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May 10, 2013

Melanie Achtemichuk, Director, Policy Initiatives
B.C. Financial Institutions Commission
By email: CUandTrusts@ficombc.ca

Re: March 2013 Draft Governance Guideline for B.C. Credit Unions

Dear Ms. Achtemichuk:

Thank you for your work on the important issue of credit union governance. I appreciate FICOM's open process of publishing the task force report and draft Guideline, then inviting comments.

Introduction:

I am a financial economist specializing in the governance of large organizations. My cv is online at linkedin.com/in/marklatham. I did a master's in finance at UBC, a PhD in finance at MIT, and was assistant professor of finance at U C Berkeley. I worked six years for Wall Street firms, on derivatives arbitrage and risk management.

I left Wall Street in 1995 to work independently on reforming corporate governance. Since then, my reform work has broadened to include democracies, co-ops and credit unions -- see votermedia.org/publications. In 2009, U.S. Securities and Exchange Commission Chairman Mary Schapiro appointed me to their Investor Advisory Committee "to represent individual investors, particularly with respect to their role in corporate governance."

Last year I wrote a paper on the need for governance reform in co-ops and credit unions, entitled We Want Our Co-ops Back, and submitted it to FICOM in September 2012. In March 2013 I wrote a shorter overview article with a similar title, in the *Vancouver Observer*.

Most of the FICOM draft Guideline's principles and standards seem reasonable to me, but overall they seem to lack guidance on ensuring that credit union boards are accountable to members. So my comments below focus on strengthening that aspect.

Accountability requires competition in board elections:

Board elections are the primary mechanism for ensuring accountability to members. That is why we bother to have board elections. But if a board can prevent competitors from getting onto the ballot, then this mechanism is ineffective and accountability is lost. "Competitors" are candidates who may challenge the dominant majority on the board, disagree with some of their decisions, and compete with them for reputation in the eyes of members.

If a board and/or its chosen nomination committee has the power to disqualify director candidates based on subjective criteria, then they can easily use that power to disqualify competitors, and only approve candidates loyal to the dominant clique. So although it is fine for a board (or committee) to recruit candidates with specific skills as described in the Guideline (pp 9-10 point #3), they should not have the power to disqualify candidates on that basis, because skills assessments are subjective. Only a few simple objective criteria may be appropriate grounds for disqualification, such as length of credit union membership.

For a recent example of a board using its power to disqualify a highly qualified competitor, see votermedia.blogspot.ca/2013/04/mec-slides-from-democracy-to-oligarchy.html.

Lack of accountability opens the door to corruption:

Once a dominant clique no longer faces effective democratic competition for its control of a credit union board, the door is open to a wide range of corruption. The clique can take over the entire board, so that there are no independent eyes and voices. It can put its own interests ahead of members' interests, endangering the success and stability of the credit union. Even if current directors refrain from doing this, future directors may not be so benevolent.

Running a large business organization involves making many subjective decisions that determine transactions, such as hiring, firing and pay of staff, contractors and other service providers. A credit union that supports its community also makes subjective decisions in allocating support funds, including donations and loans. Just as with assessing director candidate skills, subjectivity can provide cover for favouritism.

In such an environment, the pervasive gravitational force of self-interest will encourage cronyism between directors and senior staff, so that both can enjoy higher pay and less competition for their jobs. They may use the credit union's funds to pay service providers (lawyers, accountants, consultants, public relations firms) to further strengthen the board's entrenchment. Community support funds may be allocated to the directors' or staff's friends and allies.

All this corruption can occur in subjective decisions that give plausible deniability, so that courts and regulators cannot prevent it. Only competitive democratic accountability to members can keep it in check, which also requires an effective member information system -- more on that below.

These mutually beneficial covert relationships are broadly similar to those of regulatory capture -- another type of corruption that FICOM should guard against, as I'm sure you are aware.

Board control of information can bias elections:

Even in credit unions where almost any member can run for election to the board, a dominant board majority can maintain its grip on power by controlling the information conveniently available to voting members. Many members feel an obligation to vote, but are too busy to spend time doing research on which choices to vote for, in director elections and on resolutions. Their votes are thus easily influenced by whatever information is conveniently available.

As a result, a dominant clique can exert great influence on voting outcomes. For example, in 2011 the Vancity board started displaying its director election recommendations directly on the ballot, listing its recommended candidates first, with the word "Recommended" next to them. The impact can be seen in voting results since then.

One obvious case is to compare the vote counts for Michael Dubelko and Jim Wright in Vancity's 2012 and 2013 elections. In 2012, both were "Recommended", and placed 4th and 5th behind the three other recommended candidates. With only three seats to fill, neither Dubelko nor Wright was elected. In 2013 both ran again, but only Wright was recommended while Dubelko was not. The vote counts:

	2012	2013
Dubelko	**5,502**	1,408
Wright	**4,438**	**4,801**

The numbers in bold face were for "Recommended" choices. A simple comparison of Dubelko's votes in 2013 versus 2012 suggests that priority placement on the ballot, along with a recommendation, can give a candidate more than 4,000 extra votes. Such an advantage is decisive. With three board seats to fill in 2013, the top seven candidates were:

	2013	
Virginia Weiler	**14,430**	elected
Bob Williams	**9,645**	elected
Allen Garr	**8,237**	elected
Lisa Barrett	6,534	
Jim Wright	**4,801**	
Leopoldo Valdes	**4,444**	
Gil Yaron	2,808	

Here too I've bolded the "Recommended" choices. Weiler, Williams and Garr were [declared elected](). If the board had not used its control of the ballot sequence and recommendation display, we can estimate with confidence that Lisa Barrett would have been elected instead of Allen Garr, since that would need only 1,704 votes -- much less than the likely 4,000-vote impact.

Similar examples can be found by comparing Vancity election results in 2009 and 2012 -- see page 10 of We Want Our Co-ops Back, which also cites evidence in the press that the recommendations are correlated with factional allegiance.

Thus the dominant group can maintain its control of the board behind a facade of democracy, and a Vancity director can still claim that "in the end, our members choose." (*Georgia Straight* 2013-04-11 www.straight.com/news/370571/vancity-election-recommendations-generate-controversy)

Suggested change to draft Guideline:

In the section "Assembling an Effective Team" I suggest revising point #3 (pp 9-10) to become:

3. The board takes an active role in the director recruitment process by:

- identifying desirable skills, experience and personal attributes that are directly aligned to the credit union's strategic plan and to its needs for risk oversight;
- ensuring candidates with the desirable skills and qualities are actively recruited;
- establishing a transparent evaluation process to compare candidates to the desirable skills and qualities;
- communicating both the desirable skills and qualities and the evaluation process to members clearly, and in advance of the election process;
- recommending any number of candidates to vacant positions, so long as the recommendations do not appear on the ballot and are only presented to members in forums where any member can make candidate recommendations; and
- letting members choose by vote among all eligible candidates; i.e. no candidates are disqualified from nomination based on the evaluation process.

Conclusions:

Further suggestions for improving credit union governance are in the paper We Want Our Co-ops Back and its Co-op Democracy Scorecard spreadsheet.

I discussed self-serving biases in We Want Our Co-ops Back (page 4). It is natural for directors and their payees to say: "To improve governance, we should give more power to directors." But instead, we should strengthen our democratic checks and balances. Self-serving behaviour is natural for humans, as it is for foxes, so I mean no offence to either when I say: Please don't let the foxes design the hen house.

For the sake of transparency and accountability to the public, I would suggest that FICOM publish online all comments on the draft Guideline, as is standard practice at, for example, the U.S. Securities and Exchange Commission -- see www.sec.gov/comments/s7-14-10/s71410.shtml. I am publishing this letter at votermedia.org/publications.

Feel free to contact me with any questions etc. Thank you again for your attention to this important component of our financial system.

Sincerely,

Mark Latham
Founder, VoterMedia.org