CREDIT UNION DEPOSIT GUARANTEE CORPORATION Alberta

GUIDANCE

Business Succession Planning–Underwriting Assessment Criteria

Reference:
Standards of Sound Business and Financial Practices
- **M-2 Risk Management Process**
- **M-3 Credit Risk**

Underwriting Assessment Commercial/Agricultural LTR Program
- **M-3 Business succession plan**

Corporation Credit Lending Guideline – Credit Evaluation

Standard M-2 Risk Management Process requires the Chief Executive Officer and Senior Management to ensure the credit union has an ongoing and effective risk management process.

Standard M-3 Credit Risk requires a credit union to have documented appropriate policies on the areas and type of credit in which the credit union is willing to engage and appropriate and prudent policies on exposure limits for a single risk, associated or connected borrowers, specific industries, geographic regions and other credit exposures warranting aggregation.

Underwriting Assessment LTR M3 asks if a business succession plan is in place. A credit union that addresses contingency planning with its business members for the occurrences mentioned below will have satisfied the assessment criteria for succession planning and helped the member to be more secure financially.

Introduction:

This guidance clarifies the Corporation's criteria for assessing the Succession Planning category under the Loan Transaction Review Program. Assessment criteria for large and small businesses can be different and are addressed separately.

Business succession planning is a process that allows transfer of control in a business with the least amount of disruption. It may also address business interruption contingency planning in smaller owner operated entities. Whether for continuity or for an orderly exit, a well thought out business succession plan should be in place, regardless of the age of the principals or whether the business is in the start-up stage. Too often business succession plans are not given consideration due to the age of the owner and this can be detrimental to the business and family if a personal life change/event occurs. It is frequently thought that family will take over when in actuality there is no desire, or ability, to do so.

For lenders dealing with business accounts it is not sufficient to simply ask if a business succession plan is in place. The discussion with the owner/key managers should entail addressing the basics of succession planning with the intent that they will pursue the implementation of a plan within a reasonable time.

Business Succession Planning

Succession Plan Basics:

A succession plan ensures the owner or shareholders have given thought to an exit plan that will be beneficial to all involved. It will provide for family, for management, for employees, and prepare for a smooth transition in ownership.

Having employees operate the company may be sufficient for its continuity in the short term. However, failure to fill a vacant key management position quickly can impact the company's ability to meet their financial obligations.

When assessing a succession plan, credit unions should consider whether the member has addressed the following:

1. Discussing the plan with a solicitor, an accountant and other key financial planning/estate planning professions.
2. Letting others, such as family and the management team, know the general details to avoid any surprises and eliminate any concerns.
3. Identifying the successor early in the process and get the successor familiarized with the business.
4. If the intent of the owner is to keep the business in the family, determining if the family wishes to keep operating the company and maintain jobs in the company is key. Who is going to operate the business and in what capacity? What will be the compensation for those family members not participating?
5. If the succession plan entails business partners, an agreement on how the business will shift, or perhaps a buy-sell agreement should be in place.
6. While a buy-sell agreement can ensure the business will stay with family or business partners, life and/or disability insurance should be considered as well. It may provide adequate funds to fulfill the commitment of the agreement.
7. Once established, the plan should be reviewed periodically and changed immediately if a major event, whether personal or business, has occurred (e.g. divorce, marriage, etc.).

For a small business or sole proprietorship succession planning is encouraged, however, a stronger focus on business continuity planning may be more important. Areas that should be addressed in these instances:

1. What if the owner/primary operator is injured?
2. Will there be sufficient cash flow to continue to meet financial obligations?
3. Is an adequate insurance plan in place to cover business interruption?
4. Planned sale of non-specialized, smaller equipment financed may be adequate mitigation for the credit union to consider a succession plan as not applicable.

When reviewing a member's business succession plan, a credit union should be considering and commenting on all of the above. With a well conceived plan, the credit union's risk is reduced.