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Credit Union Director Compensation: From Taboo to Typical

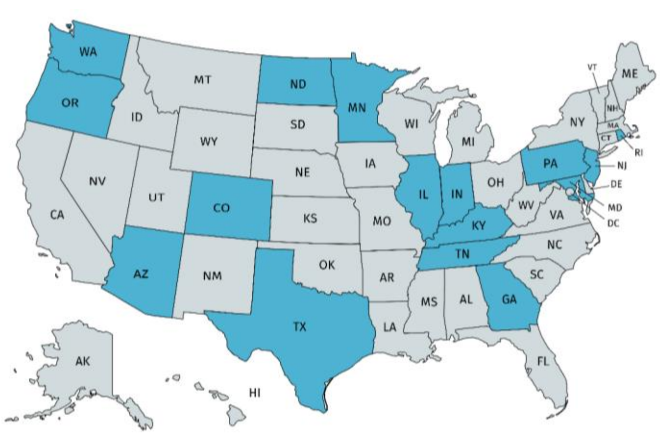
Are you thinking about providing director compensation at your credit union? This article discusses the pros and cons of this trending topic, and how your credit union should approach its board compensation philosophy.

To attract and retain talent that can carry out a member-focused mission, top credit unions have been developing more robust and sophisticated executive compensation packages. For many credit unions, the next frontier is compensation for the board of directors. Discussing director compensation can quickly become contentious, as it concerns some of the fundamental values of credit unions. Yet, despite any philosophical controversy, 71% of the largest credit unions that can compensate their directors *are* doing so.

Current legal status

Providing direct compensation to directors at federally-chartered credit unions is not allowed. State laws govern the legality of director compensation for state-chartered credit unions. However, there are several different stances on the issue. While roughly half of the state statutes explicitly declare that directors may not be compensated, and seven states allow only a treasurer to receive compensation, sixteen states currently permit at least *some* director compensation.

Figure 1: States Allowing Compensation of Directors



■ States permitting director compensation

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The number of permissive states is increasing (see blue states above), with Arizona, Colorado, Illinois, and Oregon recently amending their state laws to allow director compensation. State credit union leagues are focused on driving this legislative change to empower their credit unions to recruit the most qualified members for board positions, which demand more time and expertise than ever before.

Current prevalence

McLagan has reviewed director compensation practices among state-chartered credit unions headquartered in states that allow director compensation for credit unions $1.75 billion in assets and above. 71% of these credit unions are currently compensating their directors. Further, plans to begin paying directors are being developed or have already been approved by members at additional credit unions, commonly in states that have most recently allowed the practice.

Why would your credit union want to compensate directors?

- **Attract and retain talented board members:** The expectations, responsibilities, and time demands of directors and officials are significant, particularly for larger credit unions. Competition for the attention and energy of professionals, community leaders, and subject matter experts is extensive. Providing compensation can attract more skilled and experienced candidates.
- **Higher expectations:** Allowing compensation can also help justify higher expectations for the board. The chairperson, membership, and management team can require more time and accountability from paid board members than may seem reasonable to ask of volunteers.
- **Recognition:** Board members put a significant amount of time and energy into improving the credit union. Compensation provides tangible recognition for this time and energy.

The bottom line is that compensating directors has the potential to lead to better board-level decision making. Members and employees benefit from retaining a talented and diverse board that works on their behalf.

Why wouldn’t your credit union want to compensate directors?

- **Not part of the mission:** Credit unions have a long history of not compensating directors. Most directors of credit unions do not serve for a financial reward, but as a form of community service.
- **Bank differentiator:** As more credit unions begin to compensate directors, this erodes one area of differentiation with banks. The Credit Union Membership Access Act discusses what makes credit unions different from other financial services firms, and why tax exemption is appropriate:
    - Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means.
- **Money:** Lastly, compensating directors costs money—money that could potentially be applied to member dividends, additional services, or employee compensation.

Board compensation philosophy

If your credit union is interested in creating a compensation package or understanding further how your current package compares to market, the first step is creating a compensation philosophy. To successfully do so, the two main questions to ask include:

1) With whom does your credit union compete for talent (e.g., just credit unions or credit unions and banks)?
2) How does your credit union want to compare (lag, meet, or lead the market)?

While a compensation philosophy for a board of directors may differ from a compensation philosophy for employees, many companies choose to have alignment. The primary difference in board compensation relative to employee compensation is that it is not based on a pay-for-performance philosophy. The board should not be incented based on financial metrics. Instead, the board should be focused on fulfilling its oversight role, and not meeting financial or business targets.

In conclusion

A credit union considering compensation for directors may find the topic controversial and the process daunting. While some credit unions may already provide compensation to their board, they are often unsure of the appropriate amount to allocate. Through market information, we can uniquely provide clarity and context on this topic to help firms make informed decisions. McLagan has also partnered with credit unions on the development of their board compensation philosophy. Our market knowledge and your understanding of your firm's specific needs provides the perfect combination to determine the best course of action for your credit union.

To learn more about director compensation in credit unions, please contact our team.

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