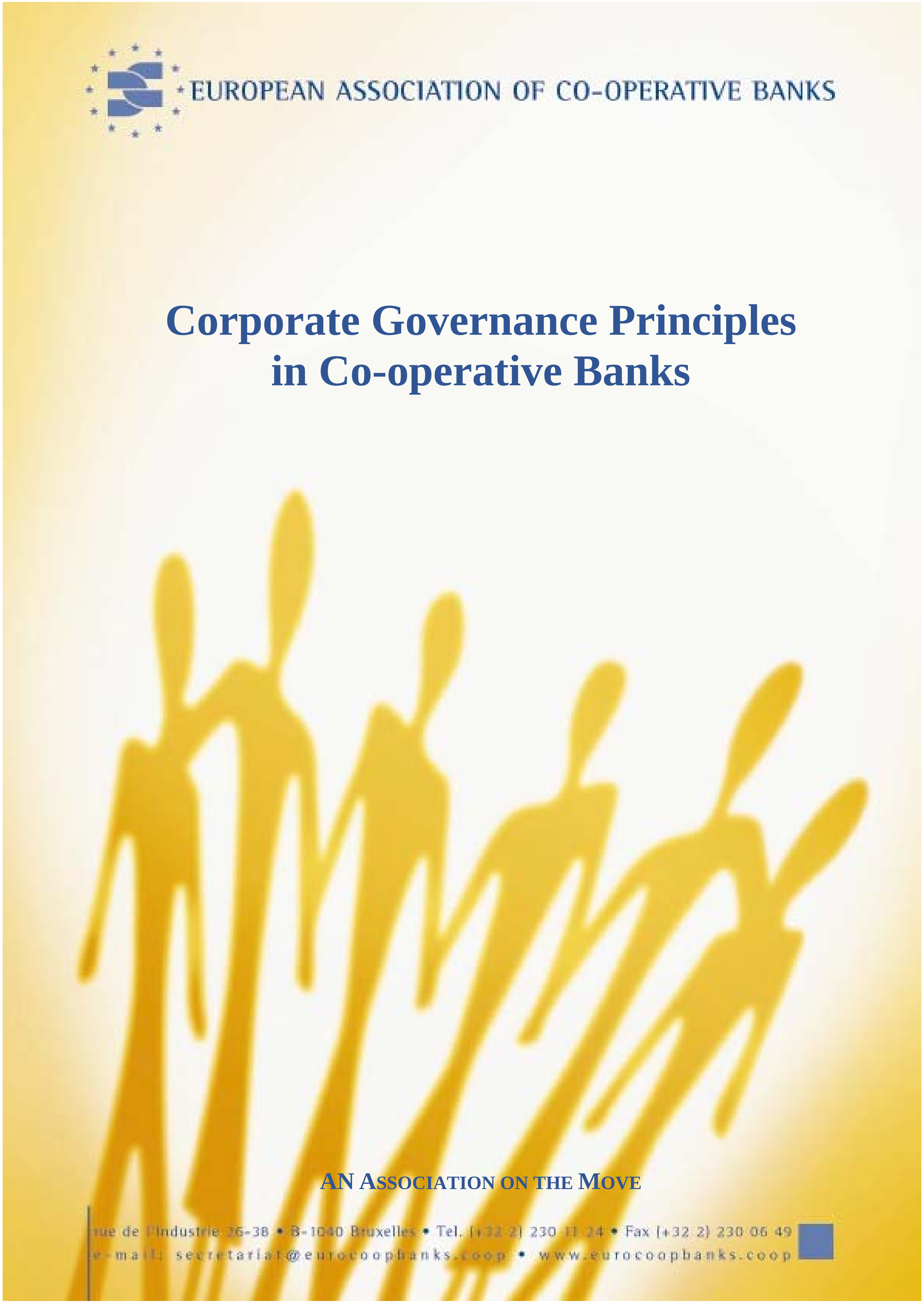

Corporate Governance Principles in Co-operative Banks

AN ASSOCIATION ON THE MOVE

The European Association of Co-operative Banks

The Association of co-operative banks was created in 1970. It represents, promotes, and defends the interests of its members and co-operative banks in general. As such, the Association is the official spokesman to the European institutions. To this end, the missions of the Association include:

- To provide information to members on all initiatives and measures taken by the European Union that affect the banking sector;
- To organize an exchange of views and experiences and to coordinate member organisations' positions on issues of common interest;
- To carry out efficient and active lobbying to European institutions;
- To develop positions on issues of common interest.

The European Association of Co-operative banks fosters co-operation between co-operative banking groups. Furthermore, with the other representative co-operative organisations, the Association promotes the spirit of co-operation throughout the banking sector and beyond. In order to fulfil such goals, the Association is one of the founding members of the European Banking Industry Committee (EBIC), the European Payments Council (EPC), the European Committee for Banking Standards (ECBS) and the European Financial Reporting Advisory Group (EFRAG). The Association also maintains close contacts with UNICO and the International Confederation of Popular Banks (Confédération Internationale des Banques Populaires: CIBP). It is a founding member of the Co-ordinating Committee of European Union Co-operative Associations (CCACE). Moreover the Association chairs the European Regional Committee of the International Co-operative Banking Association (ICBA). The Association maintains close links with the International Raiffeisen Union (IRU), the Confédération Internationale du Crédit Agricole (CICA) and the World Council of Credit Unions (WOCCU).

Other publications:

- Co-operative Banks in Europe: Values and Practices to Promote Development
- Co-operative Structures, Principles and EU- Law
- Corporate Social Responsibility (CSR): The Performance of Cooperative Banks

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Introduction

"Corporate governance" in its broad sense is regarded as the system by which companies are directed and controlled. The corporate governance structure involves a set of relationships between the boards, the shareholders and other stakeholders. It specifies the distribution of rights and responsibilities among them and spells out the rules and procedures for making decisions on corporate affairs.

The corporate governance of co-operative banks is strongly influenced by the fact that co-operative banks are expressly focused on their members. Co-operative banks have as their principal objective the satisfaction of their members' needs and/ or the development of their economic and social activities.[1] With its credit institution's activities, the co-operative banks support the economic success of the bank's members. They promote their members' interest by conducting the business of banking in the widest sense.

The concrete targets of the policy of the co-operative bank are defined by its members. The motivation for membership principally comes from the services produced by the co-operative rather than a return on capital invested.

By consequence, the corporate governance of co-operative banks is focusing not only on the financial claims of its members but rather on the fulfillment of their provision of adequate and price worthy services.[2]

[1] Article 1 (3) of the SCE-Regulation.

[2] These objectives may imply that co-operatives are not capital-market orientated and profit maximisation with the aim of creating shareholder value is not the core aim. But, of course, co-operative banks cannot operate below costs or even without any profit margin since they have to operate profitably to exist (Articles 48 (2) of the EC Treaty is not opposed to such objective.)

I. Structural and operating characteristics of Co-operative Banks

1. Membership

Members of co-operative banks are not simply shareholders. Membership aims at establishing a long term relationship with the co-operative bank and generates rights, particularly voting rights.

In co-operatives, "ownership" rights (e.g. the right to vote and to speak in the General Assembly, the election of directors etc.) emanate only from the acquisition of membership. It means that the rights are vested in the membership of the individual, not in the share.

Furthermore, the members of co-operatives do not only formulate different objectives, but also have a strong involvement in their co-operative.

Indeed, members are generally more involved in the activities of their co-operative and therefore, they are likely to have a higher degree of understanding of the cooperative's business than would be the case for a shareholder of a public limited company. Membership is decided upon on a well-informed basis and represents a commitment in the longer-run.

Members of co-operative banks generally look at the co-operative banks activities and exert influence from a double perspective.

In the first instance, members are users of the services of their co-operative banks. As users, it is in their first interest that their banks provide services of high quality, which meet their needs. Therefore, co-operative banks dispose of a customer led policy and give their members a say on their business policy. Accordingly, co-operative banks are customer driven banks. **As a result, the interests of the using members converge to a large degree with the business policy of co-operative banks.**

On the other hand, they generally invest a limited amount of capital in their co-operative banks. The members, as investors, do not expect high profits, but they want that the co-operative business conduct is sound and it works efficient and profitable.

2. Character of investment

For a wide majority of co-operative banks, the shares of members can be redeemed by the co-operative only at nominal value.[3]

Members usually receive limited compensation on capital subscribed as a condition of membership: Co-operatives may pay a dividend to their members, depending on the performance on the entity. But the distribution as dividend is constrained by the fact that at least a certain part of the profits is used to set up reserves to ensure the operations and the financial situation of the co-operative bank in order to pursue their objective targets. In some countries, these reserves are indivisible and would be transferred to a social economy fund in case of liquidation.

3. Democratic member participation: The "one man- one vote" principle

The democratic idea is the basis of the corporate governance of co-operatives.

The Regulation on the SCE specifies that principle of democratic structure *"…where the 'one man, one vote' rule is laid down and the right to vote is vested in the individual…."*[4]

There are only limited derogations from this principle, which not undermine this democratic idea.[5]

This "one man- one vote" principle offers optimal protection for the democratic participation of all members of a co-operative. It ensures a fair representation of the interests of all individuals, who are members in a co-operative. The "one man- one vote" principle provides equal rights to all members regardless of the amount of shares they hold, and guarantees each member the same influence on decisions and thereby the supply of the members' demands to the greatest extent. In contrast, as minority stakeholders, they would have no influence in public limited companies, where the principle "one share- one vote" applies.

[3] The remaining capital is either paid out in form of dividends or the common property of the co-operative and used to set up reserves.

[4] The Regulation (EC) No 1435/2003 on the Statute for a European Co-operative Society (SCE), Recital 8 of the SCE-Regulation.

[5] e.g. see Article 59 II Regulation (EC) No 1435/2003 on the Statute for a European Co-operative Society (SCE), which allows the attribution of a limited number of votes, which shall not exceed five votes per member or 20 % of total voting rights, whichever is lower.

4. Ownership structure

The "one man- one vote" principle is complemented by special restrictions concerning the ownership structure of co-operatives.

For members of a co-operative bank, **there are limitations regarding the numbers of shares purchasable.** They are not free to acquire an uncapped number of shares. Consequently, usually members of co-operatives contribute equitably to the capital of their co-operative bank.

This set-up helps avoiding an "unbalanced" ownership structure where a single shareholder could hold vast numbers of shares. Such restrictions ensure the proper functioning of a co-operative and prevent to undermine the notion of democratic participation of all members.

II. The institutional structure

As a general rule, the structure of co-operatives in Europe comprises a General Assembly and either an administrative organ (one-tier system/ unitary board) depending on the form adopted in the statutes or a management and supervisory organ (two-tier system/ dual board).

1. General Assembly

The General Assembly is the principal institution which determines the democratic character of the institution. It represents all individual members as an integrated entity. It is the body, where the members or their delegates can be consulted and informed as well as participate in the life of the co-operatives and defend their interests. The members exercise their power through the General Assembly. The main tasks of the General Assembly comprise the process of electing directors and controlling the decisions made by the management.

As a general rule, the participation can take place at different levels. The members can attend the General Assembly organized at local or regional level. All local members are also represented by elected delegates in the General Assembly of the bodies at national level.

The General Assembly's constitution does not depend on other bodies' decisions. Generally, all power directly originates from the members represented in the General Assembly.

2. Board of directors

In general, in a one-tier system, the executive directors of the Administrative Board are engaged in the management of the cooperative. The power to represent the cooperative in dealing with third parties can be conferred on a single person or on several persons acting jointly. Some members (non-executive directors) of the Administrative Board may not be vested with management responsibilities but have a supervisory function over the executive directors.

In a two-tier system, the members of the Management Board (managing directors) are responsible for managing the cooperative[6] and can represent the banks in dealing with third parties and in legal proceedings. The members of the

[6] They are entrusted with the management of the bank. They are usually vested with management powers and engaged in the day to day business.

Supervisory Board (supervisory directors) supervise the duties performed by the Management Board.

III. Corporate governance control mechanism

Control occurs both externally (auditing, banking supervision) as well as internally.

Internal control by the members is characterized by the democratic principles of cooperatives and pervades the whole cooperative network. Besides, there are compliance and auditing mechanisms.

1. Democratic control emanates from the basis

In most European countries, co-operative banks are organized in banking networks that are usually composed of local banks, regional banks and national institutions, among which is a central cooperative or other entity acting as a central bank for its members.

The power of all bodies originally emanates from the members and relates mostly to the allocation of mandates and the control of the performance of the bodies.

As it fits any democratic system in general, the members exert influence through the General Assembly. The members are either member of the General Assembly or represented by delegates which they elect amongst themselves.

The General Assembly, as the body representing all members, is the body that controls the orderly conduct of corporate governance as a whole. Due to the equality of voting rights of each member, the decisions taken by the General Assembly illustrate democracy as a feature of corporate governance. The powers of the General Assembly include the elections of the Boards members and the approval of annual accounts and balance sheet.

The legitimacy of the directors relies solely on the fact that they are elected by the members of a given territorial level (local, regional, national), whom they represent. In consequence, the directors are responsible to the members. The members control the actions of elected officials. They can in the last resort sanction violations of the mandate given by the removal of the elected official from their post. Furthermore, the General Assembly can refrain from adopting the annual report and thereby demonstrate their control over decisions taken by the directors.

The democratic participation of the members in the General Assembly efficiently maintains the balance of power among the members as owners and the directors of co-operative banks.

2. Balance between the responsibilities of the executive and non-executive directors

The supervisory/ non-executive bodies are empowered to control the management.

Pursuant to the laws and statutes of the association, at national level, the supervisory/non-executive directors are responsible for supervising the actions and the policies of the management and the course of business of the affiliated entities as well as the general course of business of the co-operative banks concerning their legitimacy, expedience and economical convenience. They supervise the compliance with the provisions of the law, the articles of associations and the by-laws. Therefore, the managing/ executive directors are obliged to report at the request on the Supervisory Board/ non-executive directors of the Administrative Board, and to allow inspection of the documents, scripts and assets of the co-operative bank. The Supervisory Board/ non-executive directors of the Administrative Board shall present their views on the general policy and procedures and shall assist the managing/ executive directors with its advice. When important strategic decisions are taken, their approval is required.

3. Less conflicts of interest

Specific governance features of co-operatives structurally prevent potential situations of conflict of interest.

The directors can not exert a stronger voting influence than any other member since they are also, as other members, subject to the principle "one man- one vote".[7] Therefore, there can not be any accumulation of a majority voting stake and a managing position.

In addition, as for all members, the directors basically can not derive substantial capital gains from holding a co-operative share. The general absence of capital gains to be made from co-operative shares ensures that management decisions are guided by the interest of sustained development of the cooperative and not by the short-termed personal financial interest of any member of the managing staff.

Conclusion: *Corporate governance of co-operative banks- an original model for the European entrepreneurship models*

From a corporate governance point of view, why is the co-operative form of enterprise relevant for the EU?

The co-operative governance specificities underline the diversity of European entrepreneurship. Co-operatives are a special form of enterprise, whose business model shows substantial structural and operating characteristics, which are fundamentally different from other companies~~,~~ whose shares are publicly listed. "*These include the principles of democratic structure and control and the distribution of the net profit for the financial year on an equitable basis.*"[8] Co-operatives' decision-making shows a democratic, equal participation of their members on local and/or regional basis.

While there are some differences between governance systems of the co-operative banks in Europe, they all stick to the same core elements. The governance system of the co-operative form of enterprise is well balanced, works efficiently and moreover economically highly successful throughout Europe. In particular, the

[7] In some co-operative banks, managing directors are even excluded from membership and therefore have not vote at all.

[8] cf. Regulation (EC) No 1435/2003 on the Statute for a European Co-operative Society (SCE), Recitals 7

corporate governance rules of co-operatives as a general rule grant an equal, democratic participation of its members and give them a say and control about all decisive decision respective their company.

Therefore, no need for new EU initiative in the field of corporate governance can be identified as far as co-operatives are concerned.

In case of developing any future legislative activities, it seems inevitable that the co-operative specificities have to be taken into consideration. Even when taking a functional approach, initiatives should not be adjusted only to the stock companies.

The existence of co-operatives and their significance as independency of form of enterprise has to be present in the general perception.[9]

In conclusion, co-operative banks, which support the level playing field principle, have developed an original, innovative and highly successful corporate model and, in so doing, contribute to the success of national and European policies in the framework of the Lisbon strategy.

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[9] As stated in the Action Plan concerning future regulatory initiatives, it is necessary to make a proper distinction between different categories of companies and to take full account of both the companies' "form and size" to allow a more flexible framework.