European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

Secretariat of the Basel Committee
on Banking Supervision
Bank for International Settlements

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Consultative Document *"Principles for enhancing corporate governance"*

Ladies, Gentlemen,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to comment on the Consultative Document *"Principles for enhancing corporate governance".*

Please find our remarks on the following pages.

Do not hesitate to contact us should you have any questions.

We will remain at your disposal,

Yours sincerely,

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1. GENERAL COMMENTS

The members of the EACB appreciate the Basel Committee's efforts to revise and enhance the corporate governance principles to assist banks in improving their own corporate governance efforts to overcome the corporate governance failures that became evident during financial crisis.

Specific Feature of cooperative banks

Despite the differences between co-operative banks in the different countries, all networks share one common and defining feature – member ownership. The cooperative banks are effectively owned and controlled by their local customers through the membership concept. The cooperative banks in turn own and control the supporting infrastructure, regardless of the number of tiers, their roles and the authority that has been delegated to them. The member ownership concept is not only central to the co-operative ideology but is also a unique aspect[1]. The statutory aim of cooperative banks is explicitly defined as promoting economic interest of its members.

Another feature that distinguishes corporative banks is the 'one person- one vote' principle which ensures democratic control and prevents the predominant control of separate shareholders.

Member ownership entails a conservative banking approach with a longer term perspective and a focus on retail banking because the primary mission of co-operative banks is to provide services to their members/ customers who are typically, individuals, household and SMEs, i.e. retail banking.

Cooperative Banks are characterised by relatively lower risks, lower volatility and more stable returns. Cooperative banks are active in retail banking. Their focus on retail banking is mirrored in the type and number of customer they serve.

We would therefore like to remind that due to these core values and corporate governance rules, cooperative banks were not at the root of the crisis and have shown to be more resilient during the crisis[2].

Cooperative Banks and diversity

Co-operative banks serve more than 159 million customers in Europe with an average market share in SME financing of around 29%. Although co-operative banks have naturally expanded the scope of their activities in recent years by moving into cross-

[1] Oliver Wyman, 2008. Co-operative bank: Customer Champion, p. 22. Online available at: http://www.oliverwyman.com/ow/pdf_files/OW_En_FS_2008_CooperativeBank.pdf.

[2] International Labour Organisation, 2009. Resilience of Cooperative Business Model in Times of Crisis, p. 35. Online available at: http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_108416.pdf.

border markets and rolling out new services, this expansion has respected their core values and their corporate governance rules, resulting in a business model with prudent management and clear responsibilities towards members.

It is therefore important for bank regulators to recognise that this diversity of business and governance models enhances the stability in banking. Corporate governance principles should therefore be sufficiently flexible to promote this diversity.

Corporate Governance and the crisis

With core values and corporate governance model of cooperative banks in mind, the importance of corporate governance is much greater than is considered at present.

The general feeling of regulators and supervisors is that corporate governance did not directly cause the crisis. It is considered generally that the lack of effective control mechanisms only contributed to a significant extent to risk taking on part of financial institutions[3] and can contribute to bank failures[4].

However, the governance in certain 'too big to fail' institutions were either too large and too complex for a CEO or a Board of Directors to manage or monitor. This led to certain activities in the different bank governance structures that can explain the origin of the crisis.

This point of view is also underlined in a study of the OECD in 2009[5], which stated that "the financial turmoil has revealed severe shortcomings in practices both in internal management and in the role of the Board in overseeing risk management system at a number of bank". In addition, in a study conducted by the World bank in March 2010 it is mentioned that[6] "the central irony of the governance failures that became apparent in the crisis is that many took place in some of the most sophisticated banks operating in the most developed governance environments in the world".

Therefore, it is of great importance to carefully reflect on specific features of different governance models and their direct effects on the sound operation of banks and financial stability.

[3] European Commission, 2010. Green Paper o Corporate Governance in Financial Institutions and Remuneration policies, p. 2. Online available at:
[4] Basel Commitee on banking Supervision, 2010. Consultative Document, principles for enhancong corporate governance, p. 5.
[5] OECD,2009, The Corporate Governance Lessons from the Financial Crisis.
[6] Worldbank, 2010, Bank Governance, Lessons from the Financial Crisis.

2. SPECIFIC REMARKS

The principles set out by the Basel Committee are considered as important elements of an effective corporate governance process. However, the principles are rather focused towards commercial banks rather than banks which apply the cooperate principles.

Explicit reference to cooperative banks

We are grateful for the recognition of the cooperative model as mentioned in paragraph 18 on page 7-8. We acknowledge that the principles should also apply to cooperative banking groups. Many of the principles in fact already apply to cooperative banks by virtue of legislation or governance codes. However, we consider that cooperative banks should not be put in the same context as state owned or state supported banks as described in paragraph 18. Especially considering the fact that cooperative banks have not been subject to any bank failures or were dependent on state funds during the crisis. We consider that cooperative banks who have been resilient during the financial crisis merit to be mentioned in a separate individual paragraph.

Consolidated approach

Consolidation implies the power to govern the financial and operating policies of the consolidated entity so as to obtain benefits of its activities.

In such highly integrated consolidated groups such control may even imply the central liquidity management, the central solvency management, a cross guarantee system and other far reaching institutional powers , the full implementation of the principles should only be possible on a consolidated level.

As regards corporate governance, such distribution of power as describe above must also have implications on corporate governance standards. The application of the proportionality principle should result in the implementation of the corporate governance principles at group level with an emphasis on the parent undertaking.

The proportionality principle

We are appreciate that the principle of proportionality has been introduced into the document for general application regarding the principles. This also highlights that the different banking models are being taking into account. We would like to emphasize that in the application of the principles especially the complexity, the business model and systemic relevance of banks should be kept in mind.

Board practices:

Principle 1

The Board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives, risk strategy, corporate governance and corporate values. The Board is also responsible for providing oversight of senior management.

We acknowledge that the overall responsibility for the bank should lie in principle with the Board. The focus is however too much on the Board of Directors. In all kinds of companies (joint stock model or cooperative model) there is also a General Assembly or Supervisory Board that - depending in the national legislation - may be involved in taking strategic decisions e.g. defining and approving bank strategies and objectives.

Especially, in cooperative banks, whose statutory purpose is explicitly defined as promoting the economic interest of its members, certain strategic decisions are often taken by the general assembly. In some instances, the general assembly has the final word. The suggestion is therefore to include in this principle to mention the general assemblees and that strategic decisions can be taken by the general assemblees.

Principle 2

Board members should be and remain qualified, which entails that they should have adequate knowledge and experience relevant to each of the material financial activities the bank intends to pursue to enable effective governance and oversight of the bank.

Of course, it is fundamental that the board members should have appropriate experience, competencies, and personal qualities. We consider that the principle of proportionality as mentioned in paragraph 6 on page 3 should apply to this principle in so far as the experiences, and competencies of individual board members is concerned. For bank, the adequate knowledge of individuals should be of an appropriate level. In this respect, it is necessary that the size, complexity and the business of a bank, the absence of tradable securities issued by a bank, the local character of a bank, the fact that board members are chosen among the shareholders are taken into account and that it should be sufficient for the board collectively to dispose of adequate knowledge and experiences.

We like to underline that the strength of cooperative banks lies in the fact that Board members have different backgrounds, are involved in the activities of their cooperatives and understand the cooperative’s business model. Therefore, it is necessary to look at the collective knowledge.

Principle 3

The Board should define appropriate governance practices for its own work and have in place the means to ensure such practices are followed and periodically reviewed for improvement.

This principle does not pose any challenges for cooperative banks.

Principle 4

In a group structure, the Board of the parent company has overall responsibility for adequate corporate governance across the group by ensuring there are governance policies and mechanisms appropriate to the structure, business and risk of group and its entities.

This principle does not sufficiently address the consolidation of powers in a consolidated group where the power is with the board company while the power of the subsidiary is reduced. The principle of proportionality in this respect should be addressed accordingly.

Senior Management

Principle 5

Senior management should ensure that the banks activities are consistent with the business strategy, risk tolerance/appetite an policies approved by the board.

As mentioned in principle 1, certain decisions are made under the auspices of the general assembly. In the statutes of cooperative banks the powers and responsibilities of the members of each of the governing organs is included.

Risk Management and Internal Controls

Principle 6

Banks should have an independent risk management function (including a chief risk officer or equivalent with sufficient authority, stature, independence, resources and access to the board).

Principle 7

Banks should identify, monitor and manage risks on an ongoing firm-wide and individual entity basis, and the sophistication of the bank's risk management systems and internal control infrastructures should keep pace with any changes to the bank's risk profile (including its growth), and to the external risk landscape.

Principle 8

Effective risk management requires robust internal communication within the bank about risk, both across the organisation and through reporting to the board and senior management.

Principle 9

The Board and senior management should effectively utilise work conducted by internal audit functions, external auditors and internal control functions;

As mentioned above, the internal control of cooperative banks occurs by the members and pervades the whole structure. This includes compliance and auditing mechanisms. Co operative banks support this principle but question their implementation and their monitoring. Furthermore, the implementation of these principles should be proportional to the size, complexity, structure and economic significance and risk profile of the bank. In particular, for smaller banks, due to the limited number of staff or because certain functions are carried out on a part-time basis, it may be impractical to achieve a full separation and independence of the risk management function.

Compensation

Principle 10

The Board should actively oversee the compensation system's design and operation, and should monitor and review the compensation system to ensure that it operates as intended.

Principle 11

An employee's compensation should be effectively aligned with prudent risk taking: compensation should be adjusted for all types of risk; compensation outcomes should be symmetric with risk outcomes; compensation payout schedules should be sensitive to the time horizon of risks; and the mix of cash, equity and other forms of compensation should be consistent with risk alignment.

This principle is self evident and should not have any implications for cooperative banks especially because corporative banks are not primarily focused on profit maximisation which as a result curtails excessive employee compensation.

Complex and opaque corporate structures

Principle 12

The Board and senior management should know and understand the bank's operational structure and the risks that it poses (i.e. "know-your structure')

Principle 13

Where a bank operates through special-purpose or related structures or in jurisdiction that impede transparency or do not meet international banking standards, its board and senior management should understand the purpose,

structure and unique risks of these operations. They should seek to mitigate the risks identified (i.e. "understand your structure")

The management and oversight function of most cooperative banks consist of their members that have approved the operational structure, any other structure, to operate in another jurisdiction and should therefore 'know' and 'understand' their structure and the risks it poses.

Disclosure and transparency

Principle 14

The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

The final principle is self evident as the idea of a clear and open corporate structure and transparency is embedded in the cooperative business model as the stakeholders govern the bank.