



Global Financial Framework Reassessment : the Cooperative Perspective

CONTEXT : On April 2nd, the G20 Summit will lay out ideas for a new international monetary system. The ICBA welcomes the perspective of a renewed international financial framework. The cooperative banking movement, directly involved in the reform of the global financial landscape, has a special vision of the future of banking and finance. This vision could be a precious contribution to the coming reflection phase, and to the construction of a long-lasting, sustainable new financial world order. The latter would necessarily involve the contribution of cooperative finance.

* *
*

COOPERATIVE FINANCIAL INSTITUTIONS HAVE BECOME GLOBAL PLAYERS

Financial cooperatives in their diverse forms serve over 621 million people in the G-20 nations alone. They “provide US\$3.6 trillion in loans, hold US\$4.4. trillion in savings and have US\$ 7.6 trillion in total assets.” Some financial cooperatives hold prominent rankings particularly in the EU, Asia (400 million customers in China and India) and the Americas. They form a diverse, but distinct financial model.

Cooperative financial institutions have steadily expanded beyond their home markets. Some G20 financial cooperatives have grown into global players among the very first banks in the world¹.

Cooperative financial companies contribute to new forms of finance. As cooperative finance is in itself an innovation from traditional commercial banking, cooperatives are naturally at the heart of the microcredit and financial inclusion movement. Not only does microcredit have a cooperative origin and an often-cooperative form, but cooperative financial institutions are key actors in microfinance. Cooperative initiatives actually go beyond microcredit through a long-lasting financial contribution to developing economies². Moreover, financial cooperatives are at the heart of responsible financial innovation (often leaders in sustainable finance products), and are primarily customer-oriented³.

But to cooperative finance, innovation is nourished with history. The first cooperative banks were founded in 19th-century Europe, to assist underfinanced rural populations with little or no access to traditional banking or savings schemes. In 1930s America, Franklin Roosevelt made credit unions, that had been developing for decades in Canada and New England, part of the New Deal to struggle against

¹ See Top 50 Rankings by shareholder equity (2008) : *Crédit Agricole* ranked 7th largest global bank, followed by a series of banks ranking from the 20s to the 40s : *Rabobank*, *Caisse d'Epargne*, *Banque Populaire*, *Crédit Mutuel*...

² In Benin, for instance, FECECAM, a savings and credit co-operative federation, provided USD 16 million in rural loans in 2002.

³ FONTEYNE Wim, “Cooperative Banks in Europe—Policy Issues”, *IMF Working Paper*, Washington D.C., 2007.

the Great Depression. In response to both presidential and grassroots impetus, Congress passed the Credit Unions Act in 1934 in order to spur the growth of credit unions throughout the United States. In 1937, credit unions were exempt from taxation to further support their development.

COOPERATIVE BANKS CONTRIBUTE TO GLOBAL FINANCIAL STABILITY WHILE INVESTING IN THE LOCAL AND GLOBAL ECONOMY TO CREATE AND MAINTAIN JOBS

Cooperatives work within a long-term timeframe.

They inherit and hand over an intergenerational endowment which grows over time, that of cooperative members' initial and ongoing contributions. Indeed, cooperative members affect some of their capital as common property and allocate part of the annual surplus for development. Research has shown that cooperatives are efficient⁴ and represent good financial analysts and investors. Cooperative banks do benefit from their long-term perspective in their investment strategies. They do not have to follow short-term roadmaps. All the more as the major part of cooperative banks are not listed on the stock markets. Also, cooperative have strong governance principles with a "one man, one vote" member control over the decision-making process. The latter democratic principle lowers the risks for a long-term yield strategy²

Cooperative finance's long-term perspectives are nourished with "real-world" experience. Cooperative banks are strong local players, working within communities, with local business of all scales and local entrepreneurs since their foundation⁵. Cooperative financial institutions are strongly committed to their territories and will play a major role in financing the economies throughout the crisis. Their long term strategy and intimate link with consumers and SMEs gives them a major role in fostering recovery. In fact, most cooperative financial institutions were created by businesses of all natures in order to create jobs and to supply money in what were then credit-starved markets. This local, grassroots and hands-on approach has remained : the governance structures of most cooperative banks reflect bottom-up decision-making values, requiring a constant consultation process that allows to channel real economy issues into the cooperative financial industry leaders' agenda⁶.

What's more, cooperatives work primarily for members and clients, not for their own purposes. Due to their decentralized organizational model they contribute to reduce risk and better spread out risk. Their members' shares are not speculative instruments, which prevents them from short-term orientations. There is accordingly no need to maintain or improve positions in the stock markets, or hand out dividends. Furthermore, cooperative financial institutions tend to observe safer investment strategies and have demonstrated their ability to successfully create risk effect reduction tools, such as *guarantee funds* which to not fluctuate with financial markets.⁷ As they are not allowed a high level of risk, both by regulation, and internal member control and watchdog mechanisms, cooperative financial institutions have been forced to find alternatives to market-based risk instruments that often in fact amplify risk, as

⁴ See ORY Jean-Noël, LEMZERI Yasmina, "An appraisal of 'cooperative banks' versus 'pic banks' efficiency : a focus on the French situation and a European perspective", in *Working Paper (CEREFIGE)*, CEREFIGE, Metz, 2008. Ory and Lemzeri demonstrate through quantitative evidence and a Wicoxon efficiency test that French cooperative banks are generally more efficient over the 1997-2004 periode, save for the ROE index which is not the lone objective of cooperative banks, than their shareholder-owned counterparts.

⁵ In 2007, EU cooperative banks held an average market share of 25% for loans to small and medium enterprises (SMEs), while an average of 29% of their loans were SME loans (Source : EACB).

⁶ One business leader, Etienne Pfmilin of Crédit Mutuel (France) recently declared that his company had "not 12, but 2000 board meetings every year"

⁷ See HESSE Heiko, ČIHAK Martin, "Cooperative banks and Financial Stability", *IMF Working Paper*, IMF, Washington D.C., 2007. Hesse and Čihak's findings find that cooperative banks suffer "lower volatility of return" perhaps due to the "fact that cooperative banks in normal times pass on most of their returns to customers, but are able to recoup that surplus in weaker periods", as well as because of "mutual support mechanisms". These results are based on z-scores and various other tests (ratings).

recent events have demonstrated. Moreover, financial cooperatives do not allow themselves more risk than authorized by capacity, as there generally are no shareholders to pass it on to.

Therefore, cooperative banks are economically sound and yet sufficiently daring.

REGULATION SHOULD FAVOUR, NOT HAMPER, COOPERATIVE BANKING FOR THE SAKE OF FINANCIAL STABILITY AND BE PROPORTIONED TO RISK

We believe that regulation should favour equal treatment for equal risk and acknowledge differences in fundamental principles of governance.

Some countries' legislation include legal and regulatory hampering, sometimes all-out bans, to cooperative banking. We believe these norms are at the expense of the customer and of the overall solidity of the financial system. Cooperatives have indeed contributed to global stability given their relatively outstanding performance in the wake of the financial crisis. Indeed, although cooperative financial institutions certainly did suffer some of the consequences of the financial crisis and will probably be more strongly affected by the real economy crisis, they did avoid many of the problems raised by this crisis as their activities are mainly focused on the real economy, and less concentrated sectors.

The early and continued sense of responsibility demonstrated by financial cooperatives could be acknowledged through the reform of the Bretton Woods framework, but also in all international and domestic financial policies.

One principle for governments should be equality in different legal frameworks. Developing a prize-for-virtue mechanism within the banking world can only help reform past financial practices which have revealed toxic to the economy and to the reputation of the banking system itself.

Regulation should indeed favour cooperative banking in order to ensure financial biodiversity which supports global credit stability. It should at the very least make cooperative initiatives possible. Differentiated impact of the financial crisis on banking systems throughout OECD and G20 nations shows indeed that diverse financial systems favour overall stability⁸.

Risk analysis, however, shouldn't be the only reason for promoting financial cooperatives. The latter benefit from high quality management in connection with social economy and contribute to the development of small and medium sized enterprises and social undertakings.

FINANCIAL COOPERATIVES ARE READY TO ASSIST AND MAKE PROPOSALS IN ORDER TO REFORM THE GLOBAL FINANCIAL FRAMEWORK

The ICBA welcomes the perspective of a renewed international financial framework. The ICBA supports a more stable, sustainable international system in order to guarantee stability and avoid financial bubble phenomena.

We believe the new global financial framework should integrate global and domestic cooperative issues and support financial cooperatives as a complementary financial proposal for economies that need both cash and stability.

Among the issues the cooperative movement sees as strategic, different visions of propriety and ownership on banks, different visions of governance and of timeframes could be important

⁸ *Ibid.* Hesse and Čihák also demonstrate that "a higher share of cooperative banks increases stability of an average bank in the same banking system".

contributions for the global financial reform process from the cooperative movement. Appropriate representation, proportioned to their effective standing throughout the world, of cooperative financial institutions in global, multilateral and regional forums seems key to ensure the inclusion of the cooperative model, a very beneficial one for the economy as a whole, in standard-setting, negotiations, and regulatory agreements and bodies. The cooperative movement has a positive contribution to make in all realms of 21st-century finance and banking, particularly in fields such as governance, the customer relationship, development, financial stability, investment timeframes, CSR and community impact, to name only these questions.

A renewed international financial system implies the adoption of a new paradigm by replacing the concept of financial industry with the concept of financial activity to the service of the production of goods and services, the technological innovation, a sustainable development, and environmental preservation, people's educational, social and cultural development. A global regulatory regime must encompass not only risk aspects but also those relating ethics in financial activity.

As they were in the days of the Great Depression, financial cooperatives today are eager to co-elaborate solutions and to participate in the redefinition, or reform, of the global financial picture.

Beyond the G20 meeting, the depth of the crisis in the system on a global level is an opportunity to convene a worldwide forum of multiple actors that can participate in redesigning of the global financial order, democratizing decision-making, and preventing merely technocratic visions. This call may be addressed to governments, universities, multilateral financial institutions and experts, social economic organizations, trade unions and cooperatives, etc.