

**GLOBALISATION AND BANKING REGULATION:
CHALLENGES AND IMPACTS FOR CO-OPERATIVE BANKS**

Ladies and Gentlemen,

I would first like to thank the organisers for affording me the opportunity to participate in this symposium, the forum for a meeting of minds of specialist academics and practitioners to contribute to building the new environment for financial institutions. As President of the International Co-operative Banking Association, a worldwide organisation uniting co-operative banks on all continents, I wish to take the opportunity of presenting the viewpoint of structures, which while often poorly understood by academics and regulators alike, yet play a significant role in financing the real economy in both the developing and developed world.

The recent major financial crisis has led to unprecedented and salutary intervention by governments and Central Banks. The desire to “re-regulate” or more efficiently regulate banks has arisen as a consequence, or indeed a reaction. A perfect illustration of this new form of regulation is to be found in the recommendations of the G20 Pittsburgh summit for accounting standards submitted to the IASB, or its recommendations to the Basel Committee and the Financial Stability Board regarding measures to strengthen capital requirements and balance sheet management. Government leaders are endeavouring to reflect and to act in the context of globalisation, rather than merely reacting to or referring to globalisation.

This new era has been ushered by the deficiencies found in current regulations or indeed their perverse effects. These rules encouraged banks to extend the use of off-balance-sheet transactions. The high-risk, extreme-leverage policies propagated by the large, international finance and investment banks, in particular the Anglo-Saxon banking institutions, have very nearly had a devastating systemic effect as the absence of braking and shock-absorbing mechanisms were felt throughout the system.

We are becoming familiar with the preliminary drafts of the new regulations. They are the subject of fierce discussion between countries - all attempting to retain their comparative advantages. On the ground in the United States, it would seem that the “business as usual” camp is winning out over “main street” bankers, the category to which co-operative banks belong.

In my capacity as President of the ICBA, I will provide you with an overview of the impacts of and challenges associated with these developments for co-operative banks, the submerged part of the banking world.

1 – Co-operative operators: a hidden side of the banking world, including for the regulatory authorities

a. Distinctive features of co-operative operators

A co-operative bank is a banking entity that is owned by its members. They are both members and users, and are owners and customers of their bank. Co-operative banks are generally formed by the people in a local or professional community or by people sharing a common interest. They usually provide their members with a wide range of banking and financial services (loans, deposits, bank accounts, etc.). Co-operatives differ from other banks by their organisation, their aims, their values and their governance. In the majority of countries, they are supervised and controlled by banking authorities and are required to respect prudential banking regulations, which levels the playing field as regards competition with other banks. Depending on the country, this control and supervision of co-operative banks may be exercised directly by national entities or delegated to a central body or co-operative federation.

While their organisational rules may vary according to national legislation, co-operative banks share common characteristics:

- **Customer-owned entities:** the needs of members and users meet in a co-operative bank, because the members are also the bank's customers. Accordingly, the primary aim of a co-operative bank is not to maximise profits, but to provide the best possible products and services to its members. Some co-operative banks operate exclusively with their members but most of them also offer banking and financial services to non-members.
- **Democratic control by members:** co-operative banks are owned and controlled by their members, who democratically elect the members of the bank's statutory boards. Members generally have equal voting rights, in accordance with the co-operative principle of "one person, one vote".
- **Profit redistribution:** a significant portion of a co-operative bank's earnings, profits or surplus, is set aside as reserves. A share of this profit can also be distributed to the co-operative members, with legal or statutory limitations in most cases. Profits distributed in this way are allocated to members either through a patronage dividend, which is related to the use of the co-operative's products and services by each member, or through an interest or a dividend, according to the number of shares subscribed by each member.

Co-operative banks are deeply rooted in their regions or communities. They are very involved in local development and contribute to the sustainable development of their communities, because their members and officers generally belong to the communities in which they operate. By developing loans and access to banking services in regions and sectors where other banks have less of a presence (SMEs, farmers in rural areas, middle- or low-income households in urban areas), co-operative banks reduce banking exclusion and foster the abilities to operate in the economy of millions of people. They make a positive contribution to economic growth in countries in which they operate and increase the efficiency of the international financial system. Their specific form of enterprise, based on the organisational principles outlined above, has a proven track record in both developing and developed countries.

b – Recap on key data

Co-operative banks are present throughout the world.

In France, the three co-operative banking groups (Crédit Agricole, BPCE and Crédit Mutuel) account for some 50% of market share for loans and 60% of market share for deposits³, with an aggregate net banking income of EUR 53.4 billion⁴ (at 31/12/2008).

In Europe, co-operative banks hold a 21-% market share for deposits and a 19-% market share for loans⁶. Their presence is particularly marked:

- in Italy, with a market share of 34% for deposits and 30% for loans⁷.
- in Germany, with a market share of 19% for deposits and 16% for loans³,
- in the Netherlands – through Rabobank – which enjoys a market share of 43% for deposits and 30% for loans³,
- in Finland, with a market share of 34% for deposits and 32% for loans³,

Co-operative banks also have a significant presence:

- in South Korean, with the NACF and KFCBC Groups (with revenues standing at EUR 21.4 billion and EUR 1.4 billion respectively in 2008²),
- in Japan, with Norinchukin Bank (revenues totalling EUR 9.7 billion in 2008²),
- in Canada, with the Mouvement des Caisses Desjardins (revenues totalling EUR 5 billion in 2008²)
- In Morocco, with the Groupe Banques Populaires du Maroc (revenues totalling EUR 1.2 billion in 2008²)
- in Mexico, with CAJA Popular Mexicana (revenues totalling EUR 893 million in 2008²),
- in Brazil with the SICREDI Confederation (revenues totalling EUR 824 million in 2008²),
- in Taiwan, with the Taiwan Co-operative Bank (revenues totalling EUR 714 million in 2008²),

The cumulative revenue of the 50 main co-operative banks worldwide amounts to in excess of EUR 150 billion at 31/12/2008².

c – Little-known operators

I will start with the International Monetary Fund, which is traditionally regarded as a good watchtower, to illustrate this relatively widespread lack of knowledge. Three years ago and for the first time in its history, the IMF published a comprehensive report on co-operative banks in Europe⁹. Keeping to the same expression used on the IMF web site, we were we were now on the radar, instead of flying underneath

During a trip to Washington in March 2008, my colleagues at the IMF explained that, given the Fund's macro-economic mission, this was natural, because co-operative banks or "credit unions" did not involve systemic risk. We should undoubtedly rejoice in this analysis. But is this assertion correct? Digging into the statistics and looking at the national accounting frameworks provided by the IMF, it is apparent that there are no headings

1 Source: Report of the Conseil Supérieur de la coopération, 2007

2 Source: ICBA, Global 50 classification at 31/12/2008

3 Source: Report of the Conseil Supérieur de la coopération, 2007

4 Source: ICBA, Global 50 classification at 31/12/2008

5 Source: European Association of Co-operative Banks, Key statistics as on 31-12-08

6 Source: European Association of Co-operative Banks, Key statistics as on 31-12-08

7 Source: European Association of Co-operative Banks, Key statistics as on 31-12-08

8 Cooperative Banks in Europe—Policy Issues, Wim Fonteyne, IMF Working Paper WP/07/159

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dedicated to co-operative banks and micro-finance. Is the lack of measurement down to the insignificance of the subject or does the subject not exist because we do not measure it? Is this assumption, which can be viewed on a global level, also relevant at national level in each country? Knowing the position occupied by co-operative operators or by micro-finance in some countries, is it not relevant to include them in the statistical indicators?

A reading of the Financial Sector Assessment Program (FSAP) studies, a joint initiative by the IMF and the World Bank to evaluate countries' financial systems, will yield no mention of the place and role of co-operative banks, including in those countries where they play a significant role.

Let's cross the street to the World Bank: here the teams looking into co-operative finance entities (banks and insurance) are to be found in the rural development sector. While not shocking in itself, it does illustrate the limited perception one has of co-operative finance operators. Undoubtedly, we do not sufficiently broadcast the useful contribution made by our co-operative banks to financing craft industries and small enterprises, over and above our contribution to agricultural financing.

All of the above reveals a very partial or compartmentalised view of the reality of the banking world. It forgets the key role played by co-operative banks in weaving the economic fabric of developed countries, in Europe, for example. It also neglects that during the recent financial crisis, our banks often found themselves amongst the victims of the large finance and investment banks. It also leaves aside the resilience shown by our organisations in this crisis. The relative silence on the part of academics and regulators on the issue of co-operative banks would seem to indicate that co-operative banks would not constitute a proto-historical form of banking. Should we then conclude that they are not concerned by the challenges and effects of global regulation of the sector?

2. By virtue of their very characteristics, co-operative banks should be incorporated by regulators in preparing sector regulation

a. Recognising the equity status of co-operative shares

In 2004, the International Accounting Standards Board (IASB) published accounting standard IAS 32, according to which a financial instrument may not be recognised as part of equity capital if settlement is on the initiative of the holder.

Following publication of this standard, some co-operative banks were forced to amend their Articles of Association to ensure compliance with this standard, on paper, by granting their Board of Directors the authority to unconditionally refuse redemption of shares. While this option has never been exercised, it allows shares in co-operative banks to be considered as elements of equity capital, in accordance with IFRS standards.

In 2006, the IASB commenced a process of convergence with the American Financial Accounting Standards Board, the FASB, to achieve convergence between the US GAAP standards and the international accounting standards drawn up by the IASB.

The question of the definition of equity capital came under close scrutiny in the context of this convergence process: several approaches were deliberated and then discarded, the most recent consisting of adapting IAS 32 and broadening the definition of equity capital to redeemable financial instruments solely in the case of the decease, exclusion, retirement or withdrawal of the holder.

Some co-operatives had requested broadening the definition of equity capital, as they are legally bound to redeem members' shares when the latter are no longer associated with the co-operative's activity.

This positive development has been achieved after several years of lobbying by European and international co-operative organisations: It has taken a long time to achieve recognition by the IASB that co-operative member shares should be classified as equity.

In addition to these accounting aspects and in the wake of the recent financial crisis, the Basel Committee and the Committee of European Banking Supervisors (CEBS) commenced discussions in 2009 on the eligibility criteria for Tier 1 capital. The two Committees launched a consultation process in December 2009 aimed at restricting as much as possible the list of financial instruments that can be included in the calculation of Tier 1 capital. Having completed the consultation process and impact studies, these new provisions should come into force by the end of 2012.

Based on the eligibility criteria established at this stage by the Basel Committee and the CEBS, it is likely that some categories of co-operative bank shares will no longer be included in Tier 1 capital. If such is indeed the case, many co-operative banks may be compelled to abandon their co-operative status to be in a position to swiftly reconstitute Tier 1 capital in accordance the Basel Committee's requirements, at an abnormally high cost.

The International Co-operative Banking Association (ICBA), which I chair, has taken a position on the issue and has requested the Basel Committee to carefully assess the impacts of this reform on the equity capital of co-operative banks.

b. Consider the indivisible reserves of co-operative banks as a true cushion against risk

Unlike listed companies, the aim of co-operative banks is not to maximise the dividends paid to their shareholders: they have no shareholders. Their members, who own the capital in the form of shares, receive limited remuneration for their contributions. A large portion of co-operative banks' profits is therefore pooled in the form of reserves, which strengthen the equity capital of the bank while providing it with the resources required for development. In a number of countries, notably in Europe and Latin America, these reserves are indivisible, which means that the members do not have individual rights to the reserves in the event of liquidation.

The function of the reserves is clear: during a profit year, they constitute equity capital without returns to provide the resources for the bank to develop, to improve its profitability to the benefit of its members and to absorb the impact of future shocks. These reserves, whose ultimate objective is very close to the dynamic provisioning mechanism recently introduced by the Financial Crisis Advisory Group, are designed to hedge against future losses by setting capital aside for a rainy day at a time when it is easy to do so, namely when the company is making a profit.

Almost 150 years ago, co-operative banks invented a mechanism to provide a cushion against crises in the future with their indivisible reserves, the benefits of which are only now being discovered by regulators!

c. Increase understanding of the role of the solidarity mechanisms in co-operative networks

In addition to these indivisible reserves, solidarity and guarantee mechanisms have been in place in co-operative banks from their inception, based on a principle of mutual reinsurance to counterbalance their relative vulnerability.

Co-operative banks quickly structured as co-operative groups. Each bank or fund is formed as an independent legal entity, which is owned by its members but linked to the other banks or funds in the group through a joint

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subsidiary at either regional or national level. On the one hand, this structure enables each co-operative bank to benefit from economies of scale by pooling resources, while, on the other, the long-term sustainability of each of the entities in the group is guaranteed through an internal solidarity mechanism, for example in the form of a guarantee fund.

These co-operative banking guarantee mechanisms, which prefigured the creation of national deposit guarantee funds, provide co-operative bank members with an additional guarantee in the event the entire reserves of a bank are exposed to losses. Once again, the mechanism created by co-operative banks led the way and was extended to all banks by the prudential banking authorities many years later.

Conclusion

Some operators in the co-operative banking sector are arguing to keep our financial institutions outside the scope of government or inter-government regulation, because such banks are small by nature and operate mostly in closed circuits (resources are contributed and borrowed by the same circle of participants). This conception, based on the desire to protect co-operative institutions as organisations of civil society from state interference, could result in potentially damaging consequences. One such consequence could be that co-operative structures would have to remain closed and severely limited in size to continue to be eligible for exemption from the scope of prudential regulations. This leads to a risk of ghettoisation of our organisations, thus depriving the majority of taking advantage of the virtues of co-operative banks. The other risk is that of the threshold effect affecting co-operative structures that open up to the wider community and expand, as they suddenly switch from the absence of prudential constraints to a system designed for major globalised operators. Therefore, it would be useful if regulators tasked with formulating banking regulations were to devise a conceptual framework including a continuum extending from small micro-finance structures, through co-operative banks to the large globalised operators, based on control mechanisms incorporating the principle of subsidiarity, where the lowest level of regulation is at local level and the highest at inter-government level for globalised or continent-wide operators.

In short, between the proponents of “business as usual” and possible proponents of a tighter regimen where bankers would be transformed into bureaucrats, I would like to see the coherence of each operator respected in order to build the trust required to inspire confidence in financial institutions.

Thank you.