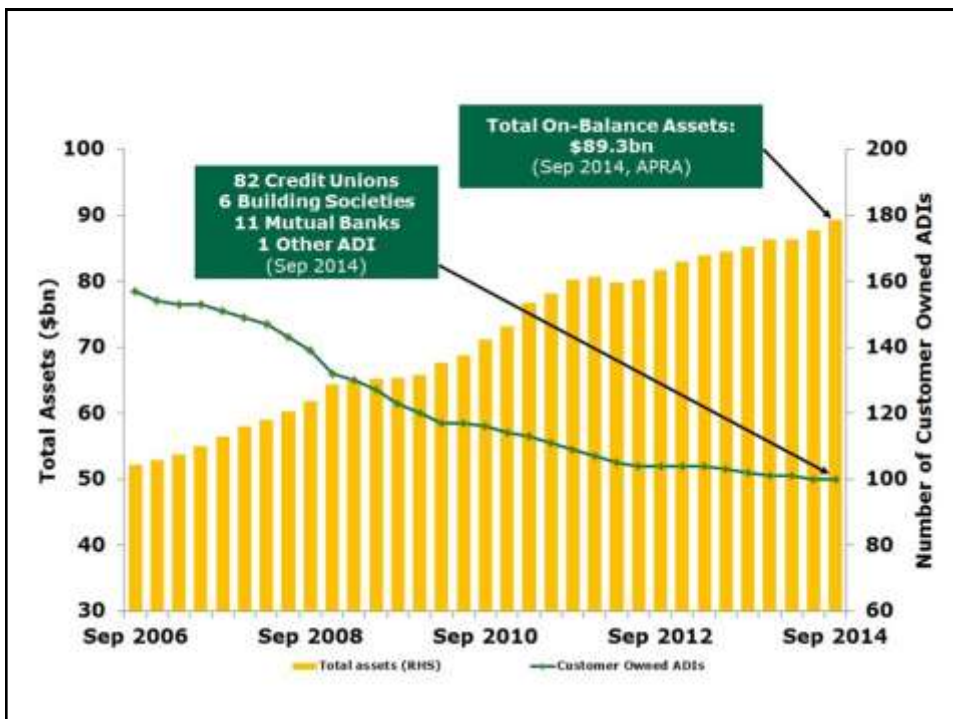
RANK	NAME	STATE	GROSS TURNOVER	EBIT
1	Co-operative Bulk Handling Ltd	WA	2,815,739,000	137,723,000
2	Murray Goulburn Co-operative Co Ltd	VIC	2,389,435,000	39,053,000
3	The Hospital Contribution Fund of Australia Ltd.	NSW	2,134,196,000	99,939,000
4	HBF Health Ltd	WA	1,268,960,000	166,493,000
5	Capricorn Society Ltd	WA	1,212,591,000	193,119,000
6	Australian Unity	VIC	1,146,136,000	62,923,000
7	Credit Union Australia	QLD	693,103,000	78,635,000
8	Namoi Cotton Co-operative Ltd	NSW	580,042,000	-3,363,000
9	RAC WA	WA	560,254,000	32,497,000
10	RACQ	QLD	532,827,000	46,297,000
11	Heritage Bank Ltd	QLD	493,712,000	52,964,000
12	National Roads & Motorists' Association Ltd	NSW	478,886,000	45,140,000
13	RACV	VIC	470,410,000	95,500,000
14	Newcastle Permanent	NSW	456,057,000	56,155,000
15	People's Choice Credit Union	SA	423,023,000	34,526,000
16	Teachers Federation Health Ltd	NSW	408,302,000	11,838,090
17	Avant Mutual Group Ltd	NSW	408,456,000	119,380,000
18	Norco Co-operative Ltd	NSW	369,891,000	350,000
19	Dairy Farmers Milk Co-operative Ltd	NSW	327,016,000	901,000
20	Defence Health Ltd	VIC	322,085,000	-24,161,000

A bit of credit union history

- **First consumer coop - Fenwick Weavers' Society 1769**
- **First credit union created by Friedrich Raiffeisen, the Heddesdorf CU in Germany in 1864**
- **1865 Italy, 1872 United Kingdom, 1878 France, 1889 India, 1901 Canada, 1908 United States**
- **1946 Australia's first credit union
Catholic Thrift and Loan Co-Operative
(renamed in 1948 as Universal Credit Union)**
- **Rabobank
(Coöperatieve Centrale Raiffeisen-Boerenleenbank)**

CU's in Australia

- 1946 1 CU
- 1956 100 CU's
- 1963 273 CU's
- 1973 833 CU's
- 1978 690 CU's
- 1993 357 CU's
- 2014 101 "Mutuals"
- Total assets A\$86.4 billion
- More than 4.5 million members
- Collectively the fifth largest deposit holders
- High member/customer satisfaction



Australian Credit Union Firsts

- To offer payroll deduction for savings and loans
- To offer free life insurance on loans
- To introduce online computer operations
- To introduce ATMs
- To introduce point of sale machines
- To provide international ATM withdrawals
- First non-US financial institutions to join VISA

History of CU regulation

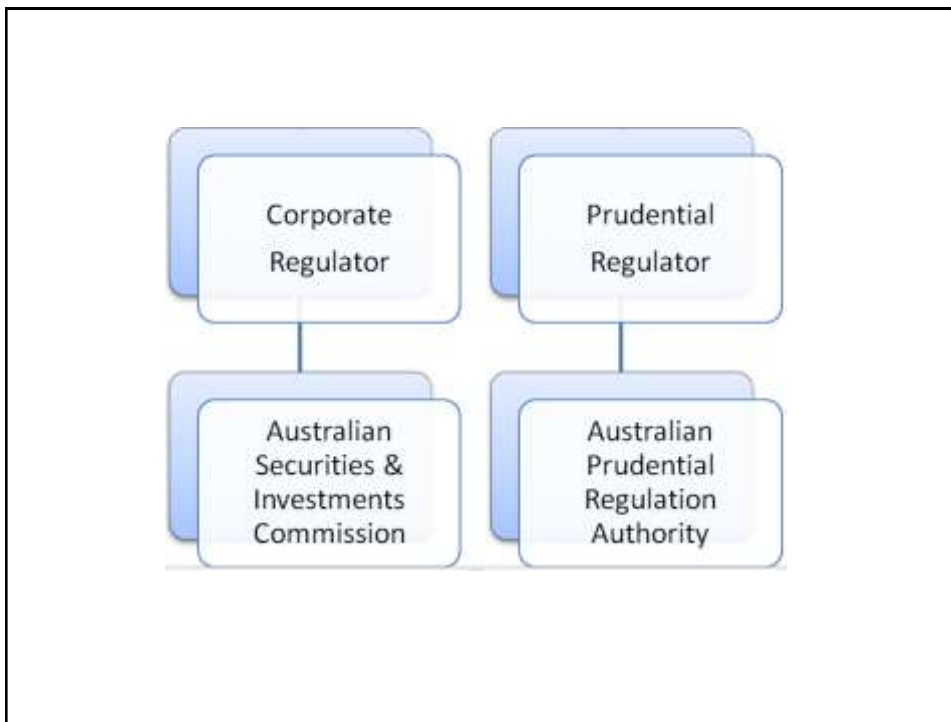
- To 1978 Registrar of Cooperatives
- 1978-92 CU Savings Reserve Board
- 1992-98 Financial Institutions Commission
- 1998- Australian Prudential Regulation Authority (APRA)

Regulation 1998 to present

- Australian Prudential Regulation Authority
- APRA sets legally enforceable “Prudential Standards” for all regulated entities
- Banks, Mutuals (credit unions, building societies, mutual banks), general and life insurance companies, as well as superannuation (pension) funds
- APRA’s mission: to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions are met
- Regulation is focused upon depositor protection

History of CU regulation

- From 1999 credit unions no longer considered to be cooperatives
- 2000 ASIC policy statement PS147, a cooperative is a “company with mutual structure”
- Definition of a mutual structure
 - Economic test - members have rights to receive an equal share of the surplus in a wind-up
 - Governance test - effectively one member one vote
- Hence, credit unions are “mutual companies” with both a corporate regulator and a prudential regulator
- Ten Australian credit unions have recently converted to become “Mutual Banks”



Corporate responsibilities

- (s180) Directors must exercise their powers and discharge their duties with... care and diligence
- (s181) Duty to act in good faith and in the best interests of the company
- (s182-183) Not improperly use position (or information) to gain advantage or cause detriment
- (s184) Identifies intentional dishonesty as a criminal offence
- (s191-194) Duty to disclose and avoid conflict of interests

History of CU regulation

- **(s180) Business judgment rule**
 - **Make judgment in good faith**
 - **Not have a material personal interest**
 - **Must inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate**
 - **Rationally believe the judgment is in the best interests of the business**

Board duties

- **Must observe restrictions to powers described by Constitution (s125)**
- **Dissenting from a Board decision**
 - **If belief that decision is in breach of corporate duties (eg disclosures within annual financial report)**
 - **Record dissent in minutes may give prosecution relief (s1318)**
 - **If able under Constitution, convene a General Meeting**
 - **Consider no longer sitting on the Board - resign**

Board duties

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Prudential responsibilities

- **Basle Committee on Banking Supervision**
- **“Principles for Enhancing Corporate Governance” Oct 2010**
- **Board practices**
 - **Ultimate responsibility for the ADI, including risk strategy & appetite/tolerance, financial soundness, organisation structure & functioning, and governance**
 - **Corporate values and code of conduct**
 - **Oversight of senior management**
 - **Board qualifications, training, composition**
 - **Proper functioning of the Board**
 - **Role of the Chair**
 - **Board committees**
 - **Conflicts of interest**

Basle II Capital Accord

- **Pillar 1 Capital**
 - Credit Risk (IRB, standardised approach)
 - Operational Risk (AMA, standardised approach)
 - Market Risk (trading activities only - not applicable)
- **Pillar 2 Supervisory Review**
 - ICAAP – credit concentration risk, interest rate risk, liquidity, strategic, contagion & reputation, regulatory, securitisation
- **Pillar 3 Market Discipline**
 - Consistency of reporting

Basle II Capital Accord

- **Operational Risk defined as “the risk of loss resulting from inadequate or failed internal processes, people and systems...”**
- **The definition of Operational Risk allows prudential regulator to set prudential requirements for governance and fit & proper**

Aust. Prudential Standards

- Capital adequacy (reserves)
- Liquidity
- Credit quality
- Risk Management
- Large exposures
- Outsourcing
- Business Continuity Management
- Audit
- Governance
- Fit & Proper

January 2015



Prudential Standard CPS 510 Governance

Objectives and key requirements of this Prudential Standard

This Prudential Standard sets out minimum foundations for good governance of an APRA-regulated institution in the deposit-taking, general insurance and life insurance industries or of a Head of a group. Its objective is to ensure that an institution is managed soundly and prudently by a competent Board (or equivalent), which can make reasonable and impartial business judgements in the best interests of the institution and which duly considers the impact of its decisions on depositors and/or policyholders.

The ultimate responsibility for the sound and prudent management of an APRA-regulated institution rests with its Board of directors (or equivalent).

It is essential that an APRA-regulated institution has a sound governance framework and conducts its affairs with a high degree of integrity. A culture that promotes good governance benefits all stakeholders of an institution and helps to maintain public confidence in the institution.

Governance prudential standard

- **The Board is ultimately responsible for prudent management**
- **Board must have a charter setting out its roles and responsibilities**
- **Board must document delegations**
- **Directors must have necessary skills, knowledge, experience**
- **Must meet with regulator upon request**
- **Independence criteria**

Governance prudential standard

- **Board composition**
 - **Minimum 5 directors**
 - **Majority assessed as independent**
 - **Chair must be independent**
- **Annual Board and director performance assessments**
- **Renewal policy**
- **Remuneration policy**
- **Remuneration Committee**

January 2013



Prudential Standard CPS 520

Fit and Proper

Objective and key requirements of this Prudential Standard

This Prudential Standard sets out minimum requirements for regulated institutions in determining the fitness and propriety of individuals to hold positions of responsibility. Its objective is to ensure that a regulated institution prudently manages the risks posed to its business operations and financial standing by having persons acting in responsible positions who are not fit and proper.

The ultimate responsibility for ensuring the fitness and propriety of the responsible persons of an APRA-regulated institution rests with its Board of directors (or equivalent).

Persons who are responsible for the management and oversight of a regulated institution need to have appropriate skills, experience and knowledge, and act with honesty and integrity. These skills and qualities strengthen the protection afforded to depositors, policyholders and other stakeholders. To this end, regulated institutions need to prudently manage the risk that persons in positions of responsibility might not be fit and proper.

Fit & Proper prudential standard

- **Purpose**
- **The objective of the prudential standard is to protect the interests of depositors and other members, by ensuring that persons who are responsible for the management and oversight of the credit union have the appropriate skills, experience and knowledge and that they will act with honesty and integrity.**

Fit & Proper prudential standard

- **Board composition**
 - **Minimum 5 directors**
 - **Majority assessed as independent**
 - **Chair must be independent**
- **Annual Board and director performance assessments**
- **Renewal policy**
- **Remuneration policy**
- **Remuneration Committee**

Fit & Proper prudential standard

- **Fitness – qualifications, skills, experience, knowledge**
- **Propriety – character, honesty, integrity**

- **Fitness and propriety must be assessed upon appointment and then annually**
- **If not fit and proper cannot be a director**
- **Applies to all “responsible persons” – directors, senior managers, external auditor**

Fit & Proper prudential standard

- Objective tests
 - Not disqualified by prudential or corporate regulator
 - No criminal history (police checks obtained)
 - Not a current or former bankrupt
 - Material qualifications verified
 - Not have conflict of interest

- Not disqualified

The screenshot shows the ASIC Register search interface. At the top, there are navigation links: "Search company and other registers", "Search business names register", "Search SM3F auditor register", "Check Name Availability", "Professional Registers", and "Information Brokers". The search parameters are set to "Within: Banned & Disqualified", "For: Worthington", and "Name: Mark Joseph". The search results section is titled "Search Results - Banned & Disqualified Persons" and displays a message: "0 results found for 'Mark Joseph Worthington'". A "New Search" button is located at the bottom of the results area.

- No criminal history

     	<p>AFP Ref: 89C88198C Client Ref:</p> <p>17 July 2014</p> <p>SELECT CREDIT UNION LTD PO BOX 313 CONCORD WEST NSW 2138</p> <p style="text-align: center;">Standard Disclosure All recorded unspent offences released Name Check Only</p> <p>This is to certify that there are no disclosable court outcomes recorded against the name of:</p> <p>WORTHINGTON, Mark Joseph born on 16 March 1961</p> <p>In the records of the Australian Federal Police and the police in all Australian States and Territories as at 09 July 2014.</p> <p>This document is not issued as a form of identification.</p> <p>Authorised by:</p>  Co-ordinator Criminal Records	<p>Australian Federal Police Criminal Records Locked Bag 8550 CANBERRA CITY ACT 2601 Ph: 02 6140 6562 M0117 864 931 143</p>
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- Not a current or former bankrupt

National Personal Insolvency Index

[Browse](#)

Provided On:	16-May-2013 13:18:21
Provider Searched With:	WORTHINGTON, MARK JOSEPH, Male
Matches:	0

NO RECORD could be found of any individual on the National Personal Insolvency Index using the specified criteria.

ITSA Disclaimer: The information in this extract comes from the Insolvency and Trustee Service Australia's (ITSA) National Personal Insolvency Index (NPI) at the time and date indicated in this document. If you consider that the information contains errors, please promptly advise ITSA on 1300 364 755.

- Material qualifications verified

The University of New England



By authority of the Council

Mark Joseph Worthington

was awarded the

Master of Business Administration

on the 6th day of April 2000

Fit & Proper prudential standard

- Subjective tests – “Required Competencies”
 - Understand the role of a director/senior manager
 - Capacity to make an effective contribution to the Board
 - Knowledge of CU, financial services industry, regulatory environment
 - Ability to read and understand financial statements
 - Capacity to undertake continuous professional development
 - Ability to evaluate, form conclusions and make good judgments (and ask questions)

Fit & Proper prudential standard

- **Must have process to prevent a not Fit & Proper person becoming a director or other responsible person (senior manager and auditor)**
- **Must be able to remove a not Fit & Proper person**
- **Select CU**
 - **Amended Constitution**
 - **Director Nominations Committee**
 - **DNC reports to Board**
 - **Board resolves to allow nominee to become a candidate**

Nominations Committee – Example questions

- **All candidates**
 - **Q. If you were presented with the financial statements for another credit union, what key information would you look for and why?**
 - **A. (Asset size, profitability, CAR & trend, capital components (ie pref shares or sub debt), credit quality/write offs)**
- **Re-standing candidates**
 - **Q. What is Select Credit Union's Capital Adequacy Ratio and why is this ratio important?**
 - **A. (APRA min 8%. Select's PCR (APRA prescribed capital ratio) is 12.5%. CU actual 23%. Capital adequacy is a buffer against the risks associated with banking activities – mainly credit risk)**

- Annual Board Assessment

BOARD ASSESSMENT

Director:		Date:	
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COMPETENCY RATING KEY:

0 = Not achieved

1 = Limited achievement (extensive shortcomings)

2 = Partially achieved (virtues/shortcomings balanced)

3 = Largely achieved (very few shortcomings)

4 = Fully achieved (no shortcomings)

	STRATEGIC PLANNING	0	1	2	3	4
1.	A regular strategic planning process is conducted					
2.	There is active director input in the planning process					
3.	There is active management input in the planning process					
4.	Strategic Plan progress is reviewed at Board meetings					
5.	Strategic Plan progress is used for senior management performance reviews					

Comments:

- 50 questions assessing Board performance

- Annual Director Assessment

DIRECTOR PEER ASSESSMENT

Director being assessed:		Date:	
Assessing director name:			

COMPETENCY RATING KEY:

0 = Not achieved

1 = Limited achievement (extensive shortcomings)

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		RATING				
	BOARD CONTRIBUTION	0	1	2	3	4
1.	The director displays thorough preparation for all meetings					
2.	The director communicates relevant views on matters before the Board/committee					
3.	The director regularly contributes informed opinion on matters before the Board/committee					
4.	The director actively participates in Board policy reviews					
5.	The director actively participates in the annual budget process					
6.	The director actively participates in the strategic planning process					
7.	The director demonstrates capacity to act as a committee chair					

Comments:

- 26 questions assessing individual director performance

Governance Framework for Credit Unions



Governance Framework for Credit Unions

30. NOMINATION AND SELECTION OF DIRECTORS



Vacancy in the Board of Directors: Any vacancy in the board of directors, other than by expiration of term, may be filled by the vote of at least a majority of the remaining directors, if still constituting a quorum; otherwise, the vacancy must be filled by the general assembly in a regular or special meeting called for the purpose. A director so elected to fill a vacancy shall serve only the unexpired term of his or her predecessor in office.

Board election at General Assembly: The Nominating Committee will be responsible for identifying, screening, personally interviewing and recommending candidates to the entire Election Committee.

In nominating candidates, the Nominating Committee shall take into consideration such factors as it deems appropriate. These factors may include integrity, achievements, judgment, intelligence, personal character, the interplay of the candidate's relevant experience with the experience of other Board members, the willingness of the candidate to devote adequate time to Board duties, and likelihood that he or she will be willing and able to serve on the Board for a sustained period.

Governance Framework for Credit Unions

Sample - Board Recruitment Matrix

Qualities we seek on the board 	Demographics					Skills and Experience						
	Male	Female	Below 35 years old	Above 35 to 60 years old	Above 60 years old	Finance	Info. & Comm. Tech.	HR or Education	Agriculture	Entreprise or Business	Marketing or PR	Medical Practice
Names of Current & Potential Board Members 												

Fit & Proper

- **Eligibility (to be a director or senior manager)**
 - **Fitness - Subjective tests (required competencies)**
 - **Propriety - Objective tests**
- **Annual assessment (to remain as director or sen mgr)**
 - **Fitness - Director assessment by peers**
 - **Propriety - Objective tests**
- **Constitution (or by-laws)**
 - **Used to prevent a not fit and proper person being appointed**

Case studies

Where directors appear to not be fit and/or proper

- **National Safety Council**
- **Centro Properties Group**
- **HIH Insurance**

National Safety Council

- **CEO John Friedrich committed \$290m fraud**
- **Investigation outcomes**
 - **Real name Johann Friedrich Hohenberger**
 - **not an Australian citizen**
 - **did not possess any valid birth certificate**
 - **did not appear on any electoral roll**
 - **The trial judge found that the company had been insolvent for nearly five years and that this could have been 'fairly easily appreciated by an adult person of normal intelligence who had a general knowledge of the company's activities and an inclination to consider the accounts and auditor's report for half an hour.'**
 - **The Chairman was found liable for \$97m**

Centro Properties Group

- The Australian company Centro has \$30bn assets and is the second largest retail property owner/manager in Australia and the fifth largest in the US
- ASIC brought a case against the CFO and directors of Centro group under s180 (care and diligence) and s344 (all reasonable steps to ensure accuracy financial reporting)
- Finding – 2007 Annual Report inaccuracies:
 - \$1.5bn of short term liabilities incorrectly classified as non current (>12 months), and
 - Failure to disclose material post balance date event (\$2bn loan guarantees)

Centro Properties Group

- Debt classification
 - directors knew that the borrowings were maturing in the short term, and a basic understanding of the meaning of current liability should have led them to ask why the borrowings had not been classified as current liabilities
- Post balance date event
 - Proper diligence would have caused directors to turn their mind to the absence of any disclosure about the \$2bn loan guarantees provided to associated companies

Centro Properties Group

- **The Judge's Reasoning**
 - **"A reading of the financial statements by the directors is not merely undertaken for the purposes of correcting typographical or grammatical errors or even immaterial errors of arithmetic.**
The reading of financial statements by a director is for a higher and more important purpose: to ensure, as far as possible and reasonable, that the information included therein is accurate.
The scrutiny by the directors of the financial statements involves understanding their content"

HIH Insurance

- **The Owen Royal Commission Report into the failure of HIH Insurance 2003**
 - **Australia's largest corporate failure**
 - **\$5.3 billion loss was as a result of mismanagement, not fraud**

Governance Lessons

- **Beware the dominant Chief Executive**
 - Appointed friends and associates to the Board
 - No clearly defined limits of authority
 - Board highly inclined to waive rules and guidelines
 - Management was not held accountable or subject to questioning
- **Ineffective Chairman**
 - Board papers not an effective tool for consideration and review
 - Chair had no involvement in determining information provided to the Board
 - Directors “had no idea what the strategy of the company was”
 - Chair did not take responsibility to ensure full disclosures of conflicts
 - Chair ignored concerns raised by two non executive directors

HIH Insurance

- **Board did not ask questions**
 - Board did not understand, test or endorse strategy
 - Long term strategic plan never formally developed
 - Failure to understand strategy led to failure to understand risks
- **Directors did not understand financial statements**
 - Failure to grasp concept of conflict of interests
 - Board members remained present when their private interests were at issue
- **Unusual accounting transactions**
 - Budgetary control ineffective
 - One off EOFY transactions used to disguise performance
 - Board did not consider appropriateness of practices

Governance Lessons

- **Ineffective Audit Committee**
 - No concern for risk management or internal controls
 - Committee rarely met with auditors in absence of management
 - Could not and did not ask the right questions
- **Compromised auditor independence**
 - Board had 3 former partners of the audit company Andersons
 - Chairman was former Andersons partner and continued to receive fees
 - Audit team member removed after meeting with Board without management

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