



EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS

Demonstrating the Case for Proportionality: *Cooperative Banks*

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proportionality in the context of Institutional and
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Cooperative Banks – “Different” Banks

- **Cooperatives: Treaty Art. 54; Reg. (EC) No 1435/2003 “SCE -Regulation”:**
“Cooperatives are primarily groups of persons or legal entities with particular operating principles that are different from those of other economic agents.”

- **Typical particularities of coops:**
 - Cooperative values: primary aim is to promote the economic interest of members by services provided, not maximum profit;
 - Ownership by members: High number of “members”, which are also customers (around 78 Million in EU);
 - Strong local and regional ties;
 - Democratic control (“one person – one vote” in general assembly);
 - Limited (and low) capital involvement of members via member shares;
 - Shares (in most cases) redeemable to the cooperative;
 - No participation of members in net assets, redemption at face value.



Cooperative Banks and Regulation

- When developing new standards and rules, regulators are not always aware of these particularities of cooperative banks and their groups and networks;
- Mainstream is thinking of banks as a joint stock company and developing rules accordingly
- **Nevertheless:**
 - Diversity is increasingly perceived, also at global level;
 - Treaty and SCE-Regulation impose an equal treatment of cooperative banks and mutuals;
 - CRR and CRD comprise (political) commitments and references to “diversity” of business models and specific legal forms and their fair treatment;
- Some good examples, where particularities coop banks/groups are reflected.



Case 1: Common Equity

- **Basel III: Criteria for classification as common shares for regulatory capital purposes:**

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2. Entitled to a claim on the residual assets that is proportional with its share of issued capital, after all senior claims have been repaid in liquidation (i.e. has an unlimited and variable claim, not a fixed or capped claim).

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3. Principal is perpetual and never repaid outside of liquidation (setting aside discretionary repurchases or other means of effectively reducing capital in a discretionary manner that is allowable under relevant law).

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8. It is the issued capital that takes the first and proportionately greatest share of any losses as they occur

➤ Impossible to meet for cooperative shares, however **footnote 12** points out:

“The criteria also apply to non joint stock companies, such as mutuals, cooperatives or savings institutions, taking into account their specific constitution and legal structure. The application of the criteria should preserve the quality of the instruments by requiring that they are deemed fully equivalent to common shares in terms of their capital quality as regards loss absorption and do not possess features which could cause the condition of the bank to be weakened as a going concern during periods of market stress.”



Case 1: Common Equity

■ EU Implementation

- During the negotiations of Basel III the CEBS was equally working on “Implementation Guidelines regarding Instruments referred to in Article 57(a) of Directive 2006/48/EC recast”, published in June 2010;
- Guidelines define principles for recognition of cooperative shares as common equity, particularly regarding “permanence” and “loss absorption”, especially:
 - Right to refuse redemption by coop + by supervisory authority;
 - No access to net assets for all shareholders;
- These principles were used by COM as a blueprint for the proposal of the CRR;
- Specific provisions in Art. 27, 29 CRR on “*Capital Instruments of mutuals, cooperative societies, savings institutions or similar institutions in Common Equity Items*” impose conditions for Common Equity recognition, especially with regard to permanence and loss absorption;
- COM Delegated Reg (EU) No 241/2014, Art. 4, 10, 11; define details regarding limitations for the redemption of cooperative shares.



Cooperative Networks and Groups

- **Cooperative banking groups and networks – a wide variety with different degrees of integration and centralization**
 - Starting point: basic cooperative network with local/regional banks cooperating and creating a common infrastructure, which they commonly own (e.g. central institution, data processing centers, etc.);
 - Specific role of central institution, e.g. very often no direct retail business, but responsible for ensuring liquidity in network group;
 - Networks with an institutional protection scheme (Art. 113(7) CRR), i.e. a liability arrangement which protects the affiliated institutions and in particular ensures their solvency and liquidity;
 - Groups, which consolidate under central institution (Art. 113(6) CRR);
 - Groups, which are supervised as a single entity (Art. 10 CRR);
 - Groups that form a single entity (with a single cooperative).



Case 2: The LCR

- **Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools**
- The LCR creates structural difficulty to cooperative networks, since:
 - division of tasks does not foresee central institution to do any retail business, which therefore does not take deposits with low outflows.
 - local banks deposit their excess liquidity at central institution, which would however have to be treated by CI with 100% outflow;
- Basel III LCR paper therefore reflects the division of tasks between central institutions and local/regional banks in coop networks:
 - Para. 105, 106 (treatment of deposits in institutional networks of cooperative banks) allow the treatment of certain deposits in central institutions as stable for central institution, if certain conditions are met.
 - (Similar provisions for NSFR).



Case 2: The LCR

- **CRR: A more differentiated approach**
 - Art. 422(3)(b) reflects para. 105, 106 of the Basel LCR paper
 - Art. 416(1)(f) also imposes conditions for the recognition of such internal deposits as liquid assets;
 - COM delegated Reg. (EU) 2015/61 with regard to the LCR further develops and details these two approaches:
 - Article 16 “*Deposits and other funding in cooperative networks and institutional protection schemes*” imposes conditions for recognition as 2B assets or assets of the same category as those the funds are invested in;
 - Article 27(1)(b) implements the Basel approach and imposes conditions for recognition of central institution deposits as “stable deposits”;
 - Rules currently under implementation in cooperative organisations.



Conclusions Case 1 + 2

- Both issues fundamental questions for cooperative organisations;
- Issues related to specific principles of cooperatives (capital) and structures of cooperative groups (LCR);
- Early analysis of issues – Early and intensive communication;
- Communication may require not only to explain a “deviation”, but a different system with numerous interacting factors;
- Understanding and support by some regulators (also on global level), COM and the EBA (CEBS);
- Nevertheless accompanied by intensive discussions, since image of mutuals and cooperative banks differs among jurisdictions;
- Discussions allowed to further develop basic ideas into detailed tailored rules for the specific situation of cooperative banks;
- Only a well-defined legal framework establishes a solid basis for a diverse banking system.



Outlook and new Challenges (2 Examples)

- Variable Remuneration (Art. 92 ss. CRR; EBA Draft Guidelines)
 - “no neutralization” creates highest burden for smallest banks (around 2000 of which are) cooperative banks (highest % of MRT, etc.)
 - Coop shares unsuitable for remuneration, since unconditional right to refuse redemption;
 - Too “dynamic” non-cash instruments conflict with the cooperative “spirit” (member satisfaction as primary purpose) and encourage management for stronger profit orientation;

- Bail-in in cooperative/mutual banks and groups
 - While legal framework determined, practical implications to be further examined and discussed, e.g.:
 - Bail-in into which instruments?
 - Resolvability of cooperative groups.



European Association of Cooperative Banks

Thank you for attention !

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