EUROPEAN ASSOCIATION OF CO-OPERATIVE BANKS

SECOND ACADEMICS AND STAKEHOLDERS' DAY

NEWSLETTER // 14 MAY 2013

Co-operative banks: significant contributors to the diversity of the banking industry by Gianni Pittella, MEP - European Parliament

Diversity is a crucial asset for the European banking sector. In the context of the financial crisis that had its beginnings in 2008 the role of diversity became even more crucial. The European Parliament believes that it is a necessary dimension to foster stability within the financial system.

Different financial players that follow different objectives, according to their respective business model, contribute to balance the banking sector. In the interest of both European firms and European consumers, only the co-existence of different structures and sizes guarantees efficient and competitive financial actors.

Co-operative banks are the main financing partners of SMEs and provide financial services across all the regions of Europe. In that way they are contributing to the economical development of the very diverse European regions.

They are further essential actors in order to provide an access to credit for many local players. Co-operative banks' strong local networks are covering most of the European territory. Especially in areas where access to funding and to financial services is more difficult, they are playing a key-role. Since most of their activity is run at the local level, their widespread local agencies allow retail activities for local communities which couldn't be served otherwise.

... Continued on page 4

Co-operative banks: reconciling economic and social needs

by Christian Talgorn - Fédération Nationale du Crédit Agricole

It is important to highlight the role and the financial stability of co-operative banks, while the crisis that started in the United States in 2008 still affects employment rates, production, markets and public finances.

In a context of market liberalisation and financialisation of the economy, prudential regulation is necessary insofar as it strikes a balance between competitiveness and protection.

This balance is achieved through respect for the diversity of banking models and the promotion of models anchored in their territory and contributing to the real economy, which are precisely the key features of co-operative banks.

Co-operative banks contribute significantly to job creation at the local and regional level. The reforms currently being discussed at international, European and national level aim at rebuilding financial stability, restoring investors' confidence and protecting savers. The last five years were therefore marked by new regulatory initiatives. However, co-operative banks would like to emphasize that adapted prudential regulation that takes into consideration the core of their retail activities and that is proportionate to their size and juridical structure is needed.

Moreover, the legislative framework should not restrain the financing of the economy and, in particular, the access to finance and credit for SMEs.

... Continued on page 4

The resilience of co-operative banks

by Patrizia Toia, MEP - European Parliament

Credit Photo: EP Copyright

The co-operative banking model has showed its resilience during the financial and economic crisis. During the financial crisis, the business model of co-operative banks has proved to be both sustainable and resilient to financial shocks. Co-operative banks have shown steady growth, low losses, lower credit risk, limited write-downs, and a strong capitalisation compared to commercial banks.

Co-operative banks have grown, kept credit flowing especially to small and medium-sized enterprises, and remained stable across regions of the world while indirectly creating employment. Their contribution is crucial. It is their unique combination of member ownership, control and benefit that is at the heart of their resilience and that provides a series of advantages over its competitors. We should recognize that their commitment to include stakeholders in the decision process is of the utmost importance.

These banks belong to their members/ customers, who make use of their services. As such, customers-owners hold shares not for speculation purposes but rather in order to invest in a real ownership instrument with participation in a common economic endeavour. In addition to the valuable democratic principle of participation, we should underline that the economic contribution of these banks, although substantial, is often underestimated, or completely ignored.

Co-operative credit keeps and creates businesses and jobs and ensures that enterprises survive. As Vice-Chair of the ITRE Committee at the European Parliament, I have always tried to highlight the importance of Social Economy Enterprises in the market, and I am convinced that it is necessary to recognize their specificity.

European Institutions and Member States should recognize the differences between co-operatives banks and investor-owned banks both in their capital structure and their corporate governance. It is not necessary to over-regulate, but we should work together, in the European context, in order to let these banks continue to supply low-income members with small savings and loan accounts. We should also support local initiative, aiming at boosting local economies and employment with a positive effect on the stability of national financial systems.

A last remark: the UN General Assembly in December 2009 proclaimed 2012 "International Year of Co-operatives", emphasizing the contribution of the co-operatives against poverty, and mentioning explicitly the role of Co-operative Banks and its importance within the international banking scene. ■

Patrizia Toia is a Member of the European Parliament since 2004. She is the Vice-Chair of the ITRE Committee and also Vice-Chair of the Progressive Alliance of Socialists and Democrats Group.

Co-operative banking as a pillar of post-crisis recovery

by Augusto Dell'Erba - Federcasse

Negative growth, tight fiscal policies and uncertainty about the future are some of the main features of the present economic environment in Europe. Firms and households are paying a high price: growing unemployment, low demand for goods and services, rising bankruptcy rate especially among SMEs.

The long wave of the crisis, propelled by the financial turmoil, has already taken various forms: financial crisis, economic crisis, sovereign debt crisis and it is hard to guess what will come next.

The path to recovery involves simultaneous efforts from different players: governments, international institutions, firms and - clearly - financial intermediaries. A sound and resilient financial sector is certainly an important requisite to turn around the present economic condition: co-operative banking is going to be a pillar of this re-shaped financial sector.

... Continued on next page

The co-operative difference: a unique governance and a sustainable banking model

by Hervé Guider - European Association of Co-operative Banks

There are more than 4.000 co-operative banks in Europe, with 72.000 branches widespread in the EU. They account for about 20% of market share of EU bank deposits and loans, and they are therefore a major feature of the banking sector.
Despite this, the co-operative banks' presence in Europe and the nature of the co-operative ownership is not always recognized and it is often perceived as a non-standard model in a largely shareholder-owned banking sector. The fact that until a few years ago only 1% of existing economic literature in Europe was devoted to co-operative banks - as pointed out by an IMF working paper in 2007 - is emblematic. This is why it is fundamental to increase awareness and stimulate new research. It is crucial to understand the structure and the governance model, to measure the contributions and to understand the impact that current legislation may have on co-operative banks.

The "co-operative difference" is the strength of co-operative banks, but also their weakness, because legislation, policy decisions and economic measures are often conceived through the prism of the shareholder model.

Today's dialogue is a precious tool to foster knowledge of the sector, stimulate research and assess the policy recommendations that can be formulated. However, in this rapidly changing competitive and regulatory environment, the challenges ahead are many.

Acknowledging the importance of diversity in the banking sector for stability and macroeconomic policy is a first important step. Now we need to go further, we need a shift that translates this acknowledgment into concrete policy measures.

We need to avoid the risk of a sector that largely contributes to stability and local development being strongly affected by a one-size-fits-all approach. I praise the work of international researchers as a key step to make this transition possible. ■

Hervé Guider is General Manager of the European Association of Co-operative Banks since 2011. He was CFO of a regional bank and responsible of EU Affairs at the National Association of Crédit Agricole.

Co-operative banking as a pillar of post-crisis recovery

by Augusto Dell'Erba - Federcasse

... continuation of page 2

Indeed, the more economic research is digging into the co-operative banking model, the more evidence emerges of the beneficial role of this governance model in term of stability and long term viability. I believe that policy makers and regulators should be more aware of this role.

The vast majority of the legislation currently under discussion at EU level is "reaction" legislation. A reaction to the financial crisis and to all the shortcomings of the system that the crisis itself has unveiled. Such effort - that of securing the sector by creating a new sound basis for banks' capitalization, more transparency in the relationship with customers, more steadiness in fighting liquidity crises and limiting the detrimental effects of unruly speculation – however, may hit the wrong targets. Co-operative banks did not cause the crisis.

In fact they represent the antibodies of the system, which in the middle of the crisis served as antidote, supporting the real and local economy, close to their territory and its community. It seems a sheer paradox that such banks which proved resient through the crisis may risk being penalized by the post-crisis legislation.

Banks with great stability, virtuous, highly capitalized and liquid must not pay the price for those who ignored such founding pillars of the banking activity. EU legislation should, therefore, protect and promote "biodiversity" within the banking industry, recognizing the specificity of the European co-operative banks, thus avoiding any risks of homologation through disproportionate and unfair law provisions.

As recognised in the Liikanen Report "*Diversity strengthens the resilience of the banking system as it mitigates vulnerability to systemic interconnections and promotes effective competition. Diversity is explicitly protected by the EU treaty*" (Liikanen Report pg. 32). In a fair competitive environment co-operative banks will be able to give their full support to a new period of economic prosperity in Europe. ■

Augusto Dell'Erba is Vice-President of the BCC di Castellanna Grotte (Puglia), Vice-President of Federcasse, President of the Deposit Guarantee Funds and Board Member of the EACB.

Performance of Banche di Credito Cooperativo (BCCs) in Italy during the crisis

by Sergio Gatti - Federcasse

When the crisis erupted in 2007, the BCCs network was completely insulated from the financial storm that hit the banking industry. The main reason was that BCCs had not strayed from a prudent and balanced banking activity aimed at serving firms and households in their local area.

They had pursued a traditional and efficient originate-to-hold model of lending funded mainly by retail deposits and plain vanilla bonds. On the asset side, BCCs maintained a solid liquidity buffer, did not invest in toxic assets nor in exotic investment instruments. Central institutions were not involved in investment banking activities but focused on developing and providing products and services to BCCs. Lastly, BCCs have always relied on a large equity base, prudent use of securitization, transparency in business practices, a reliable internal safety net and have always enjoyed a good reputation. For all these reasons the BCCs network has also proved to be resilient in the secondary phases of the crisis. The number of members and clients has shown a steady increase reflecting the trust that BCCs have earned in their local areas.

Most importantly, while most other banks were deleveraging, BCCs were able to provide financial support to SMEs and households even during the double dip recession of 2009 and 2012. With regard to the market share of loans, BCCs had 22,6% of loans to artisans, 18% to small enterprises and 18,3% to the agricultural sector at the end of 2012. This continuous effort on behalf of local economies has helped save jobs and enterprises.

Clearly BCCs' concern with sustaining the local economy came at a cost. The overall market conditions (low interest rates, weak demand, high rate of default) have been particularly demanding for small banks with a traditional business model. Profits have decreased and asset quality has shown symptoms of deterioration in line with rest of the Italian banking industry. However, BCCs have revealed great resilience thanks to their unscathed funding capacity, a good liquidity position and a level of capitalization that has remained

high. BCCs have also made a great effort to improve governance in order to increase their capacity to manage risks in an uncertain environment.

In this context, Federcasse (the national association of credit co-operative banks) believes it's crucial to increase the regulators' awareness about the specificities of co-operative banking, to avoid unintended effect on the real economy. ■

Sergio Gatti is Director General at Federcasse - Federazione Italiana delle Banche di Credito Cooperativo.

Co-operative banks: significant contributors to the diversity of the banking industry

by Gianni Pittella, MEP - European Parliament

... Continuation of page 1

Europe needs an accountable and solid set of banks, well connected to the regions and to the real economy. This is the way to ensure a more sustainable sector based on diversity and macroeconomic stability.

Therefore, co-operative banks have a key role to play. It is our responsibility as legislators to make sure that the diversity of financial actors is taken into account. The European Parliament intends to ensure this diversity by implementing with scrutiny the next measures regarding legislation on financial supervision and regulation. ■

Gianni Pittella is an Italian politician, Member of the European Parliament since 1999 and Vice President of the European Parliament since 2009. He seats in the Committee on the Internal Market and Consumer Protection and in the Committee on Economic and Monetary Affairs.

Co-operative banks: reconciling economic and social needs

by Christian Talgorn - Fédération Nationale du Crédit Agricole

... Continuation of page 1

I would like to express my gratitude to the Vice-President Mr. Pittella for hosting this second co-operative banks dialogue with academics and stakeholders. I would like also to thank the MEPs, International Organisations and Researchers for their presence today and for their contribution to the success of this event. ■

Christian Talgorn is the President of the European Association of Co-operatives Banks. He is also the Member of Fédération Nationale du Crédit Agricole, the President of the Regional Banks Caisse Régionale du Morbihan, Caisse locale de Vannes Ouest and Board member of the Grameen foundation. He is also Professor in European law at the University South Britanny.

Features, facts and figures of European co-operative banking groups over recent business cycles

by Hans Groeneveld - Rabobank Nederland

My current research has aimed to contributing to a balanced view of the European Co-operative Banking Groups (ECBGs). It describes their historical characteristics and investigates empirically the extent to wich their recent performance is connected with their proclaimed specific and historical features. This article brings up the aspect that co-operative banking can be considered as a viable and parallel alternative to particularly investor-owned banks which have been in the spotlight for most of the time in recent decades.

The main message is that the overall performance of co-operatives is still largely explicable by the original features and roots of ECBGs. The specific ownership structure at local level still appears to result in a focus on retail banking, a moderate risk appetite, stable operations and a solid capitalization for ECBGs. The analysis of components of the Z-scores leads to the conclusion that ECBGs are generally a more stable and safer part of the entire banking industry. They operate with higher capital levels and their returns on assets and equity are less volatile. Moreover, loan and deposit growth at ECBGs is significantly more stable than that of all other banks. In good times, ECBGs' credit growth is more moderate, whereas their credit expansion is higher in recessionary times.

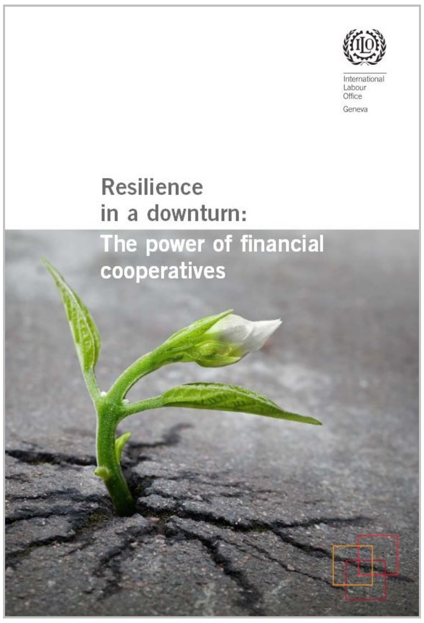
Therefore it is important to acknowledge the relationship between the specific governance and ownership structure of ECBGs and their relative stability and performance. This result has important implications for academics and policy makers alike, since it indicates that ignoring this ownership structure can lead to erroneous banking regulations which may eventually undermine the positive impact of the specific governance on ECBG's stability and hence the stability of entire national financial systems. ■

Hans Groeneveld is currently Senior Vice President Strategic, Organizational and Governance Issues at Rabobank Nederland. He is board member of the Royal Society for Economic Affairs, member of the Think Tank of the European Association of Co-operative Banks and lecturer at Radboud University Nijmegen.

Resilience in a downturn: The Power of Financial Co-operatives

Study of International Labour Office (ILO)

The International Labour Office (ILO) published a new study on the resilience of financial co-operatives during economic crisis. The report notes that financial co-operatives have fared better than the investor-owned banks in times of crisis. Savings and credit co-operatives, co-operative banks and credit unions have grown, kept credit flowing especially to small and medium-sized enterprises, and remained stable across regions of the world while (indirectly) creating employment.



It is their unique combination of member ownership, control and benefit that is at the heart of their resilience and that provides a series of advantages over its competitors. With financial co-operatives presenting an astonishingly large slice of the global banking market, it is important to better understand the model.

The report examines financial co-operatives from their origins in the 1850s to the global movement they represent today. It reviews the performance of financial co-operatives, looking in particular at the aftermath of the 2007-2008 crisis and the continuing long austerity period.

It explains why they have proven to be more resilient pointing to the specificities of the co-operative model of enterprise, and concludes with a review of practical policy options and recommendations for the way governments and development agencies should approach financial co-operatives not as conduits but as partners in the wider aims of business development, insurance against poverty, and decent work.

Co-operative banks: what benefits do they bring, where do they flourish and why, and what challenges do they face?

by Lydia Prieg - New Economics Foundation

Co-operative banks outperform shareholder owned banks on a number of measures: they generate more stable long-term profits, they provide better customer service, and they boost local economies by lending more to small and medium-sized businesses. Plus, their more prudential approach to managing capital allowed them to weather the financial crisis better than the commercial banking sector, demonstrating their positive contribution to financial stability.

Finally, their ownership model appears to have profound effects on the priorities and performance of the institutions. It places an incentive on managers to maximise long-term customer value, and ensures that profit is treated as a means to an end rather than an end in itself.

Criticisms that co-operatives are unaccountably managed and inefficient are unconvincing.

Co-operative banks have thrived where independent local institutions have collaborated in networks to gain economies of scale, and where the regulatory environment has recognised and protected the co-operative ownership model. However, in some cases the central institutions in co-operative networks have become too dominant and have entered non-traditional investment markets with poor results.

Moreover, co-operative banks face a very real challenge in the form of regulators who often do not understand the co-operative model, let alone the benefits it can bring. Co-operatives need appropriate regulation that recognises their distinct nature, and does not force them to become more like shareholder owned banks. ■

Lydia Prieg is a researcher in financial reform at the New Economics Foundation (NEF). Prior to joining nef in 2010, she worked on the trading floor at Goldman Sachs, selling interest-rate-derivatives to UK banks, asset managers and pension funds.

The power of financial co-operatives

by Johnston Birchall - Stirling University

Suddenly, everyone is talking about financial co-operatives. Known as co-operative banks in Europe, credit unions in North America and savings and credit co-ops in Africa, they share a common history that began in Germany in the 1850s and has spread all over the world. They have the same organisational 'DNA' which guarantees that the customers own it, ultimately control it and are the main beneficiaries. Contrast investor-owned banks where a separate group of investors own it, and savings banks that are not really owned by anyone but are controlled by trustees! The main source of capital for a financial co-operative is retained profits added to reserves. The main source of money for lending to members is member savings. Their focus is on long-term relationships with their customer-owners, not on making profits for shareholders. It follows from these distinctive features that financial co-operatives should be stable and risk-averse.

The banking crisis of 2008 was a great test of this hypothesis. It was like a natural experiment! Before the crisis they had already proved themselves to be a stable, low-risk alternative, but during the crisis they made far fewer losses than their competitors, needed hardly any government bailouts, and continued to lend to small businesses. Since then, they have continued to grow, and are gaining the admiration of people sickened by the 'casino capitalism' of the big banks.

Are they a realistic alternative? Already in Europe and North America they are major players, with a large slice of the market. They consist of hundreds of small, local banks but have national networks, with powerful national banks that provide them with mutual financial services. This enables them to remain local while benefitting from economies of scale. My report for the ILO considers the evidence, discusses their advantages and disadvantages, and suggests policies that can promote such 'customer-owned' banks in both low- and high-income countries. ■

Johnston Birchall is a Professor at Stirling University. A socio-economist, he focuses on member-owned businesses, including co-operatives, mutuals and user-controlled public service agencies. His latest book is Finance in an Age of Austerity: the Power of Customer-owned Banks (Edward Elgar).

Membership and performance in financial co-operatives: evidence from Finland **by Panu Kalmi - University of Vaasa**

We study the relationship between membership and performance in Finnish co-operative banks. Earlier literature finds that larger membership is detrimental to performance in financial co-operatives. By drawing from a richer conceptual literature than previously used, we develop alternative measures of membership and argue that the relationship between membership and performance is ambiguous. Our empirical results differ from earlier findings in significant ways. While cross-sectional regressions provide only limited evidence that membership rates affect bank performance, fixed effects regressions, which control for unobserved bank heterogeneity, provide stronger support for a positive relationship for two measures of membership. Findings from instrumental variable regressions provide further evidence of a positive relationship between membership rate and performance. Our results suggest that previous research has used unduly narrow theoretical and empirical frameworks in assessing the nature and impact of membership on performance in financial co-operatives and that conclusions on the negative impact of membership on performance have been premature.

Our results indicate that the measures of many European co-operative banks to extend membership are economically justified. Our results have implications for the group structure of financial co-operatives.

Panu Kalmi is professor of economics at the University of Vaasa (since 2011). He has published widely on co-operatives, industrial relations, and economic transition. His current main research interests are financial co-operatives and financial literacy. He was the President of the Finnish Economic Association in 2012-2013.

Searching for a model of governance in co-operative banking

by Silvio Goglio - University of Trento

In a research conducted at Euricse (European Research Institute on Co-operative and Social Enterprises, Trento, Italy) we have elaborated a scheme of interpretation of governance in co-operative banks based on the multiple agency problems, insisting on their diversity and on relationships among them.

The research aimed both at integrating the extant literature and to give evidences to support the theoretical arguments by focusing on the Italian Credit Co-operative Banks.

Any issue related to governance of a bank is important: as a financial intermediary it has to be efficient not only on the operative side, but also on the allocative one.

The separation between management (agent) and ownership (principal) has an impact on the efficiency and profitability.

Although the agent should act in the interest of the principal, some problems arise which alter its behaviour.

Firstly, principal and agent may have different goals, a different risk propensity, and, in cases, a different understanding of the efficiency of the firm. Secondly, asymmetries of information are widespread in the relation between principal and agent.

It is possible to identify three levels of the agency problem:

1. the level relating the shareholders with the board of directors;
2. the level linking the board of directors with the managers;
3. the level relating the depositors with the managers, and indirectly the board, which represent them versus the borrowers.

This mechanism is more complex in the case of a co-operative bank, for three reasons:

1. members can be both depositors and borrowers, and thus the board and the managers should represent the contrasting interest of both;
2. the board and the managers should represent the more general interests of the community (the stakeholders);

3. collective orientation and mutual interest are the main foundations of co-operative banks' statutes.

Silvio Goglio is Associate Professor of Political Economy at the University of Trento, Italy, and Coordinator of the Research Area in Co-operatives and Development at Euricse (European Research Institute on Co-operative and Social Enterprises, Trento, Italy).

Strategic differentiation potentials of co-operatives

by Franco Taisch - Swiss Co-operative Business Association

Industry challenges
Today's financial industry is facing many challenges. They occur simultaneously on different levels and therefore require a coordinated response.

On a strategic level there is the requirement for new business models and innovation, on the operational level there has to be more efficiency, on a regulatory level know how, capital and cost have to be monitored and on a reputational level trust has to be established and maintained.

Co-operative DNA as a basis for a strategic response
A view to the DNA of co-operative banks can be an answer to those challenges while featuring differentiation potentials to other business platforms.

Multidimensional value creation to stakeholders, value creation directly from the primary value chain, a local base combined with supra-regional network structures, democratic decision making and control processes, sustainable finances and innovation via membership contribution and co-operative value experience can make a difference.

These principles perfectly demonstrate the required credibility and trust as well as member based innovation, a sound and sustainable capital base, local customer relationship with efficient network structures and a unique governance meeting today's zeitgeist.

Co-operative distinction features, in particular, improve also governance systems designed for agile democratic structures balancing different stakeholder interests, a local base enabling social control, sustainable self-financing with a balanced risk exposure, profit optimization along the value chain rather than profit maximization via financial markets and network enabled rather than centralized business structures.

Franco Taisch is an entrepreneur and a member of several boards of directors in various industries, e.g. he is member of the audit and risk committee of the Swiss Raiffeisen Group. In addition, he is CEO of the Swiss Co-operative Business Association. As an academic, he chairs the IFU / BLI Business Law institute and is professor for business law at the University of Lucerne. He has held various Executive functions in Zurich, Geneva and New York.

Diversity in European banking: why does it matter?

by Rym Ayadi - Centre for European Policy Studies

Diversity in banking implies the co-existence of different institutional forms that organise banking activities in different ways and compete with each other. Consistent with decades of liberalization, a trend towards the homogenisation of banking models has prevailed, favouring the so-called 'shareholder-value' (SHV) model that is characterised by highly innovative, complex instruments, large risks and strong profits. Other models were regarded as inferior exceptions to the rule. In the aftermath of the financial crisis, however, the wisdom of this dominant model has been called into question and the merits of alternative models have reemerged.

Some systems seem to have weathered the crisis better than others, especially those institutions seeking to provide 'stakeholder value' (STV). In contrast to SHV institutions, the STV model strove to strike a balance between creating value for survival in a highly competitive market and bringing sustainable value to the society or community they serve.

Inevitably, these two types of institutions employ highly divergent governance models. Among the STV institutions, co-operative banks have common characteristics including a members-driven ownership, a bottom-up governance approach with multiple checks and balances and mutual support, proximity to members-customers which naturally gave them a down-to-earth focus.

Overall, their inherent characteristics allowed co-operative banks to persevere and in some cases to outperform their "*conventional*" peers and to bring sustainable values to the economy and society during the crisis. This performance provides a vivid argument in support of the merits of diversity, brought about by co-operatives banks.

Rym Ayadi is Senior Research Fellow and Head of Research of the Financial Institutions, Prudential Policy and Tax Unit at the Centre for European Policy Studies. She is expert member of several high-level expert groups in the European Commission and European Supervisory authorities as well as external advisor to the European Parliament.