ILO Cooperative Branch

International Labour Organization

MEETING SUMMARY

RESILIENCE IN A DOWNTURN: THE POWER OF FINANCIAL COOPERATIVES

26 October 2012 - International Labour Office, Geneva (Switzerland)

BACKGROUND

A presentation and discussion of the study, Resilience in a downturn: The Power of financial cooperatives was held at ILO headquarter in Geneva on 26 October 2012. The objective of the meeting was to:

- Share research and engage in discussions on the resilience of the cooperative model of enterprise in the financial sector with ILO professionals – knowledge sharing, and
- Seek input from a panel of financial cooperative experts on the study in view of finalizing the study for publication – peer review

The meeting was part of a series of event being held at the ILO for United Nations International Year of Cooperatives 2012.

MEETING SUMMARY

The meeting was opened by Ms Simel Esim, Chief of the ILO Cooperative Branch who welcomed participants and introduced the report within the frame of International Year of Cooperatives. She noted major contributions from cooperative stakeholders to the International Year in terms of research, policy reviews, events which were culminating in plans for follow-up to the year. Specific mention was made of the *Declaration of the International Cooperative Summit* recently held in Quebec (Canada) and the International Cooperative Alliance's (ICA) *Blueprint for a Cooperative Decade* both of which will be presented for adoption at the 'Cooperatives United' event being held in Manchester (UK).

Prof Johnston Birchall of Stirling University (UK) introduced his study (see annex for PowerPoint slides). He briefly introduced what financial cooperatives were and how they were organized (networks and federations). He explained the shared characteristics of credit unions/savings and credit cooperatives and cooperative banks as well as their differences, origins and the size and scope of the movement today. He noted that World Bank and IMF studies on financial cooperatives undertaken before the crisis showed that were as efficient, or a bit more or less efficient, than their

competitors; they were at least as profitable, and in several countries more profitable and that they were more stable than the investor-owned banks.

Turning to data on the performance of financial cooperatives during the financial crisis, Prof Birchall noted that the data confirmed that financial cooperatives suffered far less than other banks. Only a few central banks had to accept government assistance, and, rather than being allowed to fail, weaker cooperative societies have merged with stronger ones. Most of the losses incurred were made up within a year or two as members recapitalized their cooperatives, and only in few countries did primary societies have had to 'bail out' their centrals. Today, nearly all the indicators show that financial cooperatives have bounced back and are growing again. This resilience has had an indirect impact on employment as financial cooperatives were often the only financial institutions that continued lending to SMEs during the crisis.

Prof Birchall attributed the reason for resilience to the cooperative structure (member ownership and benefit) and the comparative advantages of financial cooperatives. He noted too that what had been considered disadvantages of the financial cooperatives – risk aversion, lack of stock option/remuneration incentives which has been said does not attract the best talent, and lack of access to capital - were recognized as advantages of the model during the crisis.

He turned to policy issues, Prof Birchall noted that an enabling environment for cooperatives was key the growth of financial cooperatives. He stressed that government's political interference and inappropriate regulation (overregulation in developed countries and too little in developing countries) has hindered financial cooperative development. He further underlined that cooperative are not and should not be conduits for government policies and interventions. He presented a series of country scenarios offering recommendations on how to promote the development, strengthening and growth of financial cooperatives. He linked financial cooperative development to other forms of development particularly supply chain development, small business development and the development of microfinance. He concluded that the financial cooperatives contribute not only to financial deepening but also the democratization of credit.

Mr Jean-Louis Bancel, President of Crédit Coopératif of France, chair of the International Cooperative Banking Association (ICBA) and former chair of the International Cooperative and Mutual Insurance Federation (ICMIF) noted that the International Year of Cooperatives should lead to new decade of cooperative growth. He mentioned major initiatives for the International Year including numerous academic studies, the various major conferences as well as the launch of a Global Cooperative Fund to support further cooperative development. Turning to the study and presentation, Mr Bancel noted that ICBA had issued a declaration on what is a cooperative bank and that this may also be helpful. He agreed that cooperative financial shared characteristics but that the historical /cultural differences of financial cooperative development in Europe and North America were important. European cooperative financial institutions developed first as trusted places for deposit of savings (thrift first) and then later as institutions that provided loans. The trust element is fundamental. In North America the origins of credit unions is access to affordable loans. The regulatory history is thus different with on the one hand regulations on lending, and on the other customer protection regulation. He stressed that inadequate regulation had enabled the failures of cooperatives as was the case of Mexico and South India. He stressed the thrift first, lend after aspect that created trust among members and fostered. This was an important characteristic of financial cooperatives given that regulators were focusing on the "know your customer" principle. He turned also the assertion

that cooperative financial institutions lacked access to capital. He noted that a 2007 IMF report on cooperative banks had found that cooperative banks were overcapitalized and underlined that in the recent crisis, those cooperative banks which did require a recapitalization turned to their members. Finally on the resilience question, Mr. Bancel warned that although in the financial crisis cooperative financial institutions were resilient as they had for the most part avoided risky behavior and were "victims" of the crisis, the continuing crisis would be an economic crisis which would touch all. As actors in the real economy, cooperatives will suffer in an economic crisis.

With regard to policy and regulation, Mr Bancel pointed out that is important to remind policy makers that in some countries, financial and insurance cooperatives are not allowed to be established and thus that there was a need to work with the World Bank, IMF and Basel III to ensure that policies and regulations do not exclude financial cooperatives.

Mr Bouke de Vries, Head of Financial Sector Research of Rabobank Netherlands stressed that for financial cooperatives to play a development role in any economy, an enabling environment that recognizes the specificities of the model of enterprise is needed. He confirmed that the positive development impact of financial cooperatives and their resilience is well documented in numerous national and regional studies – including in a recent study on European cooperative banks– Raiffiesen's Footprint[1]. The current study is useful as it provides data of a more universal nature. He also welcomed the balanced presentation of financial cooperatives both in terms of successes and challenges and concurred with the conclusion that financial cooperatives were resilient to crisis, that cooperative centrals that did incur losses on what they considered AAA investments were quickly made up and that although investment banks were more profitable, that they were not able to compensate during crisis and thus caused economic instability.

Mr de Vries also noted his appreciation for recommendations that were targeted to not only developing countries, but also to Europe and other OECD countries. He noted that the challenges in Europe were multiple including a lack of understanding and recognition of the cooperative model not only by governments, but also actors such as the European Commission, European Parliament, International Accounting Standards Board and others. There continued to be knowledge gaps in these institutions. He highlighted the fact that despite the significance of financial cooperatives, the International Accounting Standards afforded only a footnote to cooperative capital structures. Other financial regulation, the so-called 'know your customer' rules were also negatively impacting cooperatives as regulators limit the ability for differentiation among financial actors which requires cooperative banks to ask for exemptions to continue to serve their members accordingly to their set policies and practices – policies and practices that have stood the test of time.

He underlined the role of member as liable for the economic business model. Government should not provide direct financial support to cooperatives – at best it should only in the start-up phase – but members should be self-reliant and responsible. Government however could invest in education and training of financial regulators on the one side and support the strengthening cooperative capacity in governance and supervision on the other.

Turning to cooperative challenges, Mr de Vries noted the issue of scale and the need for consolidation to achieve scale to be as efficient as competitors. For European cooperative banks this was not an issue as they tended to large financial institutions. The need for innovation in

[1] Mooij, J. and Boonstra, W.W. (eds). Raiffeisen's Footprint: The Cooperative Way of Banking. VU University Press. 2012. Available for order at: www.vuuitgeverij.com/rabobank

cooperatives and the courage to change for a better future, as well as the need to development governance systems were also identified as challenges for financial cooperative growth.

Finally, Mr de Vries suggested that the study be published in a journal of scientific studies. Too little cooperative research was included in mainstream journals and that with the extensive peer review; this study should be a welcome addition.

Ms Esim opened the floor for comments and questions. The following comments were made:

- A stronger linkage to ILO issues in particular the impact on jobs, the role of cooperatives in supply chains, business development and microcredit and insurance would be helpful in order to attract more attention internally.
- The presentation did not include any sex-disaggregated data. What is the gender dimension of financial cooperatives?
- The capacity of financial cooperatives to grow and reach outside national markets can be difficult – the case of the National Agricultural Cooperative Federation and yet financial cooperatives should not be limited in cross border activity.
- Financial cooperatives are well prepared for globalization – strong networks and groups.
- Some large financial cooperatives are beginning to re-nationalize after a long period of internationalization of operations.
- The study should better balance the presentation of financial cooperatives. It is equally important to highlight more effectively the fact that what was seen as the negatives of financial cooperatives became positives during the crisis and resulted in cooperative resilience.
- Popular initiatives such as the *move your money* campaign and the concept of the financial cooperatives as an organizational means to give voice was not addressed in the presentation, but should be addressed in the study.
- The study should also mention role of financial cooperatives in addressing financial inclusion and financial literacy. The role of financial cooperatives in microfinance and addressing the unbankable.
- The role of financial cooperatives in the diversity of types of financial institutions is important and should be highlighted as important in creating stable economies.
- The more general issues related to cooperative promotion were noted including the need for further research on cooperatives, inclusion of cooperatives in curricula at all levels of studies, further recognition of the enterprise type by governments and regulators.
- The link of the resilience and stability of cooperatives with the concept of sustainable development was underlined.

Ms Esim thanked presenters, panelists and participants. She noted that the publication would be available in January 2013.

PARTICIPANTS

PRESENTER

- Prof Johnston Birchall, Professor of Social Policy, School of Applied Social Sciences, University of Stirling (UK)
- Jean-Louis Bancel, President, Crédit Coopérative (France) ; President, International Cooperative Banking Association (ICBA)

DISCUSSANTS

- Jean-Louis Bancel, President, Crédit Coopérative (France) ; President, International Cooperative Banking Association (ICBA)
- Bouke de Vries, Head of Financial Sector Research, Rabobank (Netherlands)

PARTICIPANTS

ILO

- Pierre Laliberté, Bureau for Workers' Activities (ACTRAV)
- Alexia Deleligne, Employment Sector (ED/EMP)
- Duncan Campbell, Policy Planning, Employment Department (ED/EMP)
- Sergio Iriarte Quezada, Employment Sector (ED/EMP/PMSU)
- Haq Tariq, Economic and Labour Market Analysis Department (EMP/ELM)
- Anne Van Klareren, Job Creation and Enterprise Development Department (EMP/ENT)
- Dorit Klemmer, Green Jobs, Job Creation and Enterprise Development Department (EMP/ENT)
- Liu Xu, Job Creation and Enterprise Development Department (EMP/ENT)
- Debra Perry, Disabilities Unit, Skills and Employability Department (EMP/SKILLS)
- Craig Churchill, Social Finance Programme (EMP/SFP)
- Severine Debous, Social Finance Programme (EMP/SFP)
- Simel Esim, Cooperative Branch (EMP/COOP)
- Maria Elena Chavez Hertig, Cooperative Branch (EMP/COOP)
- Igor Vocatch, Cooperative Branch (EMP/COOP)
- Roberto Di Meglio, Cooperative Branch (EMP/COOP)

ICA

- Gwangseog Hong, International Cooperative Alliance (ICA)

COPAC

- Mathieu de Poorter, Committee for the Promotion and Advancement of Cooperatives (COPAC)

RURALIA INSTITUTE

- Hagen Henrÿ, Ruralia Institute, University of Helsinki (Finland)

FURTHER INFORMATION

- ILO interview of Prof Johnston Birchall, "What financial cooperatives can teach the big banks" available at: http://www.ilo.org/global/about-the-ilo/newsroom/comment-analysis/WCMS_192406/ lang--en/index.htm

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SLIDES OF PRESENTATION

Report for the ILO
Resilience in a downturn: the power of financial co-operatives

Johnston Birchall (Professor of Social Policy, Stirling University)

ILO Global Jobs Pact

- Lists several important measure that governments should consider taking:
- Support for physical infrastructure and human capital, support for SMEs, public employment, minimum wages
- Building a stronger supervisory and regulatory framework for the financial sector, so that it serves the real economy,
- There is a need for a reliable source of credit to enable SMEs to survive and expand.
- Purpose of the report - to explore the potential of financial co-operatives in the long period of austerity that we are faced with after the banking crisis.

A definition of financial co-operatives

- The customers own the bank, with each person having one member-share.
- The bank does not belong just to current members but is an intergenerational endowment
- Membership is not transferable, and so there is no market for shares.
- The customers also control the bank – they are an integral part of the governance structure
- The customers are also the main beneficiaries. The main purpose of the bank is to benefit the members rather to maximize profit

Differences between credit unions and cooperative banks

- Credit unions are fully mutual (customers have to be members) whereas co-operative banks are not.
- Credit unions are (often) restricted by a common bond, whereas banks tend to be open to all
- Credit unions can sometimes choose to become coop banks (as in Bankmecu Australia, New Zealand Cooperative Bank, Latin American banks)
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Some operating principles that follow

- The main source of capital for the bank is retained profits added to reserves.
- The main source of money for lending to members is member savings.
- The banks are often part of a network: powerful apex bodies provide them with mutual financial services
- This enables them to remain local while benefitting from economies of scale and scope.
- Their focus is on long-term relationships with customer-owners, not on making profits for shareholders.

A product of design and evolution

- 1810: Henry Duncan's invention of the savings bank – simple, effective way of enabling people to smooth out their income, avoid the stigma of 'poor relief'
- 1848: evolution of the Rochdale system to include a safe place to hold savings
- 1850: Schultze's credit association, in 1852 modified to become member-owned
- 1849 Raiffeisen's loan bank, modified in 1862 with his third bank that was member-owned

The problem of lending to people on low incomes

- The catalysts were the famine of 1846-7 and the revolution of 1848
- The underlying problem was lack of capital
- Small business people and farmers needed to take advantage of new markets yet the commercial banks, set up to service richer customers, were unwilling to meet their needs, and savings banks were seen as charities
- People remained poor through lack of capital, and lacked capital because they were poor.
- There was a need to find a way to give credit to those who had no security to offer in exchange other than their moral character
- Reformers had to find a way, as Luzzatti put it, of 'aspiring to descend.

Two solutions

- Schulze's more commercial system with a share fixed as high as people could afford, dividend on share capital, and professional management
- Raiffeisen's more 'moral' system with no share capital, most of surprluses put into reserves, and volunteer management
- The tensions between these two ways of doing banking can still be felt today

Federation and diversification

- Both movements were good at developing regional and national unions, central banks and commercial subsidiaries
- Schulze organised the setting up of a General Union, then in 1865 he set up a central co-operative bank
- Raiffeisen set up a central bank and a trading firm supplying machinery, feed, manures, seeds and coals to farmer-members.
- Supply associations were also set up in each district, but they were kept independent of the local banks so their business would not become mixed up.
- A co-operative insurance department was set up to insure cattle. Marketing co-ops were set up for dairying, hops and wine.

A business model for people on low incomes

- The genius of Schulze and Raiffeisen was to solve persistent problems in banking for people on low incomes.
- Knowledge of the credit-worthiness of one's neighbours meant loans were safer.
- The homogeneous membership base meant peer pressure to repay.
- A strong sense of communal solidarity overcame potential conflicts of interest between borrower & saver, shareholder & manager.
- But is this still true today?

Financial co-ops spread worldwide

The current situation

- Two distinct groups, the European co-operative banks and the global credit union movement, each represented by different trade bodies.
- (Plus two other types of financial co-op – building societies/savings & loans, and co-operative banks set up by other types of co-operative)
- A historical accident: in the USA the term 'co-operative bank' was already used for mutual building and loan societies so Edward Filene called them credit unions
- The credit unions are referred to as 'savings and credit co-ops' or SACCOs in Africa

European co-operative banks

- In Europe, 20 countries have between them 24 co-operative systems of local banks topped by an apex federation and a central bank.
- Most countries have one system, but France has three and Austria and Italy two.
- There are 3874 local banks, with 181 million customers, of whom over 50 million are members.
- They have a 21 percent market share of deposits, and a 19 percent share of loans.
- They have €5647 billion in assets, €3107 billions in deposits and €3305 billion in loans.

A massive co-operative banking sector

- The top country is France with a nearly 45 percent market share of deposits, followed by the Netherlands at 40%
- Countries where the banks have over 10 percent of the market are the ones where people responded most strongly to the Schulze and Raiffeisen models coming out of Germany 150 years ago.
- Those with less than 10 percent are in two geographical groups: countries that form an outer ring around Western Europe, and recently reconstituted co-operative sectors in Eastern Europe

Global credit union movement

- The credit union movement is significant in 100 countries, where more than 51,000 unions have nearly 200 million members.
- They have a market 'penetration' of nearly eight percent.
- They have $1563.5 billions in assets, $1222.6 billions in deposits and $1016.2 in loans.
- Adding the co-operative banks and credit union together, the unions have around 18 percent of the total assets, 23 percent of total deposits, and 19 percent of total loans.
- They are much more significant than these figures suggest, because they reach down to the poorest people in each country and have a substantial economic impact.
- Unlike the co-operative banks, they are fully mutual, which means all their customers have to be members

Market penetration of credit unions

- 45% in North America
- 23.6% in Oceania
- 17.5% in the Caribbean
- 7.2% in Africa
- 5.7% in Latin America
- 3.5% in Europe
- 2.7% in Asia

The impact of co-operative savings and credit during economic crisis

- The important questions:
- Were financial co-operatives more stable than their competitors before the crisis
- If they *were* more stable, did this come at the expense of efficiency and profitability?
- What was the impact of the crisis on the sector?
- Post-crisis, what is the impact of the current period of financial austerity?

Co-operative banks before the crisis

- they were able to obtain funds at lower cost from small savers
- They had a better loan quality as a consequence of low risk lending policies
- They were profitable even at low leverage ratios, because their business was quite self-sufficient
- The lower cost of their capital allowed them to pursue other objectives than profit maximisation, and they could accept a lower margin on goods and services
- Their egalitarian culture was a strong counterweight to excessive management remuneration
- They were significantly more **stable**

Summary

Before the crisis co-operative banks were as efficient, or a bit more or less efficient, than their competitors

They were at least as profitable, and in several countries more profitable

They were everywhere more stable than the investor-owned banks.

Credit unions before the crisis

- Take the years 2005 to 2007:
- Over the two years, the amount of savings increased everywhere by an average of 29 percent
- Loans increased everywhere by an average of 39 percent
- Reserves increased by 26 percent and assets by 32 percent.
- The number of members increased by 13 percent
- Market penetration increased almost everywhere from 6.65 percent to 7.5 percent.

Control by members

- guarantees the advantages that derive from member ownership
- aligns the interests of members with those of boards and managers, and so is linked to business success.
- lowers risk-taking and so makes the business more durable
- provides informational advantages to the bank, enabling it to lend to lower income groups
- increases opportunities to pursue ethical aims as well as shareholder value

Benefit to members

- together they can channel the value added from the business to themselves rather than to investor-owners or to 'middlemen'.
- This is a kind of cost-price mechanism (but the 'inter-generational endowment' limits the benefits to existing members)
- Customers benefit from the convenience of having a more extensive branch network, and less drastic rationalisation than if they were tied to an investor-owned bank.
- Those living in rural areas benefit from access to banking facilities they would not otherwise have.
- Small firms benefit from the relationship with the bank as borrowers, Locally based banks are in a position to better respond to the needs of small, local enterprises than are larger, less regionally focused banks.

Advantages derived from federation

- Financial co-ops nearly always form federations - we have to see them as a system
- Integration as an *interest group* brings benefits such as political influence, economies of scale in training, a wider sense of community with similar banks, and a common business strategy.
- Integration as a *business group* enables cost-effective provision of common services such as IT support, data processing, training, accounting, marketing, product development, and representation. It also provides the opportunity to develop a common brand and to share risk.
- If the integration reaches the stage of having a central bank, this enables the group to centralised excess liquidity, redistribute it, place surpluses in financial markets, and run a consolidated asset-liability management policy.
- It enables the setting up or purchase of subsidiaries to offer insurance, asset management, investment banking, and information technology expertise that local banks could not afford.

The wider benefits

- To the banking system – diversity, greater stability
- To national economies - financial deepening
- To local economies – keeping savings in the locality, investing in local SMEs, preserving and creating jobs
- To people on low-incomes – savings and loans enable income smoothing, the ability to recover from shocks and setbacks

Disadvantages

- 1. Difficulty in raising capital – in bad times to replace money lost, in good times to expand quickly (but also an advantage)
- 2. Potential governance problems – lack of incentive for members to participate (but can be avoided by an active membership policy)
- 3. Lack of incentives for managers – inability to offer share options (but also an advantage)

Policy issues

- Raiffeisen and Schulze did not want much from government – just a legal framework.
- Everything else they organised through the power of federation
- Times have changed
- In developed countries after the banking crisis the threat to financial coops is from too much regulation.
- In developing countries the threat is often from too little regulation!
- In both cases there is the threat of *inappropriate regulation* by governments that do not understand the 'co-operative difference' - in particular the over-regulation of small coops

The need for a sympathetic environment

- They need dedicated promoters to set up new societies, and experts to strengthen them
- This is best done 'movement to movement', by cooperative apex bodies in countries where they are already well established.
- They need employer organisations and trade unions to see the potential benefits of employment-based credit unions.
- NGOs should pay attention to the need for apex bodies that strengthen financial cooperatives as a *system*.
- Micro-finance investment funds may find cooperatives attractive but they should not swamp them with funds that undermine their moral basis

Scenario A- ***A country with a developed financial cooperative system, with the capacity to expand its support to SMEs***

- When financial cooperatives are offered government funding, they should be careful not to allow themselves to be swamped with government money
- They must keep a healthy balance between savings and loans and have an incentive to keep up their own reserves.
- Government regulators should recognize the differences between financial cooperatives and investor-owned banks both in their capital structure and their corporate governance.
- They should understand the network type of organization and trust the way in which delegated supervision has worked over the last 150 years!
- They should not over-regulate, otherwise the cooperatives will find it too expensive to serve low-income members and be forced to move upwards towards more affluent clients.
- It is important for the stability of the cooperative system that local banks are able to make decisions.

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B: a country where an existing financial cooperative sector exists but is not 'aspiring to descend'

- Engage with the sector to find out why it is not serving the needs of those on low incomes.
- It may be that there is unfair competition from microfinance NGOs!
- Encourage the sector to find ways of extending its reach, offering financial and technical support for effective loan appraisal and risk management.
- If funds are provided for lending on, these should not overbalance the loan portfolio (25% is a good rule of thumb),
- Only those societies that meet prudential loan repayment criteria should receive funds for on-lending.

C: a country with a rapidly growing sector that has inadequate supervision

- Develop the capacity of government regulators and the national federation to supervise
- Use a grading system that incentivizes societies to become stronger.
- Where there is a new federation, allow only strong societies to become members
- incentivize them with the offer of economic benefits such as access to electronic networks or guarantee funds if they reach a required threshold.
- Close down or merge the ones that will not make it.
- Only when they have loan assessment and risk management systems in place can their lending be expanded
- Update the legal framework in consultation with the sector, and using the WOCCU or ILO guidelines

D: a country where a large financial cooperative sector exists and is politically controlled, but there is an effective reform coalition

- Pass new laws guaranteeing the autonomy of financial cooperatives, reform the regulatory system, close down non-viable societies, remove corrupt boards and hold fresh elections
- Organise a member education programme and the handing over of societies to their memb
- Take all the usual strengthening measures to ensure the societies become good at banking!
- This is the kind of process that is going in China with rural credit cooperatives.

E: a country where a large financial cooperative sector exists and is politically controlled, but there is NO effective reform coalition

- If there is no reform, then nothing can be done
- Organizations wishing to promote financial cooperatives should focus on creating an alternative system of financial cooperatives that might emerge out of existing micro-finance projects.
- This is what happened in Sri Lanka in the 1970s with the Sanasa movement
- It could be an alternative in India, if the current attempts to reform the massive credit cooperative sector are stalled.

F: a country with no financial coops, or a small number of primary societies

- Aim to promote a whole sector, with its own support structures of national federation and a central bank. Nothing less will do.
- Setting up primary societies on their own will just lead to problems that later on will be difficult to put right.
- National-level structures follow naturally from demands from primary societies for business services,
- Aim to develop the capacity of the sector largely to supervise itself,
- Pass a law that regulates the sector, recognising its unique characteristics as well as what it has in common with other types of MFI

The relationship between financial cooperatives and other kinds of development

- Supply chain development
- Small business development
- Micro-insurance
- But maintain the autonomy of the financial co-operative

Conclusion

- Financial co-operatives are not just about financial deepening but are about 'democratising credit'!